

Business Bankruptcy Case Developments - 2014

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I. ADMINISTRATIVE MATTERS

A. Jurisdiction and Constitutional Authority

***Langenkamp* Still Good Law. No Jury Trial Rights for Trustee on Fraudulent Transfer Claims.**

U.S. Bank Nat'l Assoc. v. Verizon Communications, Inc., 761 F.3d 409 (5th Cir. 2014) (King and Haynes, J.)

The litigation trustee appointed under Idearc's chapter 11 plan appealed an unfavorable judgment of the District Court, rejecting the trustee's claims against Idearc's former parent and officers for fraudulent transfers, breaches of fiduciary duty, aiding and abetting breaches of fiduciary duty, promoter liability, alter ego and similar claims. After striking the trustee's jury demand, the District Court bifurcated trial, first holding a ten-day bench trial on Idearc's values before and after the "spin-off" transaction. From this evidence, the District Court found that Idearc was solvent immediately before the spin-off transaction, worth at least \$12 billion. Such a finding defeated the trustee's constructive fraudulent transfer theory and severely undercut the trustee's alternative theories. The District Court thus required the trustee to "show cause" whether the trustee's alternative theories remained viable and ultimately (after allowing the parties to brief the issues) entered judgment in favor of the defendants. The trustee appealed. The decision covers many issues, but perhaps the central one was whether the trustee was entitled to jury trial.

Here, the Fifth Circuit concluded that the litigation trustee was not entitled to a jury trial on its fraudulent transfer claims, affirming the District Court's order striking the trustee's jury demand, and holding that, because Verizon asserted claims in Idearc's bankruptcy case, the fraudulent transfer claims were "integral to the restructuring of the debtor-creditor relationship through the bankruptcy court's equity jurisdiction." *Id.* *37-38 (quoting *Langenkamp*, 498 U.S. at 44).

The Court distinguished from its prior *Jensen* decision, where the Fifth Circuit held that a debtor *could demand* a jury trial over pre-petition state law claims if those claims did not "arise as part of the process of allowance and disallowance of claims." *See In re Jensen*, 946 F.2d 369 (5th Cir.

1991) (quoting *Granfinanciera*, 492 U.S. at 58). Here, however, the claims asserted by the trustee (on behalf of Idearc) *were* integral to resolving Verizon's claims. Because Idearc was not entitled to a jury trial, the litigation trustee was in no better position to demand a jury. *See Torch Liquidating Trust ex rel. Bridge Assoc. LLC v. Stockstill*, 561 F.3d 377, 387 (5th Cir. 2009).

The Fifth Circuit next addressed last year's *Crescent* decision out of the Western District of Texas,¹ which relying on *Grede*,² a Seventh Circuit from 2010, held that *Langenkamp* did not apply to litigation trustees and allowed the litigation trustee to try its fraudulent transfer claims before a jury. The *Crescent* Court explained that litigation trusts often receive assignments of third-party under the confirmed plans. As such, the *Crescent* Court opined that litigation trusts should only be bound to the terms of the applicable plan, while remaining free from the "strictures of the Bankruptcy Code" and the application of *Langenkamp*. The Fifth Circuit found the *Crescent* Court's logic to be flawed and reliance on *Grede* to be misplaced. If a claim is "by law integral to the resolution of the claims-allowance process," explained the Fifth Circuit, it does not cease to be integral to that process simply because it is pursued by a litigation trustee rather than a debtor or bankruptcy trustee. The Fifth Circuit held that *Langenkamp* applied to the litigation trustee.

Finally, the Court reiterated that neither *Stern* nor *Bellingham* displaced *Langenkamp*. The facts in *Stern* (debtor's state law counterclaim against creditor) were distinguishable from *Langenkamp* (fraudulent transfer claim against a creditor). Moreover, while the facts in *Bellingham* were analogous to *Langenkamp* and the present case (fraudulent transfer claims against creditors), *Bellingham* did not address jury trial rights. Thus, the Fifth Circuit held that, *Langenkamp* remains good law.

¹ *See Crescent Resources Litigation Trust v. Duke Energy Corp.*, 2013 U.S. Dist. LEXIS 62676, 2013 WL 1865450 (W.D. Tex. May 2, 2013).

² *Grede v. New York Mellon*, 598 F.3d 899 (7th Cir. 2010).

Fifth Circuit Illustrates How to Navigate *BP RE* and *Executive Benefits*, At Least, For Now.

Galaz v. Galaz (In re *Galaz*), 765 F.3d 426 (5th Cir. 2014) (Jones, J.)

Facts: The debtor (Lisa) was married to Raul until 2002. As part of the divorce, Raul assigned to Lisa his share of potential future earnings from a California LLC known as Artist Rights Foundation (“ARF”). Raul had formed ARF with his partner Julian Jackson in 1998—each held a 50% interest in ARF, but Raul was the managing member. ARF’s assets comprised primarily (if not solely) of music royalties from an old funk band known as the Ohio Players. From 2002-2005, ARF realized no royalties from the Ohio Players. But in 2005, unbeknownst to Lisa (25% interest holder as the result of the divorce) or Julian (50% shareholder), Raul conveyed ARF’s royalties to a newly formed Texas LLC called Segunda Suenos. Conveniently, the music royalties began paying out, grossing \$1 million in revenues from 2005-2010.

Procedure: Lisa filed a chapter 13 bankruptcy case in 2007, and commenced an action for fraudulent transfer and breach of fiduciary duty against Raul and Segunda Suenos in 2008. Raul asserted third-party claims against Julian. Julian responded with his own claims for breach of fiduciary duty, fraudulent conversion and similar state law causes of action. The Bankruptcy Court held a five-day bench trial, and ultimately entered two judgment—one in favor of Lisa for \$250,000 actual damages and \$250,000 exemplary damages, and a second in favor of Julian for \$500,000 actual damages, and \$500,000 exemplary damages.³ The judgments were both affirmed by the District Court. Raul appealed to the Fifth Circuit.

Holding regarding Julian’s judgment: The Fifth Circuit vacated Julian’s judgment and remanded with instruction to dismiss his claims all together, explaining that his claims (i.e., *by* a non-debtor *against* a non-debtor) had no possible impact on Lisa’s bankruptcy estate and, thus, “related to” subject matter jurisdiction was lacking.

Holding regarding Lisa’s judgment: The ruling was different for Lisa’s judgment. The Court agreed with the lower courts that subject matter jurisdiction existed, because her claims could have an impact on her estate by augmenting the size of

the estate. However, the Fifth Circuit rejected the lower courts’ conclusion that Raul’s implied consent authorized the Bankruptcy Court to enter final judgment on Lisa’s claims, explaining that “the parties’ express or implied consent cannot cure the constitutional deficiency that results from circumventing, or diminishing, the Article III structural protections for the federal judiciary.” (citing *BP RE* and *Waldman*).⁴ Instead, the Bankruptcy Court *should* have entered proposed finding and conclusions, and the District Court *should have* considered such proposed findings and conclusions *de novo*. Because that did not occur, the Fifth Circuit vacated Lisa’s judgment and remanded to the District Court, suggesting that the District Court may wish to “refer the case to the Bankruptcy Court, which may recast its judgment as proposed findings and conclusions, or may otherwise dispose of the case consistent with this opinion.” In other words, the lower courts may not have been wrong on the merits of their decisions; they just needed to recast their decisions to fit within the constitutional framework outlined by *Executive Benefits* and *BP RE*.

Bankruptcy Court in Second-Filed Forum Had Jurisdiction to Determine Estate’s Interest in Property Avoided But Not Yet Recovered in First-Filed Bankruptcy Case.

Allen v. Advanced Telecommunication Network, Inc., --- F.3d ---, 2014 U.S. App. LEXIS 18624 (3d Cir. Sept. 26, 2014) (Fisher, J.)

Advanced Telecommunications Network (ATN) was in bankruptcy in Florida. The bankruptcy trustee for ATN obtained a \$6 million fraudulent transfer judgment against Daniel Allen (Allen), one of ATN’s former owners, but before ATN’s trustee could recover any of the \$6 million judgment, Allen transferred his substantially all of assets offshore and then filed his own personal bankruptcy case in New Jersey. The ATN trustee moved for relief from the stay in Allen’s NJ case, but the NJ Bankruptcy Court denied relief, holding that the \$6 million funds were still property of Allen’s estate because they had not yet been “recovered” pursuant to the Florida Bankruptcy Court’s judgment. The NJ District Court affirmed, and this appeal followed.

³ The actual damages were reduced on remand to give Raul credit for paying ARF’s taxes from 1998-2005.

⁴ The Court reiterated that current precedent may be short-lived, depending on the Supreme Court’s ruling in *Wellness International*.

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