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'Unequivocal And Specific' Claim Preservation

Law360, New York (July 11, 2011) -- The United States Bankruptcy Court for the Northern District of Illinois has issued an opinion that clarifies the requirements for preserving claims in a Chapter 11 plan pursuant to 11 U.S.C. § 1123(b)(3), in light of two prior opinions from the United States Court of Appeals for the Seventh Circuit. The decision also adds to the body of case law developing across other circuits.

The Seventh Circuit has published two opinions that provided prior guidance on how a Chapter 11 plan can properly preserve causes of action. In the first of these cases, D & K Properties Crystal Lake v. Mutual Life Insurance Company of New York, 112 F.3d 257 (7th Cir. 1997), the court took a fairly strict approach, holding that a reservation of claims in a Chapter 11 plan must be in writing and specifically identified. Id. at 259. Thus, a reservation of "all causes of action existing in favor of the [d]ebtor and the [d]ebtor in [p]ossession" was found to be insufficient for res judicata purposes. Id. at 259.

According to the court, because the debtor failed to identify specifically the claims it intended to reserve, its later-asserted cause of action was barred by res judicata: "[a] blanket reservation that seeks to reserve all causes of action reserves nothing. To hold otherwise would eviscerate the finality of a bankruptcy plan containing such a reservation, a result at odds with the very purpose of a confirmed bankruptcy plan." Id. at 261.

The following year, the Seventh Circuit published another opinion tackling this issue in P.A. Bergner & Co. v. Bank One, Milwaukee NA (In re P.A. Bergner & Co.), 140 F.3d 1111 (7th Cir. 1998). In Bergner, the court can be seen as having modified the approach espoused in D & K Properties, holding that a claim itself need not be "specific and unequivocal" because the "statute itself contains no such requirement." Id. at 1117. The court explain that a Chapter 11 plan must "unequivocally retain claims of a given type ..." Id.

Accordingly, in the wake of both D & K Properties and Bergner, lower courts have held that "categorical reservation" can effectively prevent res judicata after confirmation of a Chapter 11 plan. Kmart Corp. v. Intercraft Co. (In re Kmart Corp.), 310 B.R. 107, 124 (Bankr. N.D. Ill. 2004). As a result, courts have held that claims are not required to be identified by name in order to be preserved. Id.

The recently decided case, Brandt v. Luxor Hotel and Casino (In re Equipment Acquisition Resources Inc., Adv. No. 10 A 02164, (Bankr. N.D. Ill. June 16, 2011)), provides additional guidance on what would satisfy the Seventh Circuit's test for a Chapter 11 plan's reservation of certain causes of action.

In Luxor, the plan administrator brought a cause of action under 11 U.S.C. § 544, 548, 550 and 740 Ill. Comp. Stat. 160/f(a)(2) (the Illinois fraudulent transfer statute) against Luxor Hotel and Casino. Id. at *2. Luxor argued that these claims were barred by res judicata, due to the plan's ineffective reservation of rights. Id. at *4.

The plan expressly reserved all "Claims, rights of action, suits or proceedings ... that the Debtor or the Estate may hold against any person or entity under the Bankruptcy Code or any non-bankruptcy law, including, but not limited to, Avoidance Actions, Claims, rights of action, suits or proceedings ..." Id. at *1.

Interestingly, the court interpreted this provision "to reserve only 'Avoidance Actions,'" which was defined in the plan to include actions brought under §§ 548 and 550, as well as "any cause of action ... under related state or federal statutes and common law, including fraudulent transfer laws ..." Id. at *7.

Accordingly, the court ultimately concluded that the Chapter 11 plan properly reserved causes of action under §§ 548 and 550, in addition to the Illinois fraudulent transfer statute. Id. at *8. However, the court also held that the plan's failure to identify § 544 specifically resulted in its preclusion via res judicata. Id.

Significantly, the court was not disturbed by the debtor's failure to identify Luxor as a potential defendant on various "potential target" lists that were incorporated into the disclosure statement. Id. at *7. The disclosure statement limited the preservation of claims only to those included in the debtor's schedules, as well as those listed on exhibit C and section II.B of the disclosure statement. Luxor was not identified in any of these places. Id.

The court concluded, however, that "while there may be some conflicting language between the Plan and Disclosure Statement, it is the language of the Plan that must prevail where there is an inconsistency." Id. As a point of practice, while the plan's conflict resolution clause thus proved necessary and useful, consistency between plans and disclosure statements is still a better approach whenever possible.

The Fifth Circuit also appears to endorse the sufficiency of a "categorical reservation" of claims. See Nordberg v. AC & Sons Inc. (In re Blue Water Endeavors LLC), Case No. Adv. No. 10-1015 (Bankr. E.D. Tex. Jan. 6, 2011) (citing Dynasty Oil and Gas LLC v. Citizens Bank (In re United Operating LLC), 540 F.3d 351, 355 (5th Cir. 2005).

However, in contrast to the court in Luxor, the court in Blue Water looked "collectively at the language of the debtor's confirmed plan, its order, as well as its disclosure statement to determine whether the Blue Water plan of reorganization 'specifically and unequivocally' reserved the challenged causes of action." Id. at *6.

In Blue Water, the debtors were hoping to use the language in their disclosure statement to their advantage, as the plan, by itself, did not satisfy even the "categorical reservation" test. Id. The court ultimately concluded that even together with the disclosure statement, the Chapter 11 plan was not sufficient to meet the "specific and unequivocal" requirement, as espoused by the Fifth Circuit. Id. at *7.

It is less clear whether a categorical reservation of rights would be sufficient in the Sixth Circuit. There, the lower courts have been grappling with the Sixth Circuit's opinion in Browning v. Levy, 283 F.3d 761 (6th Cir. 2002). In Browning, the court held that a debtor does not meet the requirements of 11 U.S.C. § 1123(b)(3) when a Chapter 11 plan claim preservation clause does not name a defendant nor state the factual bases for the reserved claims. Id. at 775.

Since Browning, at least one court has questioned the bright line nature of this rule, explaining that Browning did not "establish a general rule that naming each defendant or stating the factual basis for each cause of action are the only ways to preserve a cause of action at confirmation of a Chapter 11 plan." Elk Horn Coal Co. LLC v. Conveyor Mfg. & Supply Inc. (In re Pen Holdings Inc.), 316 B.R. 495 (Bankr. M.D. Tenn. 2004).

According to the court in Pen Holdings, "[t]he words sufficient to satisfy § 1123(b)(3) must be measured in the context of each case and the particular claims at issue[.]" Id. Notwithstanding one court's less stringent reading of the Browning opinion, it would appear that, at least in the Sixth Circuit, practitioners should be cautious about utilizing categorical reservations that might pass muster in other circuits.

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