THE LIQUIDATING 11, NOT JUST A FAILED REORGANIZATION

There was a time when I could have said, "All my liquidations started out as reorganizations." (Think of saying that to the tune of that great country western song "All My Exes Live in Texas", I know there are too many syllables for it to really work but you get the idea).

Through a couple of recent experiences I have come to think of liquidating 11's as more than just reorganizations gone bad. A liquidating 11 is not necessarily a failure or a bad thing but can be a very useful tool to help my clients.

FIRST EXPERIENCE: FAMILY FUED ON STEROIDS

Jim and I were involved in a chapter 11 involving three generations of a wealthy and well respected south Texas family that had formed into two sides of a legal brawl spread over five state court lawsuits, for over four years of litigation, at a cost of roughly $5,000,000.00 in attorneys fees, and my favorite, $173,000.00 in mediation fees.

The warring parties could not agree how the 40,000 acres of the three family ranches should be used or who should be in charge of managing the ranches.

The state court litigation had not moved the case any distance toward a trial on the merits or a final resolution.

And if it the state court litigation were to eventually reach a jury trial demanded by one of the sides, it would have taken between a month to a month and a half (according to a retired state District court judge who was one of the mediators) for the state court litigators to present the case to a jury.

The parties hated each other to the point where they accused each other of criminal conduct.

A. GETTING THE CASE INTO BANKRUPTCY COURT:

Potentially another great country western song: "You don't have to be insolvent to file." (to the tune of that great country western song, "You Don't Have to Be a Baby to Cry!").

But you do have to have a problem that bankruptcy can help you with.

We had two prongs to our argument that the bankruptcy court should have jurisdiction:

1. Under our fact situation the debtor's monthly operational and litigation expenses exceeded its monthly income. It was only able to continue to function by borrowing from affiliated entities.

2. The formation documents for the debtor expressly stated that one of its business purposes was the sale of real estate. The family faction opposed to the bankruptcy had prevented the sale of ranch land in the state court proceeding through a TRO. The TRO prevented an attempted sale and thus frustrated the Debtor's ability to accomplish its business purpose and raise additional funds for its continued operations and litigation costs.

B. ADVANTAGE OF HAVING THE FAMILY DISPUTE IN BANKRUPTCY COURT

("Ain't no place I'd rather be." Not really a country western song title but Google it and you'll see that as a lyric it appears in several songs, so as popular poetry it is hard to beat.)

It is a truth universally acknowledged that bankruptcy lawyers practice in front of better judges than state court litigators do. It is my personal opinion that we, as a bankruptcy bar, should do all we can to hide this fact from our fellow lawyers who practice primarily in the in the state courts. Personally, I would like it if our judges would savage any state court litigators who appear before them to discourage the practice of outsiders coming into our courtrooms. But that's just me wanting to keep the practice pure. This having been said, I think the principal benefits of bringing a complex acrimonious family war into the bankruptcy courts are as follows:

1. WE HAVE BETTER JUDGES.

A. They are more experienced in commercial and financial matters than their state court brethren.

B. Federal Judges (unlike state court judges) have the right to question witnesses, and we all know they also love to ask lawyers tough questions. They also read and listen to everything. They are selected because they are smarter than most of us, and they are certainly smarter than any of our clients. They are the absolute last people in the world you want to try to mislead. This contributes to the level of candor and honesty that usually pervades a bankruptcy proceeding.

C. Usually the best lawyer in the courtroom is wearing the black robe. If you in your presentation have missed asking the right question, I'm not saying you should rely on the judge to hit clean up for you, but if you have missed something he might ask just so that he has a better understanding of the case.

D. In bankruptcy court, just like state court, litigants can file whatever they want, and ask for all of the discovery they need, (frivolous pleadings and reams of unnecessary and oppressive discovery, again in my opinion, being a time honored tradition in state court actions). But in bankruptcy court, if your pleadings are without merit, or you are conducting discovery to harass the debtor, you are a lot more likely to pay for the privilege.

E. It is easier for me to get a hearing on a contested matter, and time to present evidence in bankruptcy court than it is for me to get a hearing and the opportunity to present evidence in state court. (And my bankruptcy judge has to fly into Laredo from Houston)

F. I'll also get a ruling faster in bankruptcy court than I will in state court. The bankruptcy case will not stall out while we all wait for a judge to issue a ruling that will help shape the issues in the case.

G. You can and should include in your plan and confirmation order that the bankruptcy court retains jurisdiction. The limits of what the court can continue to resolve post confirmation are not clearly defined, but you are probably safe if it is something to do with the implementation and carrying out of the Plan. I try to think of issues that may come up after confirmation that I was not able to nail down in the plan, things like a determination of the sales price for a property if my client and the lien holder get into a fight. I'd much rather have the right to present a dispute to a bankruptcy judge than a state court judge.

2. BETTER LAWYERS

A. None, or few of us, want to waste our time fighting battles we can't win.

B. None of us want to waste our time and look stupid asserting positions we should know are wrong. (It's embarrassing!)

3. TRANSPARENCY OF THE BANKRUPTCY PROCESS.

A. The bankruptcy process is completely transparent, nothing gets done without pleadings, and notice and hearing. This is a really big deal for family fight litigants. They begin to be

aware of this and are impressed by it from the time they first get to review the schedules, and make their first appearance in the bankruptcy courtroom. The full disclosure required in bankruptcy is a totally alien concept to the process they are used to in state court (ask the tricky question, obfuscate the answer, then fight in front of the judge about why everybody is confused).

B. Very early in the bankruptcy case the litigants also get an understanding that the judge is an honest broker who will not accept anything but complete candor in the bankruptcy courtroom. This goes a long way toward diffusing some of the paranoia in a truly acrimonious family war.

4. THE FEUD WILL END

And finally, "I hear that train a comin" (again, not the title to a country western song, but a truly great lyric from the immortal Johnny Cash's truly great country western song *Folsom Prison Blues*:)

A. All of the foregoing contribute to a faster resolution of the underlying dispute in the bankruptcy case.

B. You can think of the filing of a bankruptcy case as a train leaving the station. Once it's on track and on its way it will reach a destination as quickly as is reasonable in the opinion of the bankruptcy judge.

C. But it will get to a destination, and it will result in a resolution of the legal problems presented.

How all of this played out in our family feud case:

Early on in the state court litigation the parties had tried that classic mediation tactic we all learned on the playground, "You split the candy bar, and I'll pick which half I want." I submit that this is the simplest and fairest way to accomplish a partition anyone has ever thought of.

The parties realized they needed to divide the ranch properties, but the level of hatred and animosity between them was so great that there was absolutely no level of trust between them. If one of them split, and the other picked, the deal would fall through before it could be consummated because someone have been acting deviously.

We removed the state court litigation and brought everything before the bankruptcy court.

TRANSPARENCY AND SUPERVISION OF BANKRUPTCY PROCEEDING

Transparency. The 363 process for sales provided a level of transparency that even the most rabid opponent had to admit was fair. And if they didn't want to agree, who cared, the judge would decide.

Quality of judges. I think I've made my opinion clear on that. All of the foregoing.

More expeditious resolution of disputes over law and fact in bankruptcy court. Bankruptcy judges are willing to set matters, hear evidence, rule and move on.

Frequently motions would be filed, witness and exhibit lists filed, exhibits exchanged, cart loads of documents brought into court, and before we called the first witness the judge would call everybody together, have a brief discussion, ask a few questions, and then offer the parties the time to confer, before striking up the evidentiary hearing.

It is amazing the number of times a brief reading of the tea leaves produced reasonable responses and resolutions. Again, nobody wants to continue to assert a position if they think they are going to lose.

No better forum for hearing and determining claims. It is what bankruptcy courts do. You can get a jury trial but you can't play around with it (again, the judge thing).

Being in Bankruptcy court raises the ante on frivolous claims Personally, I think it is easier to assert a claim for sanctions on a frivolous claim in bankruptcy/Federal court than it is in state court. You send opposing counsel a notice under Rule 11 of the Federal Rules of Civil Procedure, ask them to withdraw the pleading, when they don't, then carry the letter and the matter of sanctions until the end of the case. Produce the letter as an exhibit to a motion for sanctions, and have a hearing on the facts that show the pleading is without foundation or merit.

RESOLUTION OF OUR CASE:

Our case was set for a final mediation effort three days before an iron clad setting on a confirmation hearing for a liquidating plan.

None of us had much hope that a one day mediation would achieve anything more than had been accomplished in our fourteen days of prior mediation. But when Judge Jones tells you that Judge Isgur owes him a favor, and that Judge Jones is willing to call in that favor so Judge Isgur can take one last shot at mediation, if you don't want to appear churlish, you go along with what Judge Jones has suggested.

To my utter amazement, in five hours, displaying a complete mastery of all of the facts in a very fact intensive case, Judge Isgur announced that we had a settlement.

(O.K., it is true, Judge Isgur is the greatest mediator on the face of the planet.).

(Just as an aside on this, the parties discussed contributing to a fund to commission and place a bust of Judge Isgur in the Laredo Federal Courthouse. The idea crashed and burned when it was pointed out that Judge Isgur cannot be paid a fee for his mediation services while he is a Federal Judge.)

(Ironic that he was not only the best mediator we had in the case, he was also the least expensive.)

Would our plan have been confirmed, I think so, Jim probably has a different opinion. But both sides were facing the pressure and uncertainty of a contested confirmation hearing. I think this probably contributed to the settlement.

The end result, after 16 months in bankruptcy court the case was resolved with complete settlement of all issues between the parties. The assets finally were divided in a manner acceptable to everyone, maybe not their first choice but a workable solution. (Or, as a Spanish Dicho would say "Un mal areglo es mejor que un buen pleito" roughly translated, "A bad settlement beats the hell out of a good fight.")(I could not find a country western song title to fit this).

A final suggestion:

If you know of a fact situation where factions of a large wealthy family, are engaged in a war that has caused their family business to become dysfunctional because of their distrust of one another, who are fighting over large tracts of land or other expensive assets, at a cost that exceeds the cash flow of the business, or with litigation that precludes achieving a legitimate business purpose, and they have been spending tons of money on a state court litigation with no resolution in sight, think of a liquidating chapter 11.

STRUCTURED DISMISSALS

With the implosion of drilling in the Eagle Ford Shale I am seeing several small oilfield service company cases. These clients usually have equipment that can be classified as oil field service specific, or just trucks and heavy equipment. There is sill a market for the trucks and heavy equipment; there is virtually no demand for the oil field specific equipment. If you talk to a machinery auction company they will tell you that the oil field specific equipment, if they can sell it at all, is going for 10 to 30 cents on the dollar of what it could have brought before the boom went bust.

In dealing with the principal of an oil filed service company you will have to work to convince your client's representative that the bust is real. Remember, this is a guy who got used to buying F- 350's and Rolexes when times were good. It is still inconceivable to him that the world could have changed so completely.

The oil field service companies are also pretty broke by the time the owner comes to see me, and there is no demand for the type of work the client was doing. No matter how strong the debtor's representative's terminal euphoria may be, resist it! These are not candidates for reorganization.

Enter the structured dismissal.

While not always a liquidating 11, structured dismissals are becoming a more popular method of dealing with resolution of a client's financial problems, and frequently involve clients without a viable reorganization chance.

The idea is to negotiate with creditors or liquidate the debtor's assets to provide for the maximum repayment of creditors. Once you have done this you file a motion to dismiss the case.

Unlike a simple one line order of dismissal, which under 349 would result in the parties being put back where they were before the case was filed, the order of dismissal in a structured dismissal approves the settlement, and states that the settlement will survive the dismissal of the case. It should also probably provide that the court will retain jurisdiction to enforce the settlement terms.

You can have a structured dismissal in the 5th Circuit. Judge Hale approved one in *In Re Buffet Partners, L.P.,* No. 14-30699-HDH-11, 2014 WL 3735804 (Bankr. N.D. Tex. 2014). His explanation of how you do this is the simplest I've found.

"On a smaller scale, structured dismissals occur regularly in this and other bankruptcy courts. Often the parties enter the case on the eve of foreclosure, work out their differences through a sale or give back of property, and the parties enter an agreement submitted to this court to for approval of the results in the dismissal of the case. This court begins its look at deals struck in this court with the eye that 'its not my money.' If appropriate notice is given and the process is fair and does not illegally or unfairly trample on the rights of parties, the proposal should be accepted."

But what you cannot do in the 5th Circuit with a structured dismissal is change 507 payment priorities per a settlement in bankruptcy or violate the absolute priority rule of 1129 (b)(2)(B)(ii). The Fifth Circuit has said, " . . . a bankruptcy court abuses its discretion in approving a settlement with a junior creditor unless the court concludes that the priority of payment will be respected as to objecting senior creditors." *In re AWECO, Inc.*, 725 F3d 293, 298 (5th Cir. 1984).

If you are asking the court to approve any compromise then you also need to consider *In re: Cajun Power Cooperative, Inc.,* 119 F3d 349 (5th Cir. 1997) wherein the Fifth Circuit considered and discussed whether a proposed settlement was a sub rosa plan of reorganization, and whether it was fair and equitable.

While alive and well in the Fifth Circuit, AWECO has been criticized in the Second and Third Circuits.

In 2007 the Second Circuit in *In re Iridium Operating LLC*, 478 F3d 452, 464-465 (2nd Cir. 2007) said the Fifth Circuit test was "too rigid." *Id* at 464. It specifically said that the absolute priority rule "is not necessarily implicated" when "a settlement is presented for court approval apart from a reorganization plan." *Id.* at 463-64. The court said that to obtain approval of a plan " . . . that in some way impairs the rule of priorities" the proponent must comply with Rule 9019 and "come before the bankruptcy court with specific and credible grounds to justify the deviation and the court must carefully articulate its reason for approval of the agreement." Id at 466.

The Third Circuit joined the Second in its criticism of the rigid rule followed by the 5th in AWECO in *In re: Jevic Holding Corp*., 787 F.3d 173 (3rd Cir. 2015) The question presented to the Third circuit, succinctly stated in the opening line of the case was:

"This appeal raises a novel question of bankruptcy law: may a case arising under chapter 11 ever be resolved in a 'structured dismissal' that deviates from the Bankruptcy Code's priority system." *Jevic* at 173. To which the court responded, "We hold that, in a rare case, it may." *Id.* at 173.

In an opinion that the 3rd Circuit admitted was a "close call" the *Jevic* court agreed with the holding in *Iridium* and its criticism of AWECO. The court found that there had been a sufficient showing under the facts of the case that the settlement was fair and equitable. *Jevic.* at 184-185.

You would think that these issues of sub rosa plans, fair and equitable, priority payment of claims, and the absolute priority rule would only apply in large cases, where sophisticated creditors and debtors are pushing agendas to accomplish complex matters like the funding of litigation trusts.

You need to look at two fairly recent opinions from Judge Rodriguez in Chapter 13 cases. In both cases he performs a frighteningly thorough analysis of proposed settlements under the standards set out in *In re: Cajun.* These are *In Re: Joseph Andrew Smith*, 541 BR 629 (Bkrtcy. S.D. Tex. 2015) and *In Re: Wright* a chapter 13 case, a February 11, 2016 decision No. 13-70472 (Bkrtcy S.D. Tex. 2016). I'm going to have to go back to my oil field equipment cases and read them in light of these two cases.

I think a structured dismissal could be an expedient and cost effective way of liquidating the debtor's assets. If the liquidation can bring a higher return than what would be realized in a chapter 7, then it might be cheaper and faster for the debtor to liquidate its own assets, and then file a motion to dismiss the case as a structured dismissal, without having to go through the expense of preparing the disclosure statement and plan, and going through the confirmation process.