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1999-2000 Fifth Circuit Bankruptcy Law Update

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1999-2000 FIFTH CIRCUIT BANKRUPTCY LAW UPDATE

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The United States Court of Appeals for the Fifth Circuit in 1999 and the first few months of 2000[1] decided a number of interesting cases touching upon bankruptcy law.[2] The purpose of this article is to summarize briefly several of those cases subjectively chosen by the author for their merit or interest. Before examining the work of the Fifth Circuit, however, it would be worthwhile to discuss a very significant opinion of the United States Supreme Court in the field of corporate reorganizations.

I. THE "NEW VALUE" EXCEPTION TO THE ABSOLUTE PRIORITY RULE

In *Bank of America National Trust & Savings Ass'n v. 203 North LaSalle Street Partnership*,[3] the Supreme Court visited the question of whether there is a "new value" exception to the absolute priority rule codified at section 1129(b)(2)(B)(ii).[4] In *203 North LaSalle*, the Bank of America National Trust & Savings Association ("Bank") made a loan to 203 North LaSalle Street Partnership ("Debtor") that was secured by a mortgage on the Debtor's interest in a Chicago office building.[5] The value of the building was less than the balance due the Bank, and thus the Bank was an undersecured creditor.[6] After the Debtor defaulted and the Bank began state court foreclosure proceedings, the Debtor filed a voluntary petition for relief under Chapter 11 of the Bankruptcy Code.[7]

The Debtor proposed a reorganization plan under which certain of its former partners would contribute new capital in exchange for the Debtor's entire ownership of the reorganized entity.[8] Under that provision, the old equity holders were the only ones who could contribute new capital.[9] The Bank objected, and as sole

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1. This article covers cases decided through approximately April 1, 2000, selected in a highly subjective fashion by the author. Any glaring omissions are my fault.

2. The United States Bankruptcy Code (the "Code" or the "Bankruptcy Code") is found at Title 11 of the United States Code. For simplicity's sake, this article will refer to provisions of the Bankruptcy Code by section number, omitting any reference to Title 11. Other federal statutes will be cited in full.

3. 526 U.S. 434 (1999).

4. *Id.*

5. *Id.*

6. *Id.* at 439.

7. *Id.* at 438. Chapter 11 of the Code, §§ 1101 et seq., is designed to permit debtors, particularly corporate debtors, to reorganize their affairs without liquidating their assets. Debtors must propose a plan of reorganization to their creditors which provides the creditors with at least as much as they would receive in a liquidation bankruptcy. The creditors' vote then determines whether or not the plan is accepted. At issue in this case were some of the legal requirements surrounding specific provisions of the Debtor's plan of reorganization.

8. *Id.* at 439-40.

9. *Id.*

member of an impaired class of creditors, thereby blocked consensual confirmation of the plan.[10] The Debtor, however, resorted to the alternate, "cramdown" process for imposing a plan on a dissenting class.[11]

Among the conditions for a cramdown pursuant to section 1129(b) is the requirement that the plan be "fair and equitable" with respect to each class of impaired unsecured creditors that has not accepted it.[12] A plan is fair and equitable if the holder of any claim junior to the claims of such class will not receive or retain any property under the plan on account of any junior claim.[13] Under this rule, the Bank argued, the plan could not be crammed down because the Debtor's old equity holders would receive property, in the form of equity in the reorganized company, even though the Bank's unsecured deficiency claim would not be paid in full.[14] The bankruptcy court approved the plan anyway, and both the district court and the Court of Appeals for the Seventh Circuit, which found ambiguity in the language of the absolute priority rule, affirmed.[15]

The Supreme Court, with its reversal and remand of the case, did little to settle the controversy surrounding the viability of the new value exception to the absolute priority rule.[16] Justice Souter, on behalf of the Court, held that a debtor's pre-bankruptcy equity holders may not, over the objection of a senior class of impaired creditors, contribute new capital and receive new ownership interests in the reorganized entity when that opportunity is given *exclusively* to the old equity holders under a plan adopted without consideration of alternatives.[17] Although the Court stopped short of rejecting the new value exception outright, the Court did hold that where, as here, a plan provides junior interest holders with exclusive opportunities to bid on a debtor through a new-value plan, free from any form of market competition and without benefit of market valuation, such a plan is prohibited under the absolute priority rule of section 1129(b)(2)(B)(ii).[18] Such a plan fails because it vests equity in the reorganized business in the debtor's partners without extending an opportunity to anyone else either to compete for that equity or to propose a competing reorganization plan.[19] Such an exclusive opportunity renders the partners' right a property interest extended "on account of" the old equity position and therefore subject to an unpaid, senior class's objection.[20]

Justice Thomas, with whom Justice Scalia joined, concurred and wrote separately to make clear his view that the issue in the case was a relatively straightforward one of statutory interpretation: since neither of the conditions set out in

10. *Id.* at 440-41.
11. *Id.* at 441.
12. This requirement is codified at Bankr. Code § 1129(b)(1).
13. Bankr. Code § 1129(b)(2)(B).
14. Under § 506 of the Bankruptcy Code, an undersecured creditor has a secured claim.
15. *203 North LaSalle*, 526 U.S. at 442.
16. *Id.*
17. *Id.* at 454-55.
18. *Id.* at 456-58.
19. *Id.*
20. *Id.*

section 1129(b)(2)(B) were met, there could be no cramdown.[21] Because the interpretation of the statutory language inescapably yields that result, Justice Thomas chided the majority for relying too heavily on a study of pre-Code bankruptcy law in making its decision.[22]

Justice Stevens was of a different mind. In his dissent, he noted that section 1129(b)(2)(B)(ii) simply states that no holder of a junior claim or interest may receive or retain any property "on account of such junior claim or interest."[23] This phrase means that when a junior claimant receives or retains an interest for a bargain price, it does so because it has a prior claim.[24] On the other hand, if the new capital that the junior claimant invests has an equivalent or greater value than its interest in the reorganized venture, it is clear that its participation is based on the fair price being paid and not "on account of" its old claim or equity.[25] The procedural requirement the majority seems to rely upon, "that the statute should be construed to require some form of competitive bidding," is not contained anywhere within the text of that section.[26] Thus, according to Justice Stevens, there is no basis for the Court's disposition of the case.[27]

The question left open by the *203 North LaSalle* decision, however, is whether and under what circumstances a new value plan *would* be permissible under the Bankruptcy Code. The Court clearly rejected such a plan where old equity holders had the *exclusive* right to invest in the reorganized debtor, but this limitation still begs the question of whether any new value plan will ever be acceptable. As one might expect, this decision has generated a fair amount of scholarly commentary, much of which criticizes the Court for not providing enough guidance to lawyers involved in Chapter 11 cases where a new value plan might just be the only alternative to liquidation of the debtor.[28]

II. JURISDICTION AND PROCEDURE

Turning to Fifth Circuit decisions, the court was active, as usual, in clarifying jurisdictional and procedural issues that are important to practitioners who daily must navigate the shoals of the Bankruptcy Code. With *Lentino v. Cage*,[29] a procedural decision, the Fifth Circuit considered the automatic stay.[30] In *Lentino*, the district court withdrew the reference of the case from the bankruptcy court and lifted the automatic stay to permit a creditor to pursue a state court action in

21. *Id.* at 458-59.
22. *Id.* at 460-61.
23. *Id.* at 465.
24. *Id.*
25. *Id.* at 465-66.
26. *Id.* at 467-68.
27. *Id.* at 468.
28. *See, e.g.*, David Gray Carlson & Jack F. Williams, *The Truth About the New Value Exception to Bankruptcy's Absolute Priority Rule*, 21 CARDOZO L.R. 1303 (2000); Bruce A. Markell, *LaSalle and the Little Guy: Some Initial Musings on the Ultimate Impact of* Bank of America, N.T. & Sav. 203 North LaSalle Street Partnership, 16 BANKR. DEV. J. 345 (2000); Harvey R. Miller, John J. Rapisardi & Reginald A. Greene, *Leaving Old Questions Unanswered and Raising New Ones: The Supreme Court Furthers the New Value Controversy in* Bank of America National Trust & Savings Ass'n v. 203 North LaSalle Street Partnership, 30 U. MEM. L. REV. 553 (2000).
29. 1999 WL 77140 (5th Cir. June 14, 1999).
30. The automatic stay is found at 11 U.S.C. § 362 (West 1994).

a case wherein a judgment had been vacated on appeal and the case remanded for a retrial.[31] The debtor appealed the district court's decision to lift the stay to the Fifth Circuit.[32] The Fifth Circuit held that the lifting of an automatic stay by the order of a district court was a final order available for review under 28 U.S.C. § 1291 because the district court was exercising original, not appellate jurisdiction.[33] The court further held that the standard of review in such cases is abuse of discretion, exactly as if it were on appeal from a bankruptcy court rather than a district court exercising its original jurisdiction.[34]

In a case that originated in Texas, *Randall & Blake, Inc. v. Evans et al. (In re Canion)*,[35] the Fifth Circuit considered the extent of a bankruptcy court's "related to" jurisdiction under 28 U.S.C. § 1332. A judgment creditor of the Chapter 7 debtor sued for monetary and injunctive relief based upon claims of various torts, fraudulent transfers, and alter ego liability.[36] After the case was referred to it, the bankruptcy court held for the defendants at the close of the plaintiff's case-in-chief.[37] The plaintiff appealed, and the district court affirmed.[38] On appeal, the Fifth Circuit held that the judgment creditor's consent to referral did not create "related to" jurisdiction, although the bankruptcy court nonetheless had "related to" jurisdiction over the claims.[39] The court noted that federal subject matter jurisdiction may be challenged at any level, and as parties cannot confer jurisdiction on federal courts by consent, the plaintiff's consent to the bankruptcy court's jurisdiction did not establish "related to" jurisdiction.[40] However, the plaintiff's claim was indeed subject to "related to" jurisdiction because the standard-whether the resolution of the claim would have any conceivable effect upon the estate-was met in this case.[41]

In the interesting case of *The Insurance Subrogation Claimants v. U.S. Brass Corp. (In re U.S. Brass Corp.)*,[42] the so-called Insurance Subrogation Claimants ("ISC") appealed an order of confirmation of a Chapter 11 plan proposed by the debtor over the objections of the ISC. The district court affirmed the bankruptcy court order, and the ISC appealed to the Fifth Circuit.[43]

The Fifth Circuit dismissed the ISC appeal as moot.[44] The court held that, when examining an appeal of an order confirming a reorganization plan in a bankruptcy case for mootness, the following factors must be considered: 1) whether the appellant has obtained a stay pending appeal to prevent the further consummation of the confirmed plan; 2) whether the plan in fact has been

31. *Lentino*, 1999 WL 77140 at *1.
32. *Id.*
33. *Id.*
34. *Id.* at *2.
35. 196 F.3d 579 (5th Cir. 1999).
36. *Id.* at 582.
37. *Id.* at 582-83.
38. *Id.* at 584.
39. *Id.* at 588.
40. *Id.* at 584.
41. *Id.* at 586-87.
42. 169 F.3d 957 (5th Cir. 1999).
43. *Id.* at 959.
44. *Id.*

substantially consummated; and 3) whether the relief requested would affect either the rights of parties not before the court or the success of the plan.[45] In this case, the ISC did not obtain a stay, the confirmed plan was substantially consummated, and the relief requested would have affected third parties not before the court.[46] Therefore, the appeal was moot.[47]

In *Southmark Corp. v. Coopers & Lybrand (In re Southmark Corp.)*[48], the Fifth Circuit considered the distinction between "core" and "noncore" matters, as well as the appropriate circumstances for abstention by a bankruptcy court. The Chapter 11 debtor filed a malpractice suit in state court against the accountant to the court-appointed examiner in the debtor's reorganization case.[49] The accountant removed the case to the bankruptcy court, which then granted the accountant's motion for summary judgment on the grounds that the claims were barred by collateral estoppel and res judicata.[50] The bankruptcy court also denied the debtor's motion for abstention or remand, and, on appeal, the district court later affirmed.[51] The Fifth Circuit also affirmed, holding that the malpractice suit was a "core" issue pursuant to 28 U.S.C. §§ 157(b)(2) & (3), rather than an issue merely "related to" the bankruptcy.[52] Though the suit arose under state law, it was inextricably tied up with the accountant's duties as performed pursuant to the bankruptcy court's order.[53] The bankruptcy court had the discretion to abstain or not, rather than a duty to abstain pursuant to 28 U.S.C. § 1334(c).[54] Therefore, the Fifth Circuit held, the bankruptcy court did not err in declining to abstain in the case.[55]

Also in 1999, the Fifth Circuit tackled a procedural case with an international flavor, *Adacom Corp. B.V. v. Byrne (In re Schimmelpenninck).*[56] An alleged creditor of a debtor in a pending Dutch liquidation proceeding brought a state court action against the debtor's wholly-owned subsidiary, in which he sought to recover from that subsidiary for the Dutch debtor's alleged contractual obligations under both alter ego and single business enterprise theories.[57] The curator (the equivalent of a bankruptcy trustee in the United States) of the debtor's Dutch bankruptcy estate filed an ancillary proceeding pursuant to section 304 and requested declaratory and injunctive relief barring the creditor from pursuing his alter ego and single business enterprise claims.[58] Both the bankruptcy court and the district court denied the curator's request, but the Fifth Circuit reversed.[59]

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45. *Id.*
46. *Id.* at 959-62.
47. *Id.* at 962.
48. 163 F.3d 925 (5th Cir. 1999).
49. *Id.* at 928.
50. *Id.*
51. *Id.*
52. *Id.* at 930-32.
53. *Id.* at 931.
54. *Id.* at 932.
55. *Id.*
56. 183 F.3d 347 (5th Cir. 1999).
57. *Id.* at 350.
58. *Id.*
59. *Id.* at 350-51.

The court of appeals held that the veil-piercing claims "belonged to" the estate, following the longstanding rule of *S.I. Acquisition, Inc. v. Eastway Delivery Service (In re S.I. Acquisition, Inc.),*[60] and thus were claims that only the curators could enforce.[61] Therefore, the curators were entitled to injunctive relief barring the prosecution of the veil-piercing claims.[62] In so holding, the court compared section 362, which requires that the creditor's claim affect "property of the estate" for injunctive relief to be available, with section 304, which merely requires that the property be "involved in" a foreign bankruptcy before injunctive relief is available.[63] The court concluded that injunctive relief was appropriate under either standard.[64]

III. CLAIMS AND NONDISCHARGEABILITY OF CLAIMS

Another perennially fertile field for Fifth Circuit bankruptcy decisions is the general area of nondischargeability of debts under sections 523 and 727. The past year and a half have been no exception. In a case with many twists and turns involving bankruptcy claims and nondischargeability, *Nikoloutsos v. Nikoloutsos (In re Nikoloutsos)*,[65] Mrs. Nikoloutsos prevailed in a personal injury trial on charges of malicious assault against Mr. Nikoloutsos.[66] Three days following the judgment, Mr. Nikoloutsos filed bankruptcy under Chapter 7.[67] The next day, the bankruptcy court lifted the automatic stay to permit the state court to proceed with the punitive damages phase of the trial.[68] Judgment was entered for the wife, and Mr. Nikoloutsos did not appeal.[69] Realizing his judgment debt probably was not dischargeable under Chapter 7, Mr. Nikoloutsos filed to convert his Chapter 7 claim to Chapter 13.[70] The bankruptcy court granted the motion four days after the Chapter 13 filing without waiting for the twenty day notice period to expire, and Mrs. Nikoloutsos did not appeal the order.[71] Ten days after the bankruptcy court granted the motion and thus well within the twenty-day notice period, Mrs. Nikoloutsos objected to the motion to convert because Mr. Nikoloutsos fell outside the statutory provisions for conversion.[72] The bankruptcy court did not rule on the objection because Mrs. Nikoloutsos failed to properly preserve error.[73]

The bankruptcy court issued an order for the meeting of creditors and announced all claims had to be filed by December 6, 1995.[74] In early August,

60. 817 F.2d 1142 (5th Cir. 1987).
61. *Byrne*, 183 F.3d at 350-51.
62. *Id.*
63. *Id.*
64. *Id.* at 354-57.
65. 199 F.3d 233 (5th Cir. 2000).
66. *Id.* at 235.
67. *Id.*
68. *Id.*
69. *Id.*
70. *Id.*
71. *Id.*
72. *Id.*
73. *Id.*
74. *Id.*

Mrs. Nikoloutsos filed a motion for dismissal on the ground that the judgment in state court was nondischargeable.[75] The bankruptcy court denied the motion.[76] Mrs. Nikoloutsos then filed a complaint to determine dischargeability of the debt under section 523(a)(6).[77] The bankruptcy court held the confirmation hearing on January 10, 1996, and found that Mrs. Nikoloutsos had failed to file a proof of claim.[78] Mrs. Nikoloutsos objected to the plan on the grounds that dischargeability had not been determined.[79] The next day, the bankruptcy court confirmed the plan, holding that no meritorious objections had been raised.[80]

Mr. Nikoloutsos next filed for summary judgment on Mrs. Nikoloutsos's claim for nondischargeability.[81] The motion was denied.[82] Mrs. Nikoloutsos filed a motion to convert or dismiss, which the court denied.[83] Mrs. Nikoloutsos moved for summary judgment to revoke confirmation because Mr. Nikoloutsos had engaged in fraudulent conduct.[84] The motion was denied.[85] Mrs. Nikoloutsos appealed to the district court, which affirmed each of six orders.[86] Mrs. Nikoloutsos appealed to the Fifth Circuit.[87]

In sorting through this all-out, domestic relations/bankruptcy brawl, the Fifth Circuit examined the district court's holding that Mrs. Nikoloutsos failed to file a timely proof of claim under two standards.[88] First, it reviewed the district court's decision to apply the Tenth Circuit's five part test de novo.[89] Second, it reviewed the trial court's balancing of equities for abuse of discretion.[90]

The Tenth Circuit has adopted a five-part test for an informal proof of claim in *Reliance Equities, Inc. v. Valley Federal Savings & Loan Ass'n:*[91]

1. the proof of claim must be in writing;
2. the writing must contain a demand by the creditor on the debtor's estate;
3. the writing must express an intent to hold the debtor liable for the debt;
4. the proof of claim must be filed with the Bankruptcy Court; and
5. based on the facts of the case, it would be equitable to allow the amendment.[92]

The Fifth Circuit formally adopted the Tenth Circuit's test and concluded that the district court erred in its decision that the equities weighed against treating

75. *Id.*
76. *Id.*
77. *Id.*
78. *Id.*
79. *Id.*
80. *Id.*
81. *Id.*
82. *Id.*
83. *Id.*
84. *Id.*
85. *Id.*
86. *Id.*
87. *Id.*
88. *Id.*
89. *Id.* at 236.
90. *Id.*
91. 966 F.2d 1338 (10th Cir. 1992).
92. *Id.* at 1345.

the complaint as an informal proof of claim.[93] The court recognized that the bankruptcy court had agreed to treat the complaint as an informal proof, that Mrs. Nikoloutsos's failure to reassert the complaint as an informal proof was irrelevant, that any concern for Mr. Nikoloutsos was misplaced given the facts, and that all informal proofs of claim are procedural aberrations for purposes of equity.[94]

In another case which reveals severe familial discord, *Felzer v. Davis (In re Davis)*,[95] the daughter of a deceased husband, acting as the administratrix of the decedent's estate, brought a nondischargeability complaint against the decedent's wife, the person who shot and killed the decedent, in the wife's bankruptcy case.[96] The complaint alleged a willful and malicious injury to the decedent within the meaning of section 523(a)(6) of the Bankruptcy Code.[97] The debtor answered the nondischargeability action by asserting that an administratrix of a decedent's estate does not have standing to bring such a suit because she is not "a creditor to whom payment is owed" within the meaning of the statute.[98] The Fifth Circuit rejected this argument largely on policy grounds, which is rather unusual in bankruptcy cases, and held that the administratrix could maintain a nondischargeability suit.[99] Construing the definition of "creditor" in section 101(10), the court held that an administratrix meets the definition of creditor for purposes of the Bankruptcy Code.[100] Moreover, the policy behind both the Bankruptcy Code in general, rehabilitation of honest debtors, and the nondischargeability provisions in particular, not permitting true miscreants to escape their liabilities through use of bankruptcy, counsels for the rule that an administratrix of a decedent's estate has standing to bring a nondischargeability action in these circumstances.[101]

IV. PROPERTY OF THE ESTATE AND LIENS

With *In re Sewell*,[102] the Fifth Circuit considered whether a debtor's retirement plan must be "tax qualified" to be excluded from property of the estate pursuant to section 541(c)(2). The bankruptcy court held that the debtor's beneficial interest in her employer's ERISA retirement plan was excluded from her bankruptcy estate pursuant to section 541(c)(2).[103] The debtor's ERISA plan contained the requisite clause against assignment or alienation (voluntarily or involuntarily) of the debtor's beneficial interest in the plan, and thus appeared to be

93. *Nikoloutsos*, 199 F.3d at 236.
94. *Id.* at 236-37.
95. 194 F.3d 570 (5th Cir. 1999).
96. *Id.* at 572.
97. *Id.*
98. *Id.* at 573.
99. *Id.*
100. *Id.* at 574.
101. *Id.*
102. 180 F.3d 707 (5th Cir. 1999).
103. *Id.* at 712.

within the rule of the Supreme Court in *Patterson v. Shumate*,[104] which permitted such plans to be excluded from the bankruptcy estate.[105] The trustee nevertheless argued that *Shumate* required that the trust be a "qualified trust" pursuant to the Internal Revenue Code.[106] The Fifth Circuit, explicitly following the Seventh Circuit's reasoning in *In re Baker*,[107] held that whether the retirement plan at issue was "tax qualified" was not relevant to the question of whether it was "ERISA-qualified" within the meaning of *Shumate*.[108] Because the debtor's plan met the *Shumate* test, it was within section 541(c)(2)'s exclusion from property of the estate.[109]

In a victory for the IRS, the Fifth Circuit in *United States v. Neary (In re Armstrong)*,[110] considered an appeal from an adversary proceeding brought by the Chapter 7 trustee against the IRS, seeking a refund of amounts in excess of Armstrong's stipulated tax liability that the debtor paid prepetition.[111] The bankruptcy court found for the trustee, and the district court affirmed.[112] The Fifth Circuit held that the automatic stay provision does not toll the statute of limitations for the filing of tax refund claims by the trustee;[113] the IRC statute of limitations controlled over the Bankruptcy Code's turnover provision;[114] and the trustee's refund claim was filed too late to qualify as a compulsory counterclaim to the IRS's claim.[115]

The Fifth Circuit in 1999 also decided an important case concerning the attachment of federal tax liens on spendthrift trusts in *Internal Revenue Service v. Orr (In re Orr)*.[116] After discharge of his personal federal tax liabilities, the debtor filed an adversary action to determine whether a federal tax lien attached to any interest he had in a spendthrift trust.[117] The bankruptcy court ruled for the debtor, and the government appealed.[118] The district court reversed, holding that distributions from a spendthrift trust were subject to prebankruptcy federal tax liens.[119] On appeal, the Fifth Circuit held that federal tax liens on a debtor's income distributions from spendthrift trusts attached to future distributions *at the time of the creation of the lien*, and not at the time each distribution was made.[120] Consequently, the lien predated and survived the bankruptcy.[121]

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104. 504 U.S. 753 (1992).
105. *Sewell*, 180 F.3d at 711.
106. *Id.*
107. 114 F.3d 636 (7th Cir. 1997).
108. *Sewell*, 180 F.3d at 712.
109. *Id.*
110. 206 F.3d 465 (5th Cir. 2000).
111. *Id.* at 468.
112. *Id.* at 468-69.
113. *Id.* at 469.
114. *Id.* at 470.
115. *Id.* at 473.
116. 180 F.3d 656 (5th Cir. 1999).
117. *Id.* at 658.
118. *Id.*
119. *Id.*
120. *Id.* at 662.
121. *Id.* at 664.

In another important case concerning secured creditors' rights, *Millette v. E B Inc. (In re Millette)*,[122] the Fifth Circuit attempted to interpret, as a case of first impression, Mississippi's law regarding assignments of rents. The debtors executed a promissory note secured with a deed of trust containing an assignment of rents gained from the debtors' property.[123] That deed was recorded properly.[124] Subsequently, another creditor obtained a judgment against the debtors in the form of a writ of garnishment against the rents from the property.[125] In the proceedings to settle the conflict regarding who owned the rents, the judgment creditor argued that Mississippi law requires an "additional action," such as the appointment of a receiver to perfect an interest in rents, and therefore, the secured creditor had not perfected its interest prior to the writ of garnishment.[126] The Fifth Circuit held that the Mississippi Supreme Court probably would hold that a mortgagee that has obtained an assignment of rents perfects its lien on those rents when it records the mortgage or deed of trust document containing the assignment of rents, and therefore, a recorded deed of trust containing an assignment of rents created a lien with priority over a subsequent garnishment lien obtained by a judgment creditor.[127] Whether this prediction comes true remains to be seen.

In *Chase Automotive Finance, Inc. v. Kinion (In re Kinion)*,[128] Chase Finance thought that it had secured a reaffirmation agreement with the Kinions for their Cadillac but was informed six months later that the court had reopened the case, disapproved their agreement, and *voided* Chase's lien.[129] The district court affirmed, and on appeal the Fifth Circuit reversed.[130]

The bankruptcy court disapproved the agreement under a local (N.D. Texas, Amarillo Division) bankruptcy rule that requires the finance contract and the title be attached to the motion for reaffirmation.[131] In the absence of these documents, the court found the debt unsecured and denied reaffirmation, even though Chase sought to comply with the rule.[132] The Fifth Circuit held the local rule, which permitted reaffirmation only for secured debt, was contrary to the Bankruptcy Code and thus void.[133] Also, the court held that Chase's offer of reaffirmation was not coercive, as it could not compel the Kinions, and the Kinions' first choice was to reaffirm the lein.[134] The bankruptcy court clearly erred when it

122. 186 F.3d 638 (5th Cir. 1999).
123. *Id.* at 639.
124. *Id.*
125. *Id.* at 640.
126. *Id.*
127. *Id.* at 641.
128. 207 F.3d 751 (5th Cir. 2000).
129. *Id.* at 753.
130. *Id.*
131. *Id.*
132. *Id.* at 754.
133. *Id.* at 755.
134. *Id.* at 756.

reopened the case to deny the reaffirmation and further abused its discretion when it failed to grant Chase's motion to reconsider.[135] The Fifth Circuit, in a stinging rebuke to the lower courts involved in this case, stated:

> The actions that occurred here do not survive scrutiny under a cursory analysis of applicable bankruptcy law. To the extent that these events were set in motion by the local rule of the Amarillo division, a rule designed in part to limit reaffirmations to secured debt, the rule is plainly inconsistent with the Code and invalid. The judgments of the bankruptcy and district courts, which abrogated Chase's lien, and the injunction against future actions by Chase to recover on its lien, are accordingly reversed.[136]

V. VOIDABLE TRANSFERS

The Supreme Court in *Grupo Mexicano de Desarrolo v. Alliance Bond Fund, Inc.*,[137] considered the issue of whether an injunction is available from a federal court to stay future transfers that *might* be voidable as preferences in a *future* bankruptcy case.[138] Alliance (an investment funds group) purchased unsecured notes from Grupo Mexicano de Desarrolo (GMD), a Mexican holding company.[139] After GMD fell into financial trouble and missed an interest payment on the notes, Alliance accelerated the notes' principal amount and filed suit for the amount due in federal district court.[140] Alleging that GMD was at risk of insolvency or already insolvent, that it was preferring its Mexican creditors by its planned allocation to them of its most valuable assets, and that these actions would frustrate any judgment Alliance could obtain, Alliance requested a preliminary injunction restraining GMD from transferring the assets.[141] The district court issued the preliminary injunction, and the Second Circuit affirmed.[142] Writing for the Court, Justice Scalia held that the district court lacked the authority to issue a preliminary injunction preventing GMD from disposing of their assets pending adjudication of Alliance's contract claim for money damages because such a remedy was historically unavailable from a court of equity.[143] A court's equity power must be interpreted, at least in federal courts, in light of the traditional uses of equity power both in the United States and England.[144] Because injunctions to forestall a potential debtor's preference of creditors were not traditionally available in English or early American equity courts, such an injunction is inappropriate today under Federal Rule of Civil Procedure 65.[145]

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135. *Id.* at 757.
136. *Id.* at 758 (emphasis added).
137. 527 U.S. 308 (1999).
138. *Id.* at 309.
139. *Id.* at 310.
140. *Id.* at 311-12.
141. *Id.* at 312.
142. *Id.* at 312-13.
143. *Id.* at 333.
144. *Id.* at 329.
145. *Id.* at 333.

In her dissent, Justice Ginsburg, with whom Justices Stevens, Souter, and Breyer joined, argued that the Second Circuit should be affirmed because Alliance met the heavy burden necessary to get an injunction.[146] In the view of Justice Ginsberg and the Justices joining her in her opinion, Justice Scalia's reliance on a pre-Revolutionary view of equity improperly limits courts of equity to the detriment of plaintiffs such as Alliance.[147]

The Fifth Circuit clarified the mechanics of an important defense to the preference statute in *Micro Innovations Corp. v. Agama Systems, Inc. (In the Matter of Micro Innovations Corp.)*.[148] The Chapter 7 trustee sought to recover as avoidable preferences payments made by the debtor to a creditor during the ninety-day exemption period.[149] The bankruptcy court permitted recovery of the full value of all such payments by the trustee, and the creditor appealed.[150]

Normally, the trustee can recover certain payments made by the debtor within the ninety-day pre-filing period as preferences.[151] An important exception exists for "subsequent advances for new value," which is codified in section 547(c)(4)(A).[152] This provision holds that the trustee may not void a transfer to or for the benefit of a creditor to the extent that after the transfer, the creditor gave the debtor new value.[153] In this case, the creditor delivered components to the debtor who paid for them with post-dated checks.[154] The court characterized this as a credit transaction.[155] The trustee argued that the literal wording of section 547(c)(4)(A) did not allow for creditors who engaged in credit transactions to take advantage of the "subsequent advance" rule.[156] Section 547(c)(4)(A) does not apply to extensions of new value to be offset against prior preferences, but only to *new* value that is "not secured by an otherwise unavoidable security interest."[157] The creditor in this case kept a security interest in all new components sent but never perfected it.[158] The trustee argued that because there was once a security interest attached to the components, the creditor was barred from using section 547(c)(4)(A).[159] The court held, however, that since no security interest existed at the time of the bankruptcy, that aspect of section 547(c)(4)(A) was inapplicable.[160] Thus, section 547(c)(4)(A) prevents application of new

146. *Id.* at 333-42.
147. *Id.* at 336.
148. 185 F.3d 329 (5th Cir. 1999).
149. *Id.* at 331.
150. *Id.*
151. *Id.*
152. 11 U.S.C. § 547 (c)(4)(A).
153. *Id.*
154. *Micro Innovations*, 185 F.3d at 331.
155. *Id.* at 331-32.
156. *Id.* at 332-33.
157. *Id.* at 335.
158. *Id.* at 335-36.
159. *Id.*
160. *Id.*

value against prior preferences only if that new value is subject to a security interest that is valid and enforceable at the time of bankruptcy. Finally, the court adopted the rule of *In re Garland*[161] for determining how to calculate the value of the preferences as reduced by the new allowable rate.[162] This rule allows a given extension of new value to be applied against *any* preceding preference.[163]

VI. ISSUES IN CHAPTERS 11 AND 13

The Fifth Circuit decided an important case concerning a Chapter 11 trustee's standard of care in *Dodson v. Huff (In re Smyth)*.[164] The Chapter 11 trustee and accountant for the estate filed an application for a final decree and a motion for final payment of his commission.[165] A creditor objected, alleging that the Chapter 11 trustee erred in handling the estate's federal income tax by not filing the return properly.[166] After a hearing, the bankruptcy court denied the trustee his commission and entered a final decree.[167] When the creditor expanded his claim against the trustee, the trustee moved to retain representation for which the estate would pay.[168] Due to an absence of Fifth Circuit precedent and a circuit split, the district court carefully concluded that a trustee cannot be held liable for simple negligence and that the creditor's claim was satisfied when the bankruptcy court denied the trustee his fees, which approximated the late filing fine.[169]

On appeal, the Fifth Circuit agreed with the district court and adopted a *gross negligence* standard of care for the Chapter 11 trustee.[170] In so doing, the Fifth Circuit chose to follow precedent from the Sixth, Seventh and Tenth Circuits, all of which impose a gross negligence standard, and declined to follow the Ninth Circuit, which imposes a "mere negligence" standard on such trustees.[171] Interestingly, the Fifth Circuit also cited the 1997 final report of the National Bankruptcy Review Commission, which also urged adoption of a gross negligence standard for trustees.[172]

In *Mississippi State Tax Commission v. Lambert (In re Lambert)*,[173] the bankruptcy court confirmed the debtor's Chapter 11 plan over the Mississippi Tax Commission's objections and awarded postpetition interest on the Commission's priority tax claim at the prevailing market rate, rather than the statutory rate.[174] The Commission appealed.[175] The district court affirmed, and the Commission appealed.[176] The Fifth Circuit held that the proper rate of interest on deferred

161. 19 B.R. 920 (Bankr. E.D. Mo. 1982).
162. *Micro Innovations*, 185 F.3d at 336-37.
163. *Id.*
164. 207 F.3d 758 (5th Cir. 2000).
165. *Id.* at 760.
166. *Id.*
167. *Id.*
168. *Id.*
169. *Id.*
170. *Id.* at 761-62.
171. *Id.*
172. *Id.*
173. 194 F.3d 679 (5th Cir. 1999).
174. *Id.* at 680.
175. *Id.*
176. *Id.*

state taxes is the current market rate equivalent to the rate the debtor would pay for the same amount of money in the commercial loan market.[177] In reaching its decision, the court relied on two earlier decisions, one from the Ninth Circuit and the other from the Eleventh Circuit.[178] Both courts rejected the application of a fixed rate from the tax code primarily because a fixed rate is unresponsive to the market and does not take into account the objectives of bankruptcy law (but reflects, instead, the objectives of tax law, which may be punitive).[179] The Fifth Circuit focused on whether a fixed rate would disproportionately punish the debtor and determined that the prevailing market rate of interest would put the creditor in the position it would have occupied if it had been allowed to end the relationship at the point of bankruptcy, thereby making it the appropriate rate to apply.[180]

In *Ramirez v. Bracher (In re Ramirez)*,[181] the Chapter 13 trustee objected to the Ramirez's Chapter 13 plan, which favored the repayment of a cosigned unsecured loan over the repayment of general unsecured debt.[182] The bankruptcy court denied confirmation of the plan, and the debtors appealed.[183] The district court affirmed.[184] On appeal, the Fifth Circuit held that the debtors' plan proposing to pay the cosigned unsecured loan in full *plus* twelve per cent (12%) interest prior to any payments on general unsecured debt could not be confirmed without justification for the high and preferential interest rate.[185] Such justification was lacking in this case.[186]

Finally, in *Williams v. Tower Loan of Mississippi (In re Williams)*,[187] a Chapter 13 debtor moved to modify her debt adjustment plan to provide for surrender of a portion of the collateral securing a creditor's claim, while the debtor made payments under the plan based on the value of the retained collateral.[188] The bankruptcy court denied the motion, and the district court affirmed.[189] The Fifth Circuit also affirmed, holding that pursuant to section 1325(a)(5), a bankruptcy court can confirm a plan over a secured creditor's objections if 1) the debtor elected to surrender the collateral to the creditor, or 2) the debtor allowed the creditor to retain its lien while providing it with payments under a plan whose present value was at least equal to the allowed amount of its secured claim.[190]

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177. *Id.* at 684.
178. *Id.* at 681 (citing *In re Camino Real Landscape Maintenance Contractors, Inc.*, 818 F.2d 1503 (9th Cir. 1987) and *In re Southern States Motor Inns, Inc.*, 709 F.2d 647 (11th Cir. 1983)).
179. *Lambert*, 194 F.3d at 681-82.
180. *Id.*
181. 204 F.3d 595 (5th Cir. 2000).
182. *Id.* at 595-96.
183. *Id.* at 596.
184. *Id.*
185. *Id.*
186. *Id.*
187. 168 F.3d 845 (5th Cir. 1999).
188. *Id.* at 846.
189. *Id.*
190. *Id.* at 847.

The language of sections 1325(a)(5)(B) & (C), however, "strongly indicates" that a debtor cannot combine these two alternatives to create an additional alternative not explicitly found in Section 1325(a)(5), and thus this debtor's attempt to modify her plan was foiled.[191]

VII. CONCLUSION

From the perspective of bankruptcy lawyers, the year past was a reasonably typical year for the Fifth Circuit and a relatively quiet year in the United States Supreme Court. The turn of the millennium, however, seems to have affected the Supreme Court, and several interesting cases on that Court's docket bear watching for next year's update.

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191. *Id.*