# BANKRUPTCY

*R. Patrick Vance*[*]

*Elizabeth J. Futrell*[**]

## I. BANKRUPTCY COURT JURISDICTION RE-EXAMINED

Subject matter jurisdiction over bankruptcy matters is "grounded in, and limited by,"[1] 28 U.S.C. § 1334.[2] Section 1334(a) provides that the district court has both original and exclusive jurisdiction of cases "under title 11," which means the bankruptcy petition for relief itself.[3] Subsection (b) of § 1334 sets forth the "core" jurisdiction of federal courts to hear all proceedings "arising under title 11" and all proceedings "arising in" a case under title 11.[4] Subsection (c) sets forth the "related to" jurisdiction of courts to hear proceedings that are merely "related to" a case under title 11.[5] Thus, bankruptcy courts have jurisdiction over both "core" matters and matters that are me931rely "related to" a bankruptcy.[6]

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[*] Mr. Vance is a partner at Jones, Walker, Waechter, Poitevent, Carrère & Denègre in New Orleans, Louisiana and is a member of the National Bankruptcy Conference, a fellow of the American College of Bankruptcy, and a fellow of the American Law Institute.

[**] Ms. Futrell is a partner at Jones, Walker, Waechter, Poitevent, Carrère & Denègre in the New Orleans, Louisiana and is a fellow of the American College of Bankruptcy.

[1] *Celote Corp. v. Edwards*, 514 U.S. 300, 307 (1995).

[2] 28 U.S.C. § 1334 (1994).

[3] *Randall & Blake, Inc. v. Evans* (*In re* Canion), 196 F.3d 579, 584 (5th Cir. 1999).

[4] *Wood v. Wood* (*In re* Wood), 825 F.2d 90, 92 (5th Cir. 1987).

[5] *Id.* Finally, subsection (d) of § 1334 provides that the federal district court has "exclusive jurisdiction of all of the property . . . of the debtor as of the commencement of the case, and of property of the estate." 28 U.S.C. § 1334(d) (1994).

[6] Although a bankruptcy court may hear a "non-core" matter otherwise "related to" a bankruptcy case under title 11, the court may only submit proposed findings of fact and conclusions of law to the district court. 28 U.S.C. § 157(c)(1) (1994). The district court then reviews the proposed

For twelve years, the leading Fifth Circuit decision to examine "core" and "related to"jurisdiction has been *Wood v. Wood* (*In re Wood*).[7] In that case, the Fifth Circuit defined a "core" proceeding as one that "invokes a substantive right provide by title 11 [the Bankruptcy Code] or if it is a proceeding that, by its nature, could arise only in the context of a bankruptcy case."[8] *Wood* adopted the definition of "related to" jurisdiction articulated by the Third Circuit.[9] The court stated that the test is "whether the outcome of [the] proceeding could conceivably have any effect on the estate being administered in bankruptcy."[10]

The Fifth Circuit's latest cases dealing with "related to" jurisdiction are *Randall & Blake, Inc. v. Evans* (*In re Canion*)[11] and *Bass v. Denney* (*In re Bass*).[12] Both decision address whether the bankruptcy court has "related to" jurisdiction in an adversary proceeding where the debtor is not a party.[13] Based on the facts of each case, the Fifth

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findings and considers *de novo* those matters to which any party makes a timely objection. *Id.* Nonetheless, to determine whether bankruptcy jurisdiction exists, "it is necessary only to determine whether a matter is at lest 'related to' the bankruptcy." *Walker v. Cadle Co.* (*In re* Walker), 51 F.3d 562, 569 (5th Cir. 1995) (quoting *Wood*, 825 F.2d at 93).

[7] 825 F.2d 90 (5th Cir. 1987).

[8] *Id.* at 97.

[9] *Id.* at 93. The definition of "core" and "related to" jurisdiction has been adopted by the majority of the circuit courts ruling on the issue. *See generally In re* Marcus Hook Dev. Park, Inc., 943 F.2d 261, 264 (3d Cir. 1991); *Miller v. Kemira, Inc.* (*In re* Lemco Gypsum, Inc.), 910 F.2d 784, 788 (11th Cir. 1990); *Gardner v. United States* (*In re* Gardner), 913 F.2d 1515, 1518 (10th Cir. 1990) (citing *Pacor, Inc. v. Higgins*, 743 F.2d 984, 994 (3d Cir. 1984)). The *Pacor* court went on to explain: "An action is related to bankruptcy if the outcome could alter the debtor's rights, liabilities, options, or freedom of action (either positively or negatively) and which in any way impacts upon the handling and administration of the bankrupt estate." *Pacor*, 743 F.2d at 994.

[10] *Wood*, 825 F.2d at 93 (citing *Pacor*, 743 F.2d at 994).

[11] 196 F.3d 579 (5th Cir. 1999) (Wiener, J.)

[12] 171 F.3d 1016 (5th Cir. 1999) (Wiener, J.)

[13] *Canion*, 196 F.3d at 584-87; *Bass*, 171 F.3d at 1022-23.

Circuit reached different conclusions.

In *Canion*, after a Chapter 7 bankruptcy case was filed, a creditor brought suit in federal district court against a number of the debtor's friends, relatives, and business associates, alleging that the defendants interfered with the creditor's efforts to collect on a judgment against the debtor.[14] The district court referred the lawsuit to the bankruptcy court.[15] After the bankruptcy court dismissed, with prejudice, the creditor's claims against the defendants,[16] the creditor appealed.[17] The primary issue in the Fifth Circuit opinion was whether the bankruptcy court had jurisdiction over the adversary proceeding.[18]

The Fifth Circuit held that "related to" jurisdiction is determined by examining whether, at the time the district court referred the case to the bankruptcy court,[19] the outcome of the litigation "could conceivably have any effect on the estate being administered in bankruptcy."[20] In *Canion*, if the creditor could collect on its judgment from the defendants in the adversary proceeding, and if the defendants were not entitled to subrogation,[21] the claims against the debtor could be reduced by the outcome of the

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[14] *Canion*, 196 F.3d at 581. The causes of action included conspiracy, fraud, tortious interference with judgment, alter ego liability, and fraudulent transfers under the Texas Uniform Fraudulent Transfer Act. *Id.* at 582.

[15] *Canion*, 196 F.3d at 581, 583.

[16] *Id.*

[17] *Id.* at 584.

[18] *Id.* at 584-87. The Fifth Circuit rejected the argument that the creditor waived all rights to contest jurisdiction when he consented to the referral to bankruptcy court. *Id.* at 585. It is well established that bankruptcy court jurisdiction is subject matter jurisdiction and thus cannot be conferred by the parties. *Id.* at 583.

[19] *Id.* at 587. "Federal subject matter jurisdiction is tested when the jurisdiction of the federal court is invoked." *Id.* at 586 n. 29. *See* discussion *infra* note 22.

[20] *Canion*, 196 F.3d at 585 (quoting *Bass v. Denney* (*In re* Bass), 171 F.3d 1015, 1022 (5th Cir. 1999)).

[21] Without coming to a conclusion, the court noted that the defendants might not be entitled to subrogation. *Id.* at 585-86.

litigation.[22] Such a reduction "would inure to the benefit of all other unsecured creditors."[23] In so ruling, the Fifth Circuit specifically noted that "[c]ourts in other circuits that have faced this question have held that a claim between two non-debtors that will potentially reduce the bankruptcy estate's liabilities produces an effect on the estate sufficient to confer 'related to' jurisdiction."[24]

The Fifth Circuit concluded that no "related to" jurisdiction existed in *Bass*, primarily because the bankruptcy case was dismissed at the time the parties attempted to invoke bankruptcy jurisdiction."[25] In 1992, the debtor filed a Chapter 7 case in Utah in which a creditor eventually obtained a judgment against the debtor, Bass, and a ruling that the judgment was not discharged by his bankruptcy.[26] Bass was the beneficiary of several irrevocable, fully discretionary "spendthrift trusts" created under Texas law.[27] The trustees were not "parties" to the bankruptcy case.[28]

After the bankruptcy case was closed in 1996, the judgment creditor determined that the debtor had received approximately $300,000 a year in distributions from one of

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[22] *Id*. at 586. Because the bankruptcy court dismised the creditor's claims against the third parties in *Canion*, the Fifth Circuit knew that the outcome of the litigation would not have an impact on the bankruptcy case. *Id*. at 586 n. 27. The court emphasized, therefore, that jurisdiction must be tested as of the referral to the bankruptcy court. *Id*. at 586-87. *See also supra* note 19 (discussing the same).

[23] *Canion*, 196 F.3d at 586.

[24] *Id*. at 586 & n. 28.

[25] *Bass*, 171 F.3d at 1022.

[26] *Id*. at 1020.

[27] *Id*. The trusts were "spendthrift" under Texas state law because the trust indentures "contain[ed] express prohibitions against voluntary and involuntary alienation." *Id*. at 1028. Therefore, no part of the trusts could be "taken on execution or garnishment by creditors of the beneficiary." *Id*. (quoting *Bank of Dallas v. Republic Nat'l Bank*, 540 S.W.2d 499, 501 (Tex. Civ. App. 1976)).

[28] *Bass*, 171 F.3d at 1020. Presumably, the trustees were not parties to the case because the trusts were not creditors or assets of the estate.

the trusts.[29] To collect on the nondischargeable judgment, the creditor filed a suit against the trustees of the spendthrift trusts in Texas bankruptcy court.[30] Relying on *Smith v. Moody* (*In re Moody*),[31] the creditor then obtained a mandatory injunction that required the trustees to give 72-hour notice before making any distribution from the trusts to the debtor.[32] The trustees appealed.[33]

Citing the definition of "related to" jurisdiction articulated in *Wood*, the Fifth Circuit found that the outcome of the litigation against the trustees could not have any conceivable impact "upon the handling and administration of the bankruptcy estate."[34] Because the Utah bankruptcy case was closed before the lawsuit was filed, no bankruptcy estate was in existence.[35] Therefore, the judgment creditor's dispute with the trustees could not be "related to" the bankruptcy estate.[36] The Fifth Circuit also dismissed the creditor's "core" jurisdiction argument because the collection of a nondischargeable money judgment does invoke a substantive right provided by the Bankruptcy Code.[37]

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[29] *Id*.

[30] *Id*.

[31] 837 F.2d 719 (5th Cir. 1988).

[32] *Bass*, 171 F.3d at 1020-21.

[33] *Id*. at 1021.

[34] *Id*. at 1022 (quoting the Third Circuit's definition of "related to" jurisdiction set forth in *Pacor Inc. v. Higgins*, 743 F.2d 984, 994 (3d Cir. 1984), and adopted by the Fifth Circuit in *Wood v. Wood* (*In re Wood*), 825 F.2d 90, 93 (5th Cir. 1987)).

[35] *Bass*, 171 F.3d at 1023. As the court pointed out, a dispute with the debtor is not sufficient to create "related to" jurisidiction. *Id*. (citing *Feld v. Zale Corp*. (*In re* Zale Corp.), 62 F.3d 746, 753 (5th Cir. 1995)).

[36] *Bass*, 171 F.3d at 1023. Because there was no bankruptcy estate, any benefit that might be derived from the trustee giving notices of distributions would not be turned over to the bankruptcy estate. *Id*.

[37] *Id*. at 1025-26; *see also supra* text accompanying note 8 (discussing a "core" proceeding). The court also dismissed the creditor's "inherent" or "supplemental" jurisdiction argument because bankruptcy courts cannot exercise supplemental jurisdiction. *Bass*, 171 F.3d at 1024 (citing *Walker v. Cadle Co*. (*In re* Walker), 51 F.3d 562, 570-73 (5th Cir. 1995)).

After deciding that the bankruptcy court had no jurisdiction, it was unnecessary to address the merits of the mandatory injunction against the trustees.[38] The Fifth Circuit did so, however, in order to "avoid the misunderstanding"[39] that was caused by the court's opinion in *Moody*.[40] The purpose of the discussion was to limit the holding in *Moody* to the facts of that case,[41] thereby discouraging its expansion beyond those facts.[42]

Perhaps the most important distinguishing characteristic in *Moody* was that the trust distributions were mandatory, rather than discretionary under state trust law.[43] In *Bass*, the Fifth Circuit concluded that a bankruptcy court could "neither prohibit nor command the exercise" of a trustee's discretion in making distributions from a discretionary "spendthrift trust," either directly or indirectly.[44] Ordering the trustee of such a trust to give advance notice before making a distribution would place the trustee "in the untenable position of either refraining from making Trust distributions although or doing so after giving

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[38] *Bass*, 171 F.3d at 1026-30.

[39] *Id*. at 1026 n. 43.

[40] The Fifth Circuit characterized the analysis of the merits as "persuasive authority at best." *Id*. at 1026 n. 43.

[41] *Id*. at 1026-30. Some of the distinguishing facts in *Moody* were as follows: (a) a pending Chapter 11 (not a closed Chapter 7); (b) the mandatory notice requirement was issued in the bankruptcy case (not a separate adversary proceeding); (c) the basis of the relief was the debtor's misappropriation of disbursements made after the bankruptcy case (not a claim that arose before the bankruptcy); (d) the trustee was a party to the Chapter 11 case (not a non-party); (e) the bankruptcy trustee was attempting to marshal assets of the estate (not a creditor's attempt to collect on a judgment); and (f) the distributions at issue would inure to the benefit of the bankruptcy estate (as opposed to an individual creditor, without passing through the estate). *Id*. at 1026-27. In summary, the Fifth Circuit found that the "circumstances of *Moody* dictate that its holding and reasoning be limited to those unique and difficult facts for which its highly imaginative solution was crafted." *Id*. at 1027.

[42] *Id*.

[43] *Bass*, 171 F.3d at 1027.

[44] *Bass*, 171 F.3d at 1030.

notice to the [judgment creditor] and thereby risking charges of breach of trust."[45]

## II. FINALITY AND APPELLATE JURISDICTION

In *Beal Bank, S.S.B. v. Caddo Parish-Villas South, Ltd.* (*In re Caddo Parish-Villas South, Ltd.*),[46] the Fifth Circuit analyzed whether a district court order was final and appealable under 28 U.S.C.§ 158(d).[47] In that case, Caddo Parish-Villas South, Ltd. (Caddo), the debtor, filed a Chapter 11 case after Beal Bank seized its sole assets, an apartment complex.[48] Beal Bank's proof of claim asserted a claim secured by the apartment complex based on a mortgage note and mortgage the Beal Bank purportedly purchased from the Department of Housing and Urban Development ("HUD").[49] At the end of a second hearing on the Caddo's objection to Beal Bank's proof of claim, the bankruptcy court granted the objection and disallowed Beal Bank's proof of claim because no evidence was offered to prove that HUD sold the mortgage note to Beal Bank.[50] The bankruptcy court refused to grant Beal Bank's motion for reconsideration, even though Beal Bank finally produced an assignment of the mortgage note.[51]

On Beal Bank's appeal, the district court reversed the bankruptcy court and overruled the debtor's objection to Beal Bank's proof of claim.[52] But the district court also remanded the case for further proceedings on the issue of whether, under applicable

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[45] *Id*.
[46] 174 F.3d 624 (5th Cir. 1999).
[47] *Id*. at 625-26 (citing 28 U.S.C. § 158(d) (1994)).
[48] *Id*. at 625.
[49] *Id*.
[50] *Id.* at 626.
[51] *Caddo*, 174 F.3d at 626-27.
[52] *Id.* If the order had stopped with this ruling, the district court's order would have been final and non-appealable.

state law,[53] Beal Bank should indemnify the debtor from future claims on the mortgage note.[54] The Fifth Circuit dismissed the appeal, finding that the district court's order was not final and, therefore, not appealable.[55]

For more than ten years, the rule in the Fifth Circuit has been that a district court order that affirms or reverses the bankruptcy court, but also remands the case for further "significant proceedings," is not final and appealable.[56] In *Caddo*, the court explained that whether an order requires "'significant further proceedings' . . . turns on whether the order calls on the bankruptcy court to perform a judicial function or a purely ministerial function. Judicial functions entail significant further proceedings; ministerial functions do not."[57] The order in *Caddo* required more than a "purely mechanical" or "computational" proceeding in the bankruptcy court, and more than the "mere entry of an order in accordance with the district court's decision."[58]

The Fifth Circuit rejected Caddo's argument that the district court order was purely mechanical because the proceedings on remand would not enhance or alter the appellate court's resolution of the issue on appeal (*i.e.*, whether Beal Bank's proof of claim

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[53] *Id*. at 627 (citing La. Rev. Stat. Ann. § 10:3-309(b) (West 1993).

[54] *Caddo*, 174 F.3d at 627.

[55] *Id*. at 629; *see also* 28 U.S.C. § 158(d) (1994). Appellate jurisdiction to hear bankruptcy appeals is conferred by 28 U.S.C. § 158(d) (providing that "[t]he courts of appeals shall have jurisdiction of appeals fromall final judgments, orders and decrees entered under subsections (a) and (b) of this section"); 28 U.S.C. § 1291 (1994) (providing that circuit courts have jurisdiction to consider appeals for all final decisions of the district courts on appeal from the bankruptcy court); and 28 U.S.C. § 1292 (1994) (dealing with interlocutory orders or injunctions).

[56] *Caddo*, 174 F.3d at 626. According to the Fifth Circuit in*Caddo*, piecemeal decisions on this issue were "finally assembled into a single coherent rule" in*Allegheny International Credit Corp. v. Bowman* (*In re Bowman*), 821 F.2d 245, 246-48 (5th Cir. 1987). *Id*. at 627.

[57] *Caddo*, 174 F.3d at 627-28.

[58] *Id*. at 628. The determination of whether Beal Bank should indemnify Caddo would require the bankruptcy court to make findings of fact and conclusions of law. *Id*.

should be allowed).[59] In other words, even though the indemnification issue that was remanded would not impact the allowance of Beal Bank's proof of claim, the district court's order in Caddo was not appealable.[60] Until the bankruptcy court ruled on the remanded issue, Caddo could not appeal the ruling on the proof of claim.[61]

## III. TRUSTEE IS PERSONALLY LIABLE FOR GROSS NEGLIGENCE

Judge Robert Parker, in a matter of first impression for the Fifth Circuit, established the standard of care for a bankruptcy trustee and the trustee's personal liability for damages to a bankruptcy estate.[62] In so doing, the court found that the trustee's failure to file a tax return timely did not meet the gross negligence standard.[63]

The court first noted that the Bankruptcy Code is silent on the standard of care required of a trustee.[64] However, the United States Supreme Court has held that a trustee may be held personally liable for willfully and deliberately breaching his fiduciary duty of

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[59] *Id*. at 626-28.

[60] *Id*. at 628-29. A different result was reached in *United States Trustee v. Gryphon at the Stone Mansion, Inc.*, 166 F.3d 552 (3d Cir. 1999), where only computational functions were required in the remanded proceeding. *Id*. at 557. In *Stone Mansion*, the bankruptcy court held that it did not have jurisdiction to determine whether a United States Trustee's quarterly fee, 28 U.S.C. § 1930, was due after the debtor's plan was confirmed. *In re* Gryphon at the Stone Mansion, Inc., 204 B.R. 460, 462-63 (Bankr. W.D. Pa. 1997). The district court disagreed and remanded for further proceedings. *United States Trustee v. Gryphon at Stone Mansion, Inc.*, 216 B.R. 764, 769 (W.D. Pa. 1997). The Third Circuit did not dismiss the appeal, notwithstanding the remand order. The court asked the question, "[w]hat is left for the Bankruptcy Court to do on remand?" *Stone Mansion*, 166 F.3d at 557. Because the bankruptcy court only needed to "assess the fees" by apply a statute, the Third Circuit found that the remand order was only ministerial in nature. *Id*.

[61] *Caddo*, 174 F.3d at 629.

[62] *Dodson v. Huff* (*In re* Smyth), 207 F.3d 758, 761-62 (5th Cir. 2000).

[63] *Id*. at 762.

[64] *Id*. at 761.

loyalty.[65] In so ruling, the Supreme Court did not address a trustee's liability for negligent actions.

The Fifth Circuit observed that the circuits are split on the issue of the standard of care a trustee owes his fiduciary.[66] The Ninth Circuit imposes liability for mere negligence.[67] Yet, the Seventh and Tenth Circuits have held that a trustee may only be personally liable if he acts willfully and deliberately in violation of his fiduciary duties.[68] Rather than adopt either line of reasoning, the Fifth Circuit instead followed an intermediate position "articulated in the well-reasoned *In re J.F.D. Enterprises, Inc.*"[69]

The court also cited approvingly the recommendation of the 1997 Final Report of the National Bankruptcy Review Commission, which had recommended the adoption of a gross negligence standard to measure the actions of trustees.[70] The court quoted the Black's Law Dictionary definition[71] of gross negligence approvingly:

> The intentional failure to perform a manifest duty in reckless disregard of the consequences . . . . It is an act or omission respecting legal duty of an aggravated character as distinguished from a mere failure to exercise ordinary care. It amounts to indifference to present legal duty and to utter forgetfulness of legal obligations so far as other persons may be affected.[72]

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[65] *Mosser v. Darro*, 341 U.S. 267, 272-73 (1951).

[66] *Dodson*, 207 F.3d at 761.

[67] *Id*. (citing *In re* Cochise Coll. Park, Inc., 703 F.2d 1339, 1357 (9th Cir. 1983)).

[68] *Id*. (citing *In re* Chicago Pac. Corp., 773 F.2d 909, 915 (7th Cir. 1985); *Sherr v. Winkler*, 552 F.2d 1367, 1375 (10th Cir. 1977)).

[69] 223 B.R. 610 (Bankr. D. Mass 1998.

[70] *Dodson*, 207 F.3d at 762 (citing Nat'l Bankr. Comm'n Final Report § 3.3.2 at 859 (1997)).

[71] *Id*. (citing BLACK'S LAW DICTIONARY 1033 (6th ed. 1990)).

[72] *Id*.

## IV. ASSUMPTION OF AN EXECUTORY CONTRACT DOES NOT RESULT IN A DISCHARGED DEBT UNDER A PLAN

At issue in *Century Indemnity Co. v. National Gypsum Co.* (*In re National Gypsum Co. Settlement Trust)*[73] was whether a Chapter 11 plan's assumption of an executory contract with a zero cure amount was effective and properly noticed to the affected creditor.[74] A declaratory judgment was brought against the debtor post-confirmation because of the debtor's refusal to pay an indebtedness arising out of a pre-petition executory contract which has been assumed by the Plan.[75] All three courts found that the claim was not discharged.[76] The district court and, subsequently, the Fifth Circuit, disagreeing with the bankruptcy court, found that the record did not support the debtor's position that a zero cure amount was binding and remanded the case for further hearings.[77] The controversies between the debtor and Century Indemnity revolved around the intersection of 11 U.S.C. § 365(g)[78] and 1141 (d)[79] and the notice requirements of Bankruptcy Rule 6006 when an executory contract is to be assumed, rejected or assigned.[80]

The debtor, National Gypsum, was a manufacturer of asbestos-containing products.[81] Century's predecessor in interest had issued liability insurance to National

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[73] 208 F.3d 498 (5th Cir. 2000)).

[74] *Id*. at 501.

[75] *Id*. at 503-04.

[76] *Id*. at 498.

[77] *Nat'l Gypsum*, 208 F.3d 503-04.

[78] *Id.* at 504 (citing 11 U.S.C. § 365(g) (1994)), Section 365(g) provides that the *rejection* of an executory contract constitutes a breach of the contract. 11 U.S.C. § 365(g). This gives rise to an unsecured claim.

[79] Section 1141(d) indicates that confirmation of a plan results in the discharge of enumerated debts. 11 U.S.C. § 1141(d) (1994).

[80] *Nat'l Gypsum*, 208 F.3d at 504-07, 511.

[81] *Id*. at 501-02.

Gypsum.[82] To address insurance coverage disputes that had arisen in the industry-wide litigation, the Wellington Agreement was entered in 1985 by numerous manufacturers and most of their insurers.[83] The Wellington Agreement provided, in part, that those insurers who had signed the agreement would contribute funds to the Asbestos Claim Facility.[84] The signatory insurers agreed to make gapfilling payments to cover the non-signatory insurers' share of defense and indemnity costs.[85] The Wellington Agreement was designed to compensate signatory insurers for the interim payments. Manufacturers were encouraged to pursue non-signatory insurers by imposing an interest obligation on the gap payments.[86] Prior to National Gypsum's bankruptcy, Century had made gapfilling payments for amounts owed by non-signatory insurers.[87]

When National Gypsum filed its plan, it stated that the Wellington Agreement was to be assumed and that it was not in default on any payments, and therefore, the cost to cure was zero.[88] When Century filed suit to collect amounts allegedly due post-confirmation, National Gypsum moved for summary judgment pursuant to 11 U.S.C. § 1141(d), contending that the debt had been discharged by virtue of the plan confirmation and because Century had not filed a proof of claim.[89] The bankruptcy court granted the motion.[90] Ultimately, the bankruptcy court ruled that Century was precluded by *res judicata* from asserting that any amount other than zero was due because of the confirmation of the plan.[91]

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[82] *Id*. at 506.
[83] *Id*. at 502.
[84] *Id*.
[85] *Nat'l Gypsum*, 208 F.3d at 502.
[86] *Id*.
[87] *Id*.
[88] *Id*.
[89] *Nat'l Gypsum*, 208 F.3d at 503 (citing 11 U.S.C. § 1141(d) (1994)).
[90] *Id*.
[91] *Id*.

National Gypsum argued that § 1141(d)(1) can be read to provide for discharge of amounts in default under assumed executory contrary, thereby nullifying the cure requirements of 11 U.S.C. § 365(b)(1).[92] Relying on its prior precedent, the court looked to *Wainer v. A.J. Equities, Ltd.*[93] to make its point and to clarify that decision.[94]

The *Wainer* court concluded that a lease that has been *assumed* does not give rise to a claim.[95] Thus, there is no debt to discharge.[96] The *Gypsum* court observed that the teaching of the *Wainer* court is that a claim arises *only* from a *rejection* of an unexpired lease or executory contract, *not* from the *assumption*.[97] The court noted that the position is consistent with the Fourth Circuit's seminal case on this issue, *Consolidated Gas Electric Light & Power Co. v. United Railways & Electric Co.*[98]

The court further noted that National Gypsum's argument would impose an extra-statutory requirement: that the right to cure must be preemptively protected by the filing of a proof of claim.[99] In rejecting the argument, the court wrote: "[W]e hold that § 1141(d) cannot be read to provide for discharge of amounts in default under assumed contracts in a manner that would nullify the cure requirements of section 365(b)(1)."[100]

The court then turned to the notice that was given to Century of the debtor's

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[92] *Id*. at 504.
[93] 984 F.3d 679 (5th Cir. 1993).
[94] *Nat'l Gypsum*, 208 F.3d at 507.
[95] *Wainer*, 984 F.2d at 684-85.
[96] *Id*.
[97] *Nat'l Gypsum*, 208 F.3d at 507.
[98] 85 F.2d 799 (4th Cir. 1936).
[99] *Nat'l Gypsum*, 208 F.3d at 509.
[100] *Nat'l Gypsum*, 208 F.3d at 509.

treatment of the contract and the zero cure amount.[101] The court rejected the notion that mere notice of the bankruptcy imposed the obligation on Century to determine its treatment.[102] Unsecured creditors and non-debtor parties to executory contracts in default are to be treated differently. Moreover, Bankruptcy Rule 6006 does not preclude the debtor's obligation to give notice of its specific intent to assume a contract obligation to give notice of its specific intent to assume a contract despite the rule's "peculiar wording."[103] The court emphasized that absent a showing that the non-debtor possessed actual knowledge of "a sufficiently refined degree," the debtor must demonstrate delivery of the proposed plan of reorganization or some other court ordered notice that sets forth the debtor's specific intent to assume with a zero cure amount.[104] The case was remanded to determine if Century had received notice of a debtor's intention; the summary judgment in favor of the debtor was reversed.[105]

## V. DEBTOR WHO IS NOT EMPLOYER CANNOT LIMIT EMPLOYEE'S DAMAGES RESULTING FROM TERMINATION OF AN EMPLOYMENT CONTRACT

In *Hall v. Goforth* (*In re Goforth*), [106] the Fifth Circuit found that a debtor could not limit an unsecured claim arising under an employment contract unless the debtor was the employer.[107] In *Goforth*, an arbitration award and state court judgment were entered against a company, Telemetrics, the employer, and Goforth, an owner of Telemetrics.[108]

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[101] *Id.*

[102] *Id.* at 510.

[103] *Id.* Rule 6006 provides, in part: "A proceeding to assume . . . an executory contract, *other than as part of a plan*, is governed by Rule 9014." FED. R. BANKR. P. 6006 (2000) (emphasis added).

[104] *Nat'l Gypsum*, 208 F.3d at 513.

[105] *Id.* at 503.

[106] 179 F.3d 390 (5th Cir. 1999).

[107] *Id.* at 395.

[108] *Id.* at 391-92.

The award and judgment held that both Telemetrics and Goforth were jointly and severally liable to an employee of Telemetrics for damages under an employment contract.[109] Goforth, however, did not sign or guarantee the employment agreement.[110] After the judgment became final, both Telemetrics and Goforth filed Chapter 11 bankruptcy cases.[111]

The bankruptcy court ruled that the employee's claim against Telemetrics was limited to one-year's compensation under the employment contract based on Bankruptcy Code § 507(b)(7).[112] The bankruptcy and district courts refused to limit the employee's claim against Goforth, however, because Goforth was not the employer.[113]

In affirming the district court, the Fifth Circuit noted that a plain reading of the statute supports Goforth's position that § 507(b)(7) applies to "any employee who claims damages from the termination of an employment agreement regardless of whether the debtor against whom the claim is brought is the actual employer."[114] But the Fifth Circuit concluded that the employee's claim against Goforth was not limited by § 507(b)(7).[115] Because Goforth's liability to the employee was more in the nature of a guaranty,[116] §

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[109] *Goforth*, 179 F.3d at 395.

[110] *Id*. at 391. Although Goforth did not personally execute or guarantee the employment agreement, the effect of the state court judgment was to hold Goforth liable for the employment contract as if he had executed or guaranteed it.

[111] *Id*. at 392.

[112] *Id*. at 392-93. This section limits the claims "of an employee for damages resulting from the termination of an employment contract." 11 U.S.C. § 507(b)(7) (1994). Such claims are limited to compensation provided by the contract, without acceleration of one year following the earlier of the date the bankruptcy was commenced or the date the employer directed the employment terminated. *Id*.

[113] *Goforth*, 179 F.3d at 392.

[114] *Id*. at 393.

[115] *Id*.

[116] *See supra* notes 112-13 and accompanying text.

502(b)(7) did not apply.[117] The Fifth Circuit's ruling was grounded on the principle that § 502(b)(7) must be narrowly construed because the provision "is in derogation of the general bankruptcy law principle that creditors are to share ratably in a debtor's estate."[118]

## VI. THE TAX MAN COMETH AND TAKETH AGAIN

In *United States v. Neary*, (*In re Armstrong*),[119] the trustee argued that he was not bound by the statute of limitations for refund claims in the Internal Revenue Code because of the automatic stay provisions of 11 U.S.C. § 362,[120] and that even if his refund claim was not timely, the automatic turnover provisions of 11 U.S.C. § 542(a)[121] requires the government to refund the overpaid amount once that amount was certain.[122]

Both the bankruptcy and district courts agreed with the trustee.[123] Judge Benavides, speaking for the Fifth Circuit, reversed, finding that based on the narrow and unusual set of facts, that the Internal Revenue Code provisions control the case.[124]

The Internal Revenue Code dictates the time frame for filing refund claims.[125] Title 26 U.S.C. § 6511(a)[126] "provides that a refund claim must be filed within three years of the time the return was filed, or within two years from the time the tax was paid."[127]

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[117] *Goforth*, 179 F.3d at 395 (citing *Johnson v. Beck* (*In re* Johnson), 117 B.R. 461 (Bankr. D. Minn. 1990)).

[118] *Goforth*, 179 F.3d at 394 (citing *Johnson*, 177 B.R. at 469-70).

[119] 206 F.3d 465 (5th Cir. 2000).

[120] 11 U.S.C. § 362 (1994).

[121] 11 U.S.C. § 542(a) (1994).

[122] *Neary*, 206 F.3d at 469-71.

[123] *Id*. at 468-69.

[124] *Id*. at 474.

[125] *Id*. at 469.

[126] 26 U.S.C. § 6511(a) (1994).

[127] *Neary*, 206 F.3d at 469 (citing 26 U.S.C. § 6511(a)).

Section 6511(c) further provides that "in the case of an agreement to extend the time for additional assessments, the time for filing will not expire before six months after the termination or expiration of the agreement."[128]

The bankruptcy court construed the debtor's filing of an adversary proceeding against the IRS as an informal refund claim and awarded him the taxes paid within two years prior to that filing.[129] The trustee argued that while the debtor may not have timely filed a refund claim, the automatic stay allows a trustee to file for a refund of pre-petition taxes at any time during the pendency of the bankruptcy case.[130] Thus, according to the trustee, § 362 is an implied exception to I.R.C. § 6511.[131] This contention would toll § 6511 until the conclusion of the bankruptcy case. The Fifth Circuit rejected this argument: "[W]e conclude that . . . § 362 does not toll the statute of limitations for the filing of a refund claim by a bankruptcy trustee under I.R.C. § 6511."[132]

The trustee also argued that the IRS was compelled to surrender the debtor's tax overpayment to the bankruptcy estate pursuant to 11 U.S.C. § 542(a) and thus it was unnecessary for him to file a refund claim under I.R.C. § 6511.[133] The Fifth Circuit, in reversing, noted that this issue appears to present a question of first impression in the circuit and that there is no direct instruction from the Supreme Court.[134] The court then turned to the rules of statutory construction and observed that where two statutes appear to conflict, the statute addressing the relevant matter in more specific terms governs.[135]

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[128] *Id*. (citing 26 U.S.C. § 6511(c)).
[129] *Id*. at 468.
[130] *Id*. at 469.
[131] *Neary*, 206 F.3d at 469.
[132] *Id*. at 470.
[133] *Id*.
[134] *Neary*, 206 F.3d at 470.
[135] *Id*.

The court acknowledged this to be a close case, and observed that 11 U.S.C. § 505(a)(2)(B) provides: "The court may not . . . determine any right of the estate to a tax refund, before the earlier of 120 days after the trustee properly requests such refund from the governmental unit . . . ."[136] Finding that § 542(a) is a provision of general application, the court held that § 6511 trumped and ruled against the trustee.[137]

## VII. STANDARD FOR DISCHARGEABILITY OF CREDIT CARD DEBT REMAINS UNRESOLVED

The Fifth Circuit has granted a rehearing *en banc* as a result of the three separate points of view expressed in the court's decision in *AT&T Universal Card Services v. Mercer*.[138] The majority declined to find a debt nondischargeable under § 523(a)(2)(A) where the debtor has used a preapproved credit card.[139] Writing for the majority, Judge Duhé found that the debtor had not made any representations of creditworthiness to the creditor before the credit card was issued.[140] Absent a false representation, the creditor could not meet one of the elements of the legal test which requires justifiable reliance.[141]

Judge Dennis wrote a special concurrence and Judge Barksdale authored a dissent. The court's three views articulate the national debate over the property standards to be applied to credit card treatment under § 523.[142]

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[136] *Id*. at 471-72.
[137] *Id*. at 472.
[138] 211 F.3d 214 (5th Cir. 2000).
[139] *Id*. at 216.
[140] *Mercer*, 211 F.3d at 216.
[141] *Id*.
[142] *Id*. at 218-32.

The debtor was screened and mailed a preapproved credit application.[143] In response, the debtor filled out the creditor's form which required disclosure of yearly income, social security number, date of birth, home and business phone numbers, and maiden name.[144] After review of the application, the creditor issued a $3,000 line of credit.[145] The debtor promptly obtained fourteen cash advances in thirty-one days and exceeded her credit limit.[146] A significant portion of the cash had been withdrawn from an ATM located in a casino.[147]

The debtor filed Chapter 7 and her discharge was challenged under § 523(a)(2)(A).[148] The bankruptcy court found that the creditor did not meet the reliance requirement of that section because the debtor made no representations about her creditworthiness.[149] The district court affirmed.[150]

Contrary to Judge Duhé's view that the "implied representation" theory is improper in the context of preapproved credit and debt, Judge Dennis' special concurrence embraced the theory.[151] That theory assumes that when cash is advanced by using a credit card, the implied representation is that the card holder asks the card issuer for a loan and simultaneously promises to repay it.[152]

Judge Barksdale strongly disagreed with both the result and the reasoning of the

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143 *Mercer*, 211 F.3d at 216.
144 *Id.*
145 *Id.*
146 *Id.*
147 *Id.*
148 *Mercer*, 211 F.3d at 216.
149 *Id.*
150 *Id.*
151 *Id.*at 218
152 *Mercer*, 211 F.3d at 218.

majority and urged rehearing *en banc*.[153] Judge Barksdale's plea has been heard; ultimately the entire Fifth Circuit will choose among the various opinions. If Judge Duhé's opinion survives, the Fifth Circuit's view will represent a minority position which may eventually be scrutinized by the United States Supreme Court.

## VIII. DISCHARGEABILITY OF TAXES DEPENDS ON THE MEANING OF "ASSESSED" UNDER FEDERAL LAW, NOT STATE LAW

Judge Wiener examined the meaning of the word "assessed" in determining whether a state tax liability was dischargeable under § 523(a)(1)(A).[154] In *Louisiana Department of Revenue & Taxation v. Lewis (In re Lewis)*,[155] the Fifth Circuit reversed and rendered judgment in favor of the plaintiff, finding that the state taxes were "assessed" within 240 days of the bankruptcy petition and were thus nondischargeable.[156]

The court addressed the meaning of "assessed" as that term is used in § 507(a)(8)(A)(ii) of the Bankruptcy Code.[157] The question, according to Judge Wiener, is not when the taxes were deemed "assessed" by Louisiana law, but rather when the substantive legal rights afforded by Louisiana law created circumstances that federal law recognizes as an assessment.[158]

In the absence of a definition in the Bankruptcy Code, the court noted that the vast majority of courts have adopted the Internal Revenue Code definition.[159] Under the

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[153] *Id*. at 221-32.

[154] *Louisiana Dep't of Revenue & Taxation v. Lewis* (*In re* Lewis), 199 F.3d 249, 251 (5th Cir. 2000).

[155] *Id*. at 249.

[156] *Id*. at 255-56.

[157] *Id*. at 251-53.

[158] *Lewis*, 199 F.3d at 253-54.

[159] *Id*. at 252.

I.R.C., a notice of deficiency is sent to the taxpayer before an assessment is made.[160] However, once the ninety days has elapsed or there is a final, non-appealable Tax Court decision, the IRS may then assess the tax.[161] This is done by making a notation in the records of the secretary.[162]

According to the court, the notation, or "assessment," occurs at a discreet, identifiable time.[163] It marks the precise time when federal taxes are "assessed" under federal law and thus for § 507(a)(8)(A)(ii) purposes.[164] This act creates a valid lien on the taxpayer's property.[165]

After analyzing the Louisiana assessment and collection procedure,[166] the court arrived at a date certain for "assessment" given the particular facts of the case.[167] In so doing, Judge Wiener ignored the statutory labels in Louisiana law and looked for the point in time when the tax liability is deemed to be final.

## IX. BRIGHT LINE RULE FOR TIMELY DISCHARGE COMPLAINTS

The sole issue before the court in *State Bank & Trust, N.A. v. Dunlap*[168] was how to determine the bar date for the filing of nondischargeability complaints after a bankruptcy court has dismissed a case and later reinstated it.[169]

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160 26 U.S.C. § 6212 (1994).
161 *Id.*
162 26 C.F.R. §§ 307, 6203-1 (1999).
163 *Lewis*, 199 F.3d at 252.
164 *Id.*
165 *Id.*
166 LA. REV. STAT. ANN. §§ 47:1561-1574 (West 1990 & Supp. 2001).
167 *Lewis*, 199 F.3d at 255.
168 217 F.3d 311 (5th Cir. 2000).
169 *Dunlap*, 217 F.3d at 314.

Bankruptcy Rule 4007(c) provides, in part: "A complaint to determine the dischargeability of a debt pursuant to § 523(c) shall be filed no later than sixty days after the first date set for the meeting of creditors under § 341(a)."[170]

While the rule appears straightforward enough, the facts in the *Dunlap* case created enough confusion that counting to sixty was a challenge. In the end, the court resolved the case by looking to its earlier decision in *Coston v. Bank of Malvern*[171] for guidance.[172] In *Coston*, the court had held that the sixty-day period did not run from the scheduled § 341 meeting where the proceedings were stayed due to pendency of a related action in another state.[173] The *Dunlap* court indicated that the dismissal of a case is an even more compelling set of facts than the set of facts faced in the *Coston* case which involved a stay.[174] As such, the court adopted a bright-line rule based on the *new* first meeting of creditors.[175]

In this case, a meeting of creditors had been set for August 11, 1997, and later rescheduled for September 5, 1997.[176] Dunlap did not appear at the § 341 meeting.[177] The debtor's attorney did appear and announced that a motion to dismiss the case would be filed.[178]

The case was dismissed on an *ex parte* motion on September 15.[179] In response

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[170] FED. R. BANKR. P. 4007(c) (2000).
[171] 987 F.2d 1096 (5th Cir. 1992).
[172] *Dunlap*, 217 F.3d t 315 (citing *Coston*, 987 F.2d at 1096).
[173] *Coston*, 987 F.2d at 1097.
[174] *Dunlap*, 217 F.3d at 316.
[175] *Id.*
[176] *Id.* at 312-13.
[177] *Dunlap*, 217 F.3d at 313.
[178] *Id.*
[179] *Id.*

to a motion by creditors to set aside the dismissal, the bankruptcy court reinstated the case for a hearing on whether the dismissal should be granted.[180] The Chapter 7 trustee subsequently set February 6, 1998 for the § 341 meeting and calculated the sixty-day bar date for April 7, 1998.[181] On the same day, the debtor rescheduled the meeting for January 30, 1998.[182] Both dates were docketed by the clerk.[183]

Two creditors filed § 523 complaints on March 31 and April 2, 1998, respectively.[184] Both were filed prior to the bar date of April 7, 1998.[185] Dunlap moved to dismiss both complaints and argued that they had been filed more than sixty days after the rescheduled January 30, 1998 meeting date.[186] The bankruptcy court agreed with the debtor that the sixty-day window under Bankruptcy Rule 4007(a) commenced on January 30, 1998, the date that the § 341 meeting was actually conducted.[187] The district court affirmed.[188]

The Fifth Circuit reversed.[189] Judge Parker rejected a "tolling rule" which both the bankruptcy and district courts had looked to in reaching their decisions.[190] Recognizing the confusion creditors would be confronted with, the court opted for a bright-line rule based on the new first meeting of creditors since it will eliminate creditor guesswork and adhere to Rule 4007(a).[191] Concluding that the February 6 date was the new § 341

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180 *Id.*
181 *Dunlap*, 217 F.3d at 313.
182 *Id.*
183 *Id.*
184 *Dunlap*, 217 F.3d at 313.
185 *Id.*
186 *Id.*
187 *Id.; see also* FED. R. CIV. BANKR. 4007(a).
188 *Dunlap*, 217 F.3d at 314.
189 *Id.*
190 *Id.* at 317.
191 *Id.*

meeting date, the court held that the § 523 complaints of both creditors were timely.[192]

## X. SECTION 523 COMPLAINT CONSTITUTES AN INFORMAL PROOF OF CLAIM

A state court judgment of $600,000 for malicious assault in favor of a former wife against her ex-husband gave rise to a series of bankruptcy court orders that were reversed by the Fifth Circuit Court of Appeals in *Nikoloutsos v. Nikoloutsos* (*In re Nikoloutsos*).[193] Writing for the panel in *Nikoloutsos*, Judge Reynaldo Garza saw the equities quite differently than both the bankruptcy and district courts in finding that the filing of a complaint objecting to the dischargeability of the debt constituted an informal proof of claim against the ex-husband.[194]

Mrs. Nikoloutsos obtained a jury verdict that her former spouse had maliciously assaulted her.[195] In response, Mr. Nikoloutsos filed a Chapter 7 petition within three days of the jury verdict.[196] The day after, the bankruptcy court lifted the stay to permit the state court to proceed with the punitive damages phase of the trial.[197] As a result, the judgment was amended upwards to $863,440.[198] Mr. Nikoloutsos did not appeal.[199]

Apparently realizing the judgment against him for this tortious conduct would not survive a § 523(a)(6)[200] complaint, Mr. Nikoloutsos moved to convert the case to Chapter

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192 *Id.*
193 199 F.3d 233, 234-35, 238 (5th Cir. 2000).
194 *Nikoloutsos*, 199 F.3d at 236.
195 *Id.* at 234-35.
196 *Nikoloutsos*, 199 F.3d at 235.
197 *Id.*
198 *Id.*
199 *Id.*
200 11 U.S.C. § 523(a)(6) (1994).

13 pursuant to 11 U.S.C. § 706(a).[201] Without waiting the twenty-day notice period,[202] the bankruptcy court granted the motion *ex parte* within four days.[203]

Although Mrs. Nikoloutsos did not appeal the conversion order, she filed an objection within the twenty-day notice period.[204] She argued that the judgment exceeded the $250,000 limit established by § 109(e)[205] and that it was not dischargeable under either Chapter 7 or 13.[206] The bankruptcy court did not rule on the objection.[207]

The bankruptcy court entered a bar date.[208] Prior to the bar date, Mrs. Nikoloutsos, the only creditor in the case, filed a motion for dismissal of the case because the debt was not dischargeable.[209] The bankruptcy court denied the motion.[210] Also, prior to the bar date, Mrs. Nikoloutsos filed a complaint to determine dischargeability under 11 U.S.C. § 523(a)(6).[211]

The bankruptcy court next held a confirmation hearing and found that Mrs. Nikoloutsos had failed to file a proof of claim.[212] She had objected to the plan contending

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[201] *Nikoloutsos*, 199 F.3d at 235 (citing 11 U.S.C. § 706(a) (1994)).

[202] FED. R. BANK. P. 2002(a)(4) (2000).

[203] *Nikoloutsos*, 199 F.3d at 235.

[204] *Id.*

[205] 11 U.S.C. § 109(e) (1994). To be an eligible debtor under this section, an individual may not have more than $250,000 in unsecured debt. *Id.*

[206] *Nikoloutsos*, 199 F.3d at 235.

[207] *Id.*

[208] *Id.*

[209] *Nikoloutsos*, 199 F.3d at 235.

[210] *Id.*

[211] *Id.* This section bars the dischargeability of a debt "for willful and malicious injury by the debtor to another entity or to the property of another entity." 11 U.S.C. § 523(a)(6) (1994.)

[212] *Nikoloutsos*, 199 F.3d at 235.

that the court should resolve the dischargeability issue first.[213] The bankruptcy court then confirmed the plan.[214]

Mrs. Nikoloutsos filed a motion for summary judgment in the dischargeability complaint matter; the motion was denied.[215] She also filed a motion to dismiss or convert and a motion to revoke confirmation under 11 U.S.C. § 1330(a) on the basis that Mr. Nikoloutsos engaged in fraudulent conduct.[216] That motion was denied and Mr. Nikoloutsos prevailed on the merits in the adversary proceeding.[217]

Mrs. Nikoloutsos appealed the six adverse orders to the district court.[218] Each order was affirmed by the district court.[219] The Fifth Circuit found error and abuse of discretion below holding held that equities clearly weighed in Mrs. Nikoloutsos's favor and reversing and remanding the case.[220]

The court formally adopted the Tenth Circuit's five-part test and concluded that the dischargeability complaint qualified as an informal proof of claim.[221] The five-part test set forth in *Reliance Equities* requires that, "to qualify as an informal proof of claim: (1) the claim must be in writing; (2) the writing must contain a demand by the creditor on the debtor's estate; (3) the writing must evidence an intent to hold the debtor liable for such debt; (4) the writing must be field with the bankruptcy court; and (5) based upon the facts

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213 *Id.*
214 *Id.*
215 *Id.*
216 *Id.; see also* 11 U.S.C. § 1330(a) (1994).
217 *Nikoloutsos*, 199 F.3d at 235.
218 *Id.*
219 *Id.*
220 *Nikoloutsos*, 199 F.3d at 236.
221 *Id.* at 235-36 (citing *Reliance Equities, Inc. v. Valey Fed. Sav. & Loan Ass'n*, 966 F.2d 1338, 1345 (10th Cir. 1992)).

of the case, allowance of the claim must be equitable under the circumstances."[222] The district court found that Mrs. Nikoloutsos did not meet the fifth requirement.[223] The Fifth Circuit found abuse of discretion[224] and concluded that the conversion from Chapter 7 to 13 was erroneous because Mrs. Nikoloutsos' judgment was in excess of the $250,000 limit as set forth in 11 U.S.C. § 109(e).[225]

## XI. REAFFIRMATION AGREEMENTS AND THE DISCHARGE OF UNSECURED DEBTS

The Fifth Circuit reversed the "stripping" of a secured claim in *Chase Automotive Finance, Inc. v. Kinion* (*In re Kinion*).[226] Before filing a Chapter 7 bankruptcy case, the debtor's in *Kinion* financed the purchase of a car through Chase Automotive Finance (Chase).[227] The debtor's bankruptcy schedules of assets and liabilities[228] listed Chase as the holder of an undisputed claim that was secured by the car.[229] On other occasions, the

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[222] *Nikoloutsos*, 199 F.3d at 236 (citing *Reliance Equities*, 966 F.2d at 1345).

[223] *Id.*

[224] *Id.*

[225] *Id.* at 238 (citing 11 U.S.C. § 109(e) (1994)).

[226] 207 F.3d 751 (5th Cir. 2000). If a secured claim is "stripped," the creditor may not enforce its security interest and is left only with an unsecured claim. If the debtor receives a discharge in bankruptcy, except for the types of debts set forth in Bankruptcy Code § 523, the debtor is discharged from any personal liability on the unsecured claim. *See infra* notes 239-41 and accompanying text.

[227] *Kinon*, 207 F.3d at 753.

[228] In every bankruptcy case, the debtor must file schedules that list the debtor's assets, as well as the debtor's liabilities, broken down by priority liabilities, secured liabilities, and unsecured liabilities. FED. R. BANKR. P. 1007 (2000).

[229] *Kinion*, 207 F.3d at 753. Unlike Chapter 11, in a Chapter 7 bankruptcy case a creditor must file a proof of claim even though the creditor's claim is not listed on the debtors schedule as being disputed or contingent. FED. R. BANKR. P. 3002(c) (2000). Because the schedules of assets in *Kinion* did not list assets from which a dividend to unsecured creditors could be paid, FED. R. BANKR. P. 2002(e), notice was given to the creditors that they should not file proofs of claim. *Kinion*, 207 F.3d at 754. Thus, Chase was not required to – and did not – file a proof of claim. *Id.* at 753-54.

debtors conceded that Chase had a valid and perfected security interest in the car.[230]

After the bankruptcy case commenced, Chase offered to permit the debtors to retain the car provided they executed a reaffirmation agreement.[231] The debtors executed the reaffirmation agreement and filed it in the bankruptcy case.[232] At a discharge hearing, the debtors' counsel contended that, in contravention of the local rules, Chase failed to attach its security documents to the reaffirmation agreement.[233] Consequently, the debtors requested and obtained an order (a) denying the reaffirmation agreement and (b) finding that Chase did not have a secured claim.[234] Later, after the Chapter 7 case was closed, the bankruptcy court reopened the bankruptcy case on motion of the debtors and enjoined Chase from attempting the collect any debt from the debtors personally or from interfering with the debtors' possession of the car.[235] In essence, one or both of these orders "stripped" Chase of its otherwise undisputed lien on the car.[236]

The Fifth Circuit reversed the bankruptcy and district court's rulings, finding that the "extraordinary train of events"[237] in *Kinion* did not support "stripping" Chase of its

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[230] *Kinion*, 207 F.3d at 753-54.

[231] *Id.* at 753. Bankruptcy Code § 524(c) governs reaffirmation agreements. 11 U.S.C. § 524(c)(1) (1994). To be enforceable, the reaffirmation agreement must comply with all of the requirements of § 524(c), including the requirement that the agreement must be complete "before the granting of the discharge." 11 U.S.C. § 524(c)(1). Additionally, if counsel represents the debtors, counsel's declaration must accompany the reaffirmation agreement. *Id.* Because neither of these requirements were satisfied in *Kinion*, the reaffirmation agreement would have not been enforceable even if Chase had attached its security documents to the reaffirmation agreement. *See infra* text accompanying note 243.

[232] *Kinion*, 207 F.3d at 754.

[233] *Id.*

[234] *Id.* at 753. The order also gave Chase thirty days to file a motion for rehearing. *Id.* Chase did not file a motion for reconsideration until after the expiration of the thirty days. *Id.* at 753-54.

[235] *Kinion*, 207 F.3d at 754.

[236] *Id.* at 754-55.

[237] *Id.* at 753.

secured claim.[238] "A bankruptcy discharge operates as an injunction against the commencement or continuation of an act to collect a pre-petition unsecured debt from property of the debtor," not a secured claim.[239] Instead, the discharge only prevents the secured creditor[240] from attempting to enforce personal liability on the discharged parties.[241] The bankruptcy court's orders improperly converted the issue of whether the reaffirmation agreement was enforceable into a ruling on whether Chase's secured claim was enforceable. To challenge properly the secured status of a debt, the Fifth Circuit found that the debtors should have filed an adversary proceeding, so that Chase would have the safeguards of a civil litigant.[242] The Fifth Circuit also noted that unsecured claims can be reaffirmed under § 524(c), contrary to the implication of the bankruptcy court's local rule that required reaffirmation agreements to include proof of a secured claim.[243]

## XII. CHAPTER 13 PLANS MAY NOT UNFAIRLY DISCRIMINATE IN FAVOR OF A CLASS OR SEPARATELY CLASSIFIED CO-SIGNED CONSUMER DEBTS

In two related opinions involving Chapter 13 wage earner plans, *Chacon v*.

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[238] *Id*.

[239] *Id*. at 757.

[240] Bankruptcy "operates as an injunction against the commencement or continuation of an action . . . to collect, recover or offset any such debt as a personal liability of the debtor . . . ." 11 U.S.C. § 524(a)(2) (1994).

[241] As the Fifth Circuit noted, "creditor's liens ride through bankruptcy unaffected unless the Bankruptcy Code clearly permits their modification, *e.g.*, in reorganization cases." *Kinion*, 207 F.3d at 757 n. 12.

[242] *Id*. at 757. *See* FED. R. BANKR. P. 7001. An adversary proceeding incorporates "nearly verbatim most of the Federal Rules of Civil Procedure." *Kinion*, 207 F.3d at 757.

[243] *Kinion*, 207 F.3d at 755-56. Because "[t]he Code permits reaffirmations of unsecured as well as secured debt," local rules "may not impose a requirement of secured status upon a creditor seeking court filing of a reaffirmation agreement." *Id*. at 755.

*Bracher* (*In re Chacon*)[244] and *Ramirez v. Bracher* (*In re Ramirez*),[245] the Fifth Circuit addressed unfair discrimination in the classification and treatment of unsecured claims. The facts in *Chacon* and *Ramirez* are similar. In each, the debtors proposed plans that separately classified unsecured claims into two classes, one class for specific unsecured consumer claims that were co-signed by relatives of the debtors and another for the remaining unsecured claims.[246] Additionally, the plans proposed more favorable treatment for the co-signed unsecured claim, such that the co-signed unsecured claim would be fully paid, with 12% interest, before any distributions would be made to the class of general unsecured creditors.[247]

The issue in *Chacon* and *Ramirez* is whether Chapter 13 plans may unfairly discriminate in favor of the co-signed consumer debt.[248] Bankruptcy Code § 1322(b)(1) permits a plan to classify unsecured claims separately, but provides that such a plan "may not discriminate unfairly against any class so designated; however, such plan may treat claims for a consumer debt of the debtor if an individual is liable on such consumer debt with the debtor differently than other unsecured claims."[249] Struggling with the "however" clause in § 1322(b)(1), bankruptcy courts are split on whether co-signed consumer debts are an exception or "carve out" to the general prohibition against unfair discrimination contained in § 1322(b)(1).[250] The Fifth Circuit is the first circuit court to consider the issue.[251]

In *Chacon*, the Fifth Circuit easily concluded that no such "carve out" is found is

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[244] 202 F.3d 725 (5th Cir. 1999).
[245] 204 F.3d 595 (5th Cir. 2000) (per curiam).
[246] *Chacon*, 202 F.3d at 726; *Ramirez*, 204 F.3d at 595-96.
[247] *See supra* note 246.
[248] *Id.*
[249] 11 U.S.C. § 1322(b)(1) (1994).
[250] *Supra* note 246.
[251] *Chacon*, 202 F.3d at 726.

§ 1322(b)(1) and that unfair discrimination is prohibited regardless of whether a co-signed consumer debt is involved.[252] In so ruling, the Fifth Circuit concluded that the "however" provision in § 1322(b)(1) permits "different" treatment of co-signed consumer debt, not unfair discrimination for such a debt.[253] Bound by *Chacon*, the Fifth Circuit affirmed the lower court's denial of plan confirmation in *Ramirez.*[254] In a lengthy concurring opinion, after reviewing other decisions addressing the issue, Judge Benavides, on the *Ramirez* panel, expressed his disagreement with the holding in *Chacon*.[255]

## XIII. PRE-BANKRUPTCY PARTITION OF COMMUNITY PROPERTY

The Fifth Circuit addressed the voidability of community property partitions in two recent opinions, *Anderson v. Conine* (*In re Robertson*),[256] and *Hinsley v. Boudloche* (*In re Hinsley*).[257] In *Robertson*, unlike *Hinsley*, there were no allegations of actual or constructive fraud.[258] Both cases examined the powers of a bankruptcy trustee to avoid pre-bankruptcy partitions based on Bankruptcy Code § 544[259] and applicable non-bankruptcy law.

### A. Judgment Partitioning Former Community Property Before Former Spouse's Bankruptcy Is Not an Asset of the Estate and Judgment Is Not Voidable

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[252] *Chacon*, 202 F.3d at 726.

[253] *Id.*

[254] *Ramirez*, 204 F.3d at 596.

[255] *Id.* at 598-601 (Benavides, J., concurring). In summary, Judge Benavides found that "[t]o give the word 'however' operative effect, we must interpret it as indicating that the second clause is somehow in contrast to the first clause." *Id.* at 599.

[256] 203 F.3d 855 (5th Cir. 2000).

[257] 201 F.3d 638 (5th Cir. 2000).

[258] *Robertson*, 203 F.3d at 857.

[259] 11 U.S.C. § 544 (1994).

The former husband in *Robertson* commenced a Chapter 7 bankruptcy case after (a) obtaining judgment of divorce that terminated the community property regime,[260] (b) recording that judgment in the pertinent conveyance records,[261] and (c) consenting to a judgment whereby the former wife, in exchange for assuming all liabilities with respect to the former family residence,[262] acquired the residence as her separate property.[263]

The trustee took the position that the residence was an asset of the bankruptcy estate, even though it was partitioned before the Chapter 7 case was filed.[264] Alternatively, the trustee argued that the partition was avoidable under Bankruptcy Code § 544(a)(3).[265] The Fifth Circuit rejected both arguments and reversed the lower court's rulings in favor of the trustee.[266]

The *Robertson* panel first reviewed Bankruptcy Code § 541, which defines property of the estate as "[a]ll interests of the debtor and the debtor's spouse in community property as of the commencement of the case that is . . . liable for an allowed claim against the debtor . . . to the extent that such interest is so liable."[267] Because the Bankruptcy Code does not define the term community property, the court started its analysis with the meaning of the term under applicable state law.[268] Under Louisiana law, property acquired by spouses during the existence of the legal regime of the community of acquets and gains

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[260] *Robertson*, 203 F.3d at 858.
[261] *Id*. at 865-66.
[262] *Robertson*, 203 F.3d at 858. The liabilities included a mortgage debt and tax liens. *Id*.
[263] *Id*.
[264] *Id*.
[265] *Id*. at 863-66.
[266] *Id*. at 867.
[267] *Robertson*, 203 F.3d at 858-59 (citing 11 U.S.C. § 541(a)(2) & (a)(2)(B) (1994)).
[268] *Id*. at 859.

is community property.[269] Because the residence in *Robertson* was acquired after the regime was established, the residence was community property.[270] The judgment of divorce terminated the legal regime of community property,[271] at which point each former spouse owned a one-half undivided interest in the residence (now former community property).[272] Under the Fifth Circuit's analysis in *Robertson*, the residence was property of the estate under § 541(a)(2) until the residence was partitioned.[273]

After the partition by consent judgment,[274] the *Robertson* panel also found that the former spouses ceased to be co-owners of the residence, and the former wife acquired sole ownership of the residence as the "separate, exclusive property of that former spouse."[275] Because partition by consent judgment removed the residence from the former community property regime, reclassified the residence as separate property of the debtor's former spouse under state law,[276] the Fifth Circuit ruled that the residence was not community property and did not pass into the bankruptcy estate under § 541(a)(2).[277]

The court next examined whether the *Robertson* trustee could avoid the partition of the residence under Bankruptcy Code § 544(a)(3).[278] That section gives the trustee the power, as of the commencement of the bankruptcy, "to avoid any lien or transfer avoidable by a hypothetical bona fide purchaser of real property of the debtor."[279] While the

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[269] *Id.* (citing LA. CIV. CODE ANN. art. 2327 (West 1985)).
[270] *Id.* at 860.
[271] *Robertson*, 203 F.3d at 859 (citing LA. CIV. CODE ANN. arts. 2327-2329, 2365 (West 1985)).
[272] *Id.* (citing LA. CIV. CODE ANN. art. 2369.2 (West 1999)).
[273] *Id.* at 861.
[274] *Robertson*, 203 F.3d at 860. The Fifth Circuit determined that the consent judgment in *Robertson* was a valid and enforceable partition of the residence. *Id.*
[275] *Id.* at 859 (citing LA. CIV. CODE ANN. arts. 1382, 2335, 2336, 2341, 2369.1 (West 1999)).
[276] *Id.* at 862.
[277] *Robertson*, 203 F.3d at 861-62.
[278] *Id.* at 863 (citing 11 U.S.C. § 544(a)(2) (1994)).
[279] *Id.* at 864.

trustee's rights are "without regard to any knowledge of the trustee or of any creditor,"[280] the "extent of the trustee's rights as a bona fide purchaser of real property . . . is measured by the substantive law of the state governing the property in question."[281] "A hypothetical bona fide purchaser under section 544(a)(3) is a purchaser who under state law could have conducted a title search, paid value for the property and perfected his interest as a legal title holder as of the date of the commencement of the case."[282]

When the spouse commenced the *Robertson* bankruptcy case, it appears that the consent judgment partitioning the residence was not recorded in the conveyance records for the residence.[283] The judgment of divorce, which terminated the community of acquits and gains, was recorded in the conveyance records of the pertinent parish.[284] The Fifth Circuit found that the recordation of the judgment of divorce was sufficient to defeat the rights of a hypothetical bona fide purchaser under state law and § 544(a)(3).[285] Although the actual knowledge of the trustee or a creditor cannot defeat the trustee's rights, "a trustee is still bound by the state law regarding recordation and constructive notice, as well as other state law limitations upon bona fide third party purchaser status.[286] Under Louisiana law, the recordation of the divorce judgment terminates the community acquets and gains.[287] After the divorce judgment, therefore, a "spouse may not alienate, encumber or lease former community property or his undivided interest in that property without the concurrence of the other spouse."[288] That termination became effective against third persons with respect to the residence, therefore, from the date and time that the judgment

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[280] 11 U.S.C. § 544(a)(3) (1994).
[281] *Robertson*, 203 F.3d at 864.
[282] *Id*.
[283] *Id*. at 864-65.
[284] *Robertson*, 203 F.3d at 865.
[285] *Id*. at 866-67.
[286] *Id*. at 864.
[287] *Robertson*, 203 F.3d at 865.
[288] LA. CIV. CODE ANN. art. 2369.8 (West 1999).

was recorded in the parish of the residence.[289] After the recordation, "a solo transfer by the debtor to a hypothetical buyer . . . would be a relative nullity, would not transfer valid title to such a buyer, and would not enable that buyer to obtain bona fide purchaser status."[290] Because a hypothetical bona fide purchaser, as of the commencement of the former spouse's bankruptcy case, could not acquire the residence without the non-debtor spouse's signature, the trustee could not maintain an action to avoid the partition under § 544(a)(3).[291]

### B. Partition of Community Property Held to Be Voidable Under State Law Made Applicable in the Bankruptcy Case

In *Hinsley*, the district court[292] granted summary judgment in favor of a trustee, finding that the partition of community property was fraudulent under Texas state law and Bankruptcy Code § 544(b).[293] Unlike *Robertson*, the husband and wife in *Hinsley* never divorced.[294] Instead, in 1989, at a time when the Hinsleys had a preexisting debt,[295] they executed partition agreements that divided their community estate into separate

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[289] *Robertson*, 203 F.3d at 865 (citing LA. CIV. CODE ANN. art. 1839 (effective Jan. 1, 1984); LA. CIV. CODE ANN. § 9:2721 (West 1991 & Supp. 2001)).

[290] *Robertson*, 203 F.3d at 866.

[291] *Id*. at 867.

[292] *Hinsley v. Boudloche* (*In re Hinsley*), 201 F.3d 638, 650 (5th Cir. 2000).

[293] *Hinsley*, 201 F.3d at 640-42. Section 544(b) provides that the trustee or debtor-in-possession "may avoid any transfer of property . . . that is voidable under applicable law by a creditor holding an unsecured claim that is allowable under section 502" of the Bankruptcy Code. 11 U.S.C. § 544(b)(1) (1994). Subsection (2) provides an exception for certain charitable contributions. 11 U.S.C. § 544(b)(2) (1994). The applicable law in *Hinsley* was Texas law, which provides for voiding a partition executed with the intent to defraud preexisting creditors. *Hinsley*, 201 F.3d at 642 (citing TEX. FAM. CODE ANN. § 4.106(a) (Vernon 2000)).

[294] *Hinsley*, 201 F.3d at 640.

[295] *Id*. at 640 n. 2. The existence of debt at the time of the partition is important under Texas state law. *Id*. at 644.

property.[296] The Hinsleys were still married in 1995, when Mr. Hinsley filed a Chapter 7 bankruptcy.[297] The trustee in *Hinsley* filed an adversary proceeding seeking a declaration that the partition was void under Bankruptcy Code § 544(b) and Texas state law.[298] In an earlier appeal, the Fifth Circuit "affirmed the district court's determination that the partition was void as to Mr. Hinsley, but found that due process required separate consideration of Mrs. Hinsley's interest."[299]

The trustee's motion for summary judgment against Mrs. Hinsley was supported by 700 pages of financial documents."[300] The Fifth Circuit apparently agreed with the trustee that the documents established numerous badges of frauds[301] that were sufficient

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[296] *Hinsley*, 201 F.3d at 640 (citing TEX. FAM. CODE ANN. § 4.102 (Vernon 2000)).

[297] *Id*. at 641.

[298] *Id*. at 642. More particularly, the trustee alleged that the partition violated Texas Family Code section 4.106(a), which provides that a "provision of a partition or exchange agreement made under this subchapter [of marital property agreement] is void with respect to the rights of a preexisting creditor whose rights are intended to be defrauded." *Id*. (quoting TEX. FAM. CODE ANN. § 4.106(a) (Vernon 2000)).

[299] *Hinsley*, 201 F.3d at 641; *see also Hinsley v. Boudloche* (*In re Hinsley*), 149 F.3d 1179 (5th Cir. 1998) (unpublished decision on prior appeal).

[300] *Hinsley*, 201 F.3d at 642.

[301] Under the Texas version of the Uniform Fraudulent Transfer Act that was applicable to the 1989 partition, section 24.005(b) of the Texas Business and Commerce Code, "there are eleven, non-exclusives badges of fraud that may be used to prove the fraudulent intent of the transferor." *Hinsley*, 201 F.3d at 642 (citing TEX. BUS. & COM. CODE ANN. § 24.005(b) (Vernon 2000)). One such badge of fraud is a transfer of property for "less than the reasonable equivalent value of the property," the same language used in the constructive fraud provisions of the Bankruptcy Code, 11 U.S.C. § 548(a)(2). *Id*. at 643. The *Hinsley* court found that "[i]ntangible, non-economic benefits, such as preservation of marriage, do not constitute reasonably equivalent value." *Id*. (citing *Dietz v. St. Edward's Catholic Church* (*In re Bargfrede*), 117 F.3d 1078, 1080 (8th Cir. 1997) (interpreting § 548(a)(2) of the Bankruptcy Code)). In addition, the value of consideration should be "determined from the standpoint of creditors," with the focus being on the "net effect of the transfers on the debtor's estate." *Id*. at 644.

to prove Mrs. Hinsley's intent to defraud creditors.[302] In opposition, Mrs. Hinsley submitted her personal affidavit that denied any intent to defraud creditors and attempted to explain why significant marital problems led to the partition.[303]

The Fifth Circuit found that Mrs. Hinsley's affidavit was insufficient to defeat summary judgment because her "self-serving and unsupported claim that she lacked the requisite intent [to defraud] is not sufficient to defeat summary judgment where the evidence otherwise supports a finding of fraud."[304] Similarly, the Fifth Circuit found that Mrs. Hinsley had failed to meet the burden or proof, as required under applicable state law, and that the statute of limitations had run, even though the partition occurred more than five years before the bankruptcy case was filed.[305]

## XIV. NON-DISCLOSURE LEADS TO JUDICIAL ESTOPPEL

The Fifth Circuit reaffirmed the applicability of judicial estoppel in the bankruptcy context in *Browning Manufacturing v. Mims* (*In re Coastal Plains, Inc.*).[306] The facts in *Coastal* are complicated but critical to understanding the applicability of judicial estoppel. Before filing a Chapter 11 bankruptcy case, Coastal Plains, Inc. (Coastal) was attempting to restructure financially without resort to bankruptcy.[307] As part of that effort, Coastal agreed to return inventory it purchased on credit from Browning Manufacturing (Browning) in exchange for Browning either (a) paying one-half of the inventory at cost and forgiving its claim against Coastal or (b) transferring the returned inventory back to

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[302] *Hinsley*, 201 F.3d at 641.

[303] *Id*. at 642.

[304] *Hinsley*, 201 F.3d at 643 (citing *BMG Music v. Martinez*, 74 F.3d 87, 90 (5th Cir. 1996)).

[305] *Id*. at 644. "Under Texas law, a party defending on ground of statute of limitations bears the burden of proof." *Id*.

[306] 179 F.3d 197 (5th Cir. 1999), *cert. denied*, 120 S. Ct. 936 (2000).

[307] *Id*. at 202.

Coastal.[308] Browning was told that the money Coastal received would be paid to a secured creditor, Westinghouse Credit Corporation (Westinghouse).[309] Despite Browning's earlier agreement with Coastal, Browning did not pay Coastal for the returned inventory and refused to return the inventory to Coastal.[310]

A week after filing its Chapter 11 case, Coastal filed an adversary proceeding against Browning, seeking both the return of the inventory and an unspecified amount of damages for tortious interference with contract and violation of the automatic bankruptcy stay.[311] After the bankruptcy court found that Browning had violated the stay, Browning returned the inventory to Coastal.[312] Notwithstanding the claims asserted in the adversary proceeding, Coastal's schedules of assets did not list any claim against Browning as an asset of the bankruptcy estate.[313] Similarly, Coastal's schedules of liabilities listed Browning as holding an undisputed claim in the amount of $1.3 million.[314]

Less than five months after the Coastal bankruptcy was filed, Coastal and Westinghouse stipulated that Coastal's general intangibles, one category of case assets pledged to secure Westinghouse's loan, were worth less than $20,000.[315] The claims asserted in the adversary proceeding against Browning were not mentioned in the stipulation.[316] Based in part on the stipulation, Westinghouse obtained a modification of

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[308] *Id.*
[309] *Id.*
[310] *Coastal*, 179 F.3d at 202.
[311] *Coastal*, 279 F.3d at 202.
[312] *Id.* at 203.
[313] *Id.*
[314] *Id.*
[315] *Coastal*, 179 F.3d at 203.
[316] *Id.* The stipulation also estimated the value of the collateral securing Westinghouse's claim was approximately $5 million less than the $8 million that Coastal owed Westinghouse. *Id.*

the bankruptcy stay and proceeded to foreclose on its collateral.[317]

As previously negotiated with Coastal's management, Westinghouse purchased all of Coastal's inventory at the foreclosure auction,[318] and sold the inventory to Industrial Clearinghouse, Inc. ("IC"), a new company formed by Coastal's chief executive officer.[319] Four months later, the remaining assets upon which Westinghouse had foreclosed were sold to IC, including a "potential cause of action" against Browning.[320]

Some time after Coastal's Chapter 11 reorganization was converted to a Chapter 7 liquidation, IC was substituted as the plaintiff in Coastal's lawsuit against Browning.[321] Shortly before trial, Coastal's Chapter 7 Trustee moved to intervene in the lawsuit, claiming that the Coastal bankruptcy estate owned the causes of action against Browning.[322] Eventually, IC and the Trustee agreed to share any recovery against

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[317] *Coastal*, 179 F.3d at 203. Westinghouse then foreclosed on its assets. *Id.* No mention of the claims against Browning was made in the foreclosure notice, advertisements, or auction. *Id.* Browning attended the auction but did not bid. *Id.* at 203, 213.

[318] *Id.* at 203. In exchange for the inventory, Westinghouse reduced its secured claim by $3.5 million. *Id.*

[319] *Coastal*, 179 F.3d at 203. On the same day, Coastal's employees became IC employees. *Id.*

[320] *Id.* The sale price for the remaining assets for $1.24 million. *Id.* In subsequent proceedings, the bankruptcy court found that Westinghouse had foreclosed upon and sold to IC only the causes of action arising under contract. *Id.*at 204. The claims arising under tort were not Westinghouse's collateral and, therefore, remained an asset of the Coastal baknruptcy estate. *See Coastal*, 179 F.3d at 204, 207. The merit of these rulings was not addressed in the Fifth Circuit decision.

[321] *Coastal*, 179 F.3d at 203. After the reference to bankruptcy court was withdrawn, the case against Browning proceeded to trial in district court. *Id.* at 204.

[322] *Id.* at 204. The district court referred the case back to bankruptcy court for a determination of whether the estate or IC owned the causes of action against Browning. *Id.*

Browning.[323] Then, seven years after the original adversary complaint was filed, IC and the Trustee filed a motion for leave to file an amended complaint to add new allegations that Browning had interfered with Coastal's attempts to sell its assets to a third party, Helms, for a substantial sum.[324] Although a tortious interference claim had been asserted previously in the adversary proceeding, that claim was different from the allegations regarding Helms.[325] During the ensuing trial, IC and the Trustee restricted their tortious interference claim to the Helms transaction.[326]

After a $10 million jury award was set aside,[327] final judgment against Browning was entered in the amount of $3.6 million for damages,[328] together with $1.6 million for attorney's fees and costs.[329] On appeal, Browning argued both that (a) the doctrine of judicial estoppel barred all of the causes of action against Browning except for Helms' tortious interference claim,[330] and (b) Helms' tortious interference claim was time-barred

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[323] *Id.* The bankruptcy court determined that the Coastal bankruptcy estate owned the contract claims and that IC owned the contract claims. *Id.* Therefore, IC and the Trustee agreed that 15% of any recovery would belong to the Coastal bankruptcy estate and 85% would belong to IC. *Id.* After this determination, IC and the Trustee, both plaintiffs, proceeded to trial. *Id.*

[324] *Coastal*, 179 F.3d at 213. The amended complaint, however, was not filed for almost two more years. *Id.* at 213-14.

[325] *Id.* at 213-14.

[326] *Id.* Although the tortious conduct regarding Helms allegedly took place "around the start of 1986," IC alleged that it did not discover the conduct until years later. *Id.* at 213.

[327] *Coastal*, 179 F.3d at 204. The $10 million award included $5 million for breach of contract, $2.5 million for conversion, $1.75 million for breach of fiduciary duty, $1.3 million for tortious interference, and $7.5 million for punitive damages. *Id.* at 204.

[328] *Id.* This $3.6 million amount was net of Browning's $1.4 million offsetting claim. *Id.*

[329] *Coastal*, 179 F.3d at 204. The trial court partially granted Browning's motion for judgment as a matter of law, finding that the evidence was insufficient to support a breach of fiduciary duty claim. *Id.*

[330] *Id.* The Fifth Circuit does not explain why the plaintiffs were not estopped from asserting Helms' tortious interference claim. *Id.* There are two possibilities. First, the bankruptcy court apparently rejected judicial estoppel relative to all of the tort claims against Browning because

under applicable state law.[331] The Fifth Circuit accepted both arguments.[332]

The most notable holding in *Coastal* deals with the applicability of judicial estoppel. As defined by the Fifth Circuit, judicial estoppel is the "common law doctrine by which a party who has assumed a position in his pleadings may be estopped from assuming an inconsistent position."[333] Unlike equitable estoppel, detrimental reliance is not required to establish judicial estoppel.[334]

Judicial estoppel may be more important in the bankruptcy context than other areas of the law due to the debtor's duties of full disclosure.[335] The debtor is obligated to disclose all of its assets, including all potential causes of action. The "*integrity of the bankruptcy system depends on full and honest disclosure by debtors of all of their assets.*"[336] The Fifth Circuit concluded that non-disclosure occurred twice in *Coastal*. First, the bankruptcy schedules not only failed to list the claims against Browning, but failed to list Browning's claim against Coastal as disputed.[337] Second, the stipulation accompanying Westinghouse's motion to lift the stay failed to disclose claims against

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Westinghouse could not foreclose upon tort claims, making them property of the *Coastal* bankruptcy estate. *See id*. at 207. Second, apparently the debtor did not know about the existence of Helms' intentional interference claim until after the schedules of assets and liabilities were filed and the stipulation had been filed. *Id*. at 212. Because judicial estoppel requires that the debtor failed to disclose a known fact, and Helms' interference claim was not known, judicial estoppel was applicable. *See id*. at 207, 213. The later rationale is more likely because the lawsuit proceeded on tort claims other than Helms' intentional interference claim, such as conversion, that were judicially estopped. *Id*.

[331] *Coastal*, 179 F.3d at 209, 213.

[332] *Id*. at 204, 216.

[333] *Id*. at 205 (quoting *Brandon v. Interfirst Corp*., 858 F.3d 266, 268 (5th Cir. 1988)).

[334] *Coastal*, 179 F.3d at 205.

[335] *Id*. at 208 (citing *Rosenshein v. Kleban*, 918 F. Supp. 98, 104 (S.D.N.Y. 1996). As the court in *Coastal* noted, "[v]iewed against the backdrop of the bankruptcy system and the ends it seeks to achieve, the importance of this disclosure duty cannot be overemphasized." *Id*.

[336] *Coastal*, 179 F.3d at 208 (emphasis added) (quoting *Rosenshein*, 918 F. Supp. at 104).

[337] *Coastal*, 179 F.3d at 210.

Coastal as an asset of the estate.[338]

The Fifth Circuit was not persuaded that the debtor satisfied its disclosure duties because the adversary proceeding against Browning was filed.[339] Nor was the Fifth Circuit persuaded by the argument that Coastal's failure to disclose the claims in the schedules and stipulation was mere "inadvertence." In so ruling, the court articulated the following definition for "inadvertence" in the bankruptcy context: "[T]he debtor's failure to satisfy its statutory disclosure duty is 'inadvertent' only when, in general, the debtor either lacks knowledge of the undisclosed claims *or* has no motive for their concealment."[340] In *Coastal*, the court concluded that Coastal both had knowledge of the undisclosed claim and had a motive to conceal the claim.[341]

The Fifth Circuit postulated that the motive in concealing the information was to ensure that the bankruptcy stay was modified or that Coastal's assets were sold to Westinghouse, who, in turn, had agreed to sell them to IC, a company owned by Coastal's management.[342] By concealing the claims against Browning, Coastal (which had the same management as IC) could insure that IC could purchase the assets from Westinghouse at the negotiated price, without competitive bidding from Browning.[343] Therefore, except for Helms' tortious interference claim, the claims against Browning were judicially estopped.[344]

Finally, the Fifth Circuit found that Helms' tortious interference claim was barred

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[338] *Id*. at 209-10.

[339] *Id.* The adversary proceeding was insufficient disclosure because the general creditors did not receive notice of the proceeding. *Id*. at 209. Additionally, Browning's knowledge of the proceeding was immaterial because judicial estoppel does not require detrimental reliance. *Id*. at 210.

[340] *Coastal*, 179 F.3d at 210.

[341] *Id*. at 212.

[342] *Id*. at 212-13.

[343] *Id*. at 213.

[344] *Id*.

by the two-year statute of limitations for tortious interference applicable under non-bankruptcy law.[345] Although a tortious interference claim was pled in the original complaint, the alleged misconduct that formed the basis of the original claim was related to Helms' tortious interference claim.[346] The Fifth Circuit reversed the lower court's decision and rendered judgment in favor of Browning in all respects.[347]

## XV. RES JUDICATA AND BANKRUPTCY COURT ORDERS

In *Applewood Chair Co. v. Three Rivers Planning & Development District* (*In re Applewood Chair Co.*),[348] the Fifth Circuit addressed the *res judicata* effect of a bankruptcy court order that authorized the sale of property and an order that confirmed a plan of reorganization.[349] First, the debtor, Applewood Chair, obtained a bankruptcy court order authorizing the sale of certain equipment to a new company, the same equipment that secured Three Rivers' loan to Applewood Chair.[350] Three Rivers also held the secured, personal guaranty of Applewood Chair's president and principal shareholder.[351]

In the motion seeking court authority for the equipment sale, Applewood Chair represented that the new company would assume Three Rivers' loan to Applewood Chair and the equipment would continue to secure the loan.[352] Further, the sale motion provided that, "[*u*]*pon assumption, all claims of Three Rivers, with respect to the equipment,*

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[345] *Coastal*, 179 F.3d at 214-215 (citing TEX. CIV. PRAC. & REM. CODE ANN. § 16.003(a) (Vernon 1986)).

[346] *Id*. at 216. Therefore, the allegations did not relate back to the original complaint. *Id*.

[347] *Id*.

[348] 203 F.3d 914 (5th Cir. 2000) (per curiam).

[349] *Id*. at 918.

[350] *Id*. at 916.

[351] *Id*. at 915-16.

[352] *Id*. at 916.

*will be discharged and forgiven, as to all existing obligors . . . .*"[353] After entry of the order approving the sale motion, the new company and Three Rivers executed an assumption agreement which expressly stated "that the individual guarantees shall not be impaired" and that the assumption "shall not be considered to be a novation with regard to the individual guarantees. . . ."[354]

After the sale, the bankruptcy court confirmed a plan of reorganization.[355] While the plan did not specifically mention any release of a guaranty, the plan contained the following provision: "The provisions of the confirmed plan shall bind all creditors and parties in interest, whether or not they accept the plan and *shall discharge the Debtor, its officers, shareholders and directors from all claims that arose prior to Confirmation.*"[356] After the plan was confirmed, Applewood Chair continued to do business. The new company, however, went out of business and defaulted on Three Rivers' loan.[357] The equipment that Applewood Chair sold to the new company could not be found.[358]

Three Rivers then sought to foreclose on the property that secured the president's guaranty.[359] The president took the position that the confirmation order discharged both Applewood Chair's and his personal obligations to Three Rivers.[360] The bankruptcy court disagreed,[361] finding that neither the sale order nor the confirmation order contained

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[353] *Applewood Chair*, 179 F.3d at 916.
[354] *Applewood Chair*, 179 F.3d at 916-17.
[355] *Id.* at 918.
[356] *Id.* at 919 (emphasis added).
[357] *Applewood Chair*, 179 F.3d at 917.
[358] *Id.*
[359] *Id.*
[360] *Id.*
[361] On appeal, one of the issues was whether Three Rivers could proceed with the motion for clarification that it filed in the bankruptcy court, or whether it could only proceed by way of an adversary proceeding under Federal Rule of Bankruptcy Procedure 7001. *Id.* at 918. The Fifth Circuit

language sufficient to affect the release of the president's guaranty.[362]

On Appeal, the Fifth Circuit began its analysis with Bankruptcy Code § 524(e), which provides that a "discharge of a debt of the debtor does not affect the liability of any other entity on, or the property of any other entity for, such debt."[363] A corollary to this general principle was first expressed by the Fifth Circuit in *Republic Supply Co. v. Shoaf*.[364] In that case, The Fifth Circuit held that "the confirmation of a clear and 'unambiguous plan' of reorganization that 'expressly released' a third-party guarantor has a *res judicata* effect on a subsequent action against the guarantor who is also a creditor."[365] The Fifth Circuit held that the release provision in Applewood Chair's plan was not specific enough to release the personal guaranty of the debtor's president.[366] In *Shoaf*, the confirmed plan contained both general release language, similar to the language contained in *Applewood Chair*, and specific reference to the release of the third-party guaranty.[367] The Fifth Circuit concluded that it would not extend the holding in *Shoaf* to "situations where a plan of reorganization does not contain a specific discharge of the indebtedness of a third-party. . . ."[368]

A different result was reached in *Osherow v. Ernst & Young, LLP* (*In re*

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noted that the validity and extent of Three Rivers' lien on the debtor's equipment were not at issue. *Id.* Instead, the issue was the "intent and effect" of the sale order and confirmation order. *Id.* Accordingly, the Fifth Circuit found that Three Rivers could proceed by motion. *Id.*

[362] *Applewood Chair*, 179 F.3d at 917.

[363] 11 U.S.C. § 524(e) (1994).

[364] 815 F.2d 1046 (5th Cir. 1987).

[365] *Applewood Chair*, 203 F.3d at 918 (quoting *Shoaf*, 815 F.2d at 1049-50).

[366] The plan expressly provided a discharge to Applewood Chair, its officers, shareholders and directors from all claims that arose before plan confirmation. *See supra* text accompanying note 356. In *Applewood Chair*, the guarantor was both an officer and shareholder of the debtor and the guaranty certain was executed before plan confirmation. *Applewood Chair*, 203 F.3d at 919.

[367] *Applewood Chair*, 203 F.3d at 919.

[368] *Id.* at 920.

*Intelogic Trace, Inc.*).[369] In *Intelogic*, shortly after the confirmation of a plan of reorganization, the debtor-in-possession's accountants filed a final fee application.[370] At the time of the hearing on the fee application, the company's board of directors "'had serious concerns about the company's numbers and the state of the company's liquidity'" and had similar concerns about the company's cash flow projections that the accountants prepared.[371] Despite these concerns, the company did not object to the accountants' final fee application, and the bankruptcy court entered an order approved the fee application.[372]

Several months later, unable to generate sufficient income to meet its obligations under the confirmed plan of reorganization, the company filed a second Chapter 11 bankruptcy case.[373] After the case was converted to a Chapter 7 liquidation, the Chapter 7 Trustee filed a lawsuit in state court against the accountants. In the lawsuit, the Trustee alleged, among other things, that the accountants committed malpractice in the preparation of the company's cash flow projections.[374] After removing the state court case to bankruptcy court,[375] the accountants moved for summary judgment, arguing that the Trustee's claims were barred by *res judicata*, collateral estoppel, or waiver.[376] The bankruptcy court and district courts ruled that *res judicata* barred the claim.[377]

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[369] 200 F.3d 382, 391 (5th Cir. 2000).

[370] *Id.* at 384. The application exceeded $200,000 for fees and expenses incurred after the commencement of the bankruptcy case. *Id.* The fee that was ultimately approved by the bankruptcy court was somewhat lower. *Id.* at 385.

[371] *Intelogic*, 200 F.3d at 384.

[372] *Id.* Because he did want the bankruptcy court to "become aware of problems with the reorganization plan that had been confirmed only one month" earlier, the chairman of the company's board of directors chose not to raise any allegations of malpractice at the fee application hearing. *Intelogic*, 200 F.3d at 384.

[373] *Id.* at 385. The accountants filed a proof of claim in the second bankruptcy case. *Id.*

[374] *Id.*

[375] *Id.* Removal was accomplished under 28 U.S.C. § 1452 (1994).

[376] *Intelogic*, 200 F.3d at 386.

[377] *Id.*

On appeal, the Fifth Circuit affirmed the lower courts' rulings.[378] First, the court reiterated the Fifth Circuit's four-party test for determining whether a claim is barred by *res judicata* or claim preclusion:

> For a prior judgment to bar an action on the basis of *res judicata*, or claim preclusion, the parties must be identical in both suits, the prior judgment must have been rendered by a court of competent jurisdiction, there must have [been] a final judgment on the merits and the same cause of action must be involved in both cases.[379]

Because the parties conceded that the parties were identical, that a court of competent jurisdiction had approved the fee application, and that the fee application order was a final judgment, the Fifth Circuit focused on whether the same cause of action was involved in both the first bankruptcy case and the Trustee's malpractice claims. Applying the transactional test[380] to this determination, the Fifth Circuit identified the critical issue as whether the two actions under consideration were based on the "same nucleus of operative facts."[381]

The Trustee argued that approval of the fee application only addressed whether the accountants had provided the services and incurred the expenses that were sought to be recovered in the fee application, while the malpractice claim was based upon what the accountants had *failed* to do.[382] The Fifth Circuit easily rejected this argument, noting that

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[378] *Id.*

[379] *Id.* (quoting *Nilsen v. City of Moss Point*, 701 F.2d 556, 559 (5th Cir. 1983) (*en banc*)).

[380] *Intelogic*, 200 F.3d at 386. *See* RESTATEMENT (SECOND) OF JUDGMENTS § 24 (1982) (articulating the same transaction standard).

[381] *Intelogic*, 200 F.3d at 386 (quoting *Howe v. Vaughan* (*In re* Howe), 913 F.2d 1138, 1144 (5th Cir. 1990)).

[382] *Id.*

Bankruptcy Code required the court to determine "the nature, the extent, and the value" of the accountants' services in the first bankruptcy case.[383] Therefore, when the bankruptcy court approved the fee application, the court "implied a finding of quality and value" in the services.[384]

Although the four-part test was satisfied, the Fifth Circuit emphasized that *res judicata* would not bar the Trustee's claims unless the company "could and should have brought its malpractice claims in the former proceedings."[385] Because the company "was sufficiently aware of the real possibility" of the errors claimed in the Trustee's lawsuit before the fee application hearing, the Fifth Circuit held that the company should have asserted the claims.[386] Not only did the company's board of directors have "a general awareness of the background facts underlying the present claims before the fee hearing," but the board deliberately "chose not to voice its concerns regarding the quality of services at the fee hearing."[387] Finally, the Fifth Circuit found that the company could have pursued its claim, because procedural mechanisms existed for the pursuit of those claims.[388] For example, the company could have objected to the fee application and asserted its claim in the objection.[389] Having failed to pursue its claim, the company and the Chapter 7 Trustee were barred from asserting those claims in the second bankruptcy case.[390]

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383 *Id.* at 387 (quoting 11 U.S.C. § 330(a)(3) (1994)).
384 *Id.*
385 *Intelogic*, 200 F.3d at 388.
386 *Id.*
387 *Intelogic*, 200 F.3d at 391.
388 *Id.* at 389.
389 *Id.*
390 *Intelogic*, 200 F.3d at 386 at 391.