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RULE 9019 COMPROMISES:

THE HEART OF THE BANKRUPTCY PRACTICE

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I. The Principles and Procedures of Bankruptcy Settlements

A. Bankruptcy Rule 9019(a)

Federal Rule of Bankruptcy Procedure 9019 ("Rule 9019") is unique in that it does not have a parallel section in the Bankruptcy Code.[1] Rule 9019(a) provides that "[o]n motion by the trustee, and after notice and a hearing, the court may approve a compromise or settlement."[2] The joint purposes of Rule 9019 are to "avoid the necessity of determining sharply contested and dubious issues"[3] and to "prevent the making of concealed agreements which are unknown to the creditors and unevaluated by the court."[4] The case law of the Supreme Court and the Fifth Circuit specify Rule 9019's exact tests by which the bankruptcy court may approve a settlement in a bankruptcy case.

The majority rule with regards to the applicability of Rule 9019(a) is that judicial approval of compromise or settlement agreements is mandatory.[5] While the courts so holding sometimes acknowledge the "inconclusive" language of Rule 9019(a), they nearly uniformly focus on some version of the need for judicial

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[1] *See In re Iridium Operating LLC*, 478 F.3d 452, 461-62 (2d Cir. 2007) (discussing Rule 9019). Under the old Bankruptcy Act, one section, § 50 (pre-1979, codified at 11 U.S.C. § 27), provided: "§ 50. Compromises. The receiver or trustee may, with the approval of the court, compromise any controversy arising in the administration of the estate upon such terms as he may deem for the best interest of the estate."

[2] Fed. R. Bankr. P. 9019. The primary focus of this paper is Rule 9019(a). Rule 9019 states in its entirety:

> (a) *Compromise*
> On motion by the trustee and after notice and a hearing, the court may approve a compromise or settlement. Notice shall be given to creditors, the United States trustee, the debtor, and indenture trustees as provided in Rule 2002 and to any other entity as the court may direct.
>
> (b) *Authority to compromise or settle controversies within classes*
> After a hearing on such notice as the court may direct, the court may fix a class or classes of controversies and authorize the trustee to compromise or settle controversies within such class or classes without further hearing or notice.
>
> (c) *Arbitration*
> On stipulation of the parties to any controversy affecting the estate the court may authorize the matter to be submitted to final and binding arbitration.

[3] *In re* California Associated Products Co., 183 F.2d 946, 949–50 (9th Cir. 1950).

[4] *In re* Masters, Inc., 141 B.R. 13, 16 (Bankr. E.D.N.Y. 1992), aff'd, 149 B.R. 289 (E.D.N.Y. 1992).

[5] *See, e.g.*, Travelers Insurance Co. v. American Agcredit Corp. (In re Blehm Land & Cattle Co.), 859 F.2d 137, 141 (10th Cir. 1988) (holding that settlement between trustee and a party must be approved by court in order to be enforceable); Reynolds v. Comm'r, 861 F.2d 469, 473 (6th Cir. 1988) (holding that judicial approval for settlement between debtor and creditor is required).

approval in order to preserve the integrity of the bankruptcy system's goal of realizing fair and equitable results for the collective benefit of the parties in interest.

The minority rule hinges upon the permissive (and therefore ostensibly inconclusive) "may" contained in Rule 9019(a). Here, the authorities reason that courts retain the authority to approve settlement agreements but that nothing in Rule 9019(a) requires a trustee to obtain that approval in order for a settlement to be enforceable.[6] In addition, at least one court has held that Rule 9019 does not govern chapter 9 cases.[7]

As illustrated by the various issues discussed in this paper, and as further underscored by the Bankruptcy Code's emphasis on disclosure and transparency, the majority rule is generally both the better and the safer approach from the practitioner's perspective.[8] While requiring judicial approval of settlements raises the systemic costs and thereby conceivably reduces returns to creditors, doing so properly maintains the transparency of the bankruptcy system and encourages parties in interest to participate in good faith.

B. The Settlement Approval Standards in the Fifth Circuit

To begin, the merits of a proposed compromise and settlement are to be evaluated initially under the criteria set forth in *Protective Committee For Independent Stockholders of TMT Trailer Ferry, Inc. v. Anderson*,[9] a landmark case. There the United States Supreme Court observed that "[i]n administering [Chapter 11] proceedings in an economical and practical manner it will often be wise to arrange the settlement of claims as to which there are substantial and reasonable doubts."[10] *TMT Trailer Ferry* requires that a compromise and settlement must be "fair and equitable."[11] To determine whether a compromise and settlement is "fair and equitable" and in order to enable "the informed and independent judgment" of the court, the following factors should be considered:

> [1] the probabilities of ultimate success should the claim be litigated[,]

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[6] *See, e.g.*, *In re* Dalen, 259 B.R. 586, 598 (Bankr. W.D. Mich. 2001) (finding that judicial approval of bankruptcy settlements is not mandatory).

[7] *See In re* City of Stockton, Cal., 486 B.R. 194, 197-98 (Bankr. E.D. Cal. 2013) (noting that 11 U.S.C. § 904 limits the jurisdiction of the court over the affairs of the municipal debtor).

[8] For further discussion on this topic, *see* Linhadley Eljach, *No Seal No Deal: Amending Federal Rule of Bankruptcy Procedure 9019 to Require Judicial Approval of Settlement Agreements*, 32 Emory Bankr. Dev. J. 433 (2016) and Reynaldo Anaya Valencia, *The Sanctity of Settlements and the Significance of Court Approval: Discerning Clarity from Bankruptcy Rule 9019*, 78 Or. L. Rev. 425 (1999).

[9] 390 U.S. 414 (1968).

[10] *Id.* at 424.

[11] *Id.*

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