STATE BAR *of* TEXAS

BANKRUPTCY LAW
Section Newsletter

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IN THIS ISSUE

A MESSAGE FROM YOUR CHAIR

Dear Section Members,

First, let me wish you a happy and healthy new year.

Second, I did want to report to you that your section is doing well and, more importantly, it is also doing good in the state of Texas.

Our Moneywise program is in full force, providing education to school children across the state.

Our nonlawyer section members are becoming very active in the section. In November, the section paired with the Dallas Bankruptcy Bar Association for a presentation and reception which was informative and well attended by a large number of bankruptcy professionals. Several more events are planned for this year to use the talents of the advisors who are important section members.

The Elliot Cup competition for law students is just around the corner, scheduled for the final weekend of February in New Orleans. The planners say that they had no problem getting help this year. One wonders whether that is because of the event or the draw of the Big Easy.

Also in February in New Orleans, the Center for American and International Law will host its second Fifth Circuit Bench-Bar Conference, which will feature a large number of Texas bankruptcy lawyers and judges as faculty members. The first conference was held in Plano two years ago and was quite a success.

And, plans are underway for the Annual Meeting of the section, as part of the Texas State Bar Annual Meeting, in June, 2012 in Houston. The bankruptcy section will host a reception on a Thursday night and then CLE and awards the next day. Details will be forthcoming.

Finally, our section continues to grow. It is one of the largest in the state bar.

Again, have a great new year. And, let me know how the section may be of help to you.

Judge Harlin DeWayne "Cooter" Hale

REVIEW OF THE 30TH ANNUAL JAY L. WESTBROOK BANKRUPTCY CONFERENCE

By: Rhonda Mates, Brown McCarroll, LLP, Austin (rmates@brownmccarroll.com) with Consumer Tract contributions from Layla D. Milligan, Office of Deborah B. Langehenning, Chapter 13 Trustee, (layla@ch13austin.com)

William (Bill) Rochelle (Panelist) and Michael (Buzz) Rochelle (Conference Chair) Before They Were Lawyers.

The University of Texas CLE held the 30th Annual Jay L. Westbrook Bankruptcy Conference on November 17–18, 2011 at the Four Season Resort & Spa in Austin, Texas. Michael R. "Buzz" Rochelle chaired the conference and served as a presiding officer. The Hon. John C. Akard, William A. "Trey" Wood III, Berry D. Spears, and Patricia Baron Tomasco also served as this presiding officers. There were approximately 266 attendees, including judges, lawyers, and non-lawyer professionals from across the country, and even abroad.

THURSDAY PRESENTATIONS

Thursday's sessions tried to ignore the very buxom blonde in the room—*Stern v. Marshall*—which was scheduled to be addressed in its own session Friday morning. As a case with the potential to turn the bankruptcy world on its head, it was impossible to ignore entirely and became a recurring theme throughout the conference. In addition, the conference faculty focused on the struggling economy, both in the U.S. and globally, and its effect in the bankruptcy courts.

Recent Developments

Testing a new format to discuss case law developments over the past year, Prof. Jay L. Westbrook (Austin) presented various categories to the panel, which was comprised of R. Byrn "Byrnie" Bass Jr. (Lubbock), Deborah B. Langehenning (Austin), William J. Rochelle (New York), and Deborah D. Williams (San Antonio). Each panelist had one minute to discuss each category, which included "Game Changer," "Case That is Simply Wrong," "Deep Thoughts," "5th Circuit Cases," and on a lighter note, "Funniest Case." The "Game Changer" category proved difficult after Prof. Westbrook prohibited the panelists from choosing the obvious—*Stern v. Marshall.*

Bill Rochelle, Debbie Langehenning, Byrnie Bass, Deborah Williamson, and Prof. Jay Westbrook

Continued on page 14.

Omar Alaniz Awarded the ABA's National Outstanding Young Lawyer Award

The American Bar Association named Omar J. Alaniz (Baker Botts L.L.P. – Dallas) its 2011 winner of the ABA Young Lawyer Division National Outstanding Young Lawyer Award for his professional excellence, service to the profession, bar and community, and reputation for the advancement of legal ethics and professional responsibility. Omar will be presented the award at the 2012 ABA Midyear Meeting in New Orleans in February.[1]

The ABA recognized Omar's many contributions including his commitment to pro bono service; his current service as the Vice-President of Membership of the Bankruptcy Law Section, Chair of the Diversity Sub-committee of the ABA's Bankruptcy and Insolvency Committee of the Litigation Section, and Secretary of the Bankruptcy and Commercial Law Section of the Dallas Bar Association; his past service as president of the DFW Association of Young Bankruptcy Lawyers, and Vice-Chair of Professional and Public Education for the Section; and his service to education as an adjunct faculty member at SMU's Dedman School of Law, a faculty advisor for the law school's OUTLaw group, a coach of the law school's Duberstein Bankruptcy Moot Court Team, and volunteer at Julius Dorsey Elementary School.

In 2011, the Texas Young Lawyers Association named Omar the Outstanding Young Lawyer of Texas, the Dallas Association of Young Lawyers named him Outstanding Young Lawyer of Dallas, and he received the Bankruptcy Law Section's John C. Akard Community Service Award for his efforts in expanding and teaching the MoneyWise financial education program and other volunteer activities.

Omar currently leads a group of young bankruptcy lawyers in an ABA project that will publish summaries and analyses of all cases interpreting the Supreme Court's recent *Stern v. Marshall* decision.

1 The ABA's full announcement is available at: http://www.americanbar.org/groups/young_lawyers/awards_scholarships/national_outstanding_young_lawyer_award/2011_winner_and_finalists.html.

DAYBL Hosts Annual Casino Night Fundraiser

On February 2, 2012, the DFW Association of Young Bankruptcy Lawyers ("DAYBL") presented the Dallas Volunteer Attorney Program with a donation of $3,000.00. DAYBL raised funds for the donation from its annual Casino Night fundraiser held in October of each year. This year's Casino Night, held at Haynes and Boone, LLP's Dallas office, was well attended by bankruptcy lawyers and financial professionals from across the Dallas-Fort Worth area. Congratulations to DAYBL for another successful fundraiser and its generous contribution to the Dallas Volunteer Attorney Program ("DVAP").

Picture (l-r) Michelle Alden (DVAP); Chris Reed-Brown (DVAP); Rachael Smiley (2012 DAYBL President-Elect); John Middleton (2012 DAYBL President); Anne Burns (2012 DAYBL Secretary and head of 2011 Casino Night committee).

REVIEW OF THE 29TH ANNUAL ADVANCED BUSINESS BANKRUPTCY COURSE IN HOUSTON, TEXAS

By: M. Jermaine Watson, Cox Smith Matthews Incorporated, Dallas, Texas (jwatson@coxsmith.com)

A. Bankruptcy 101 Course

The State Bar Bankruptcy 101 Course kicked off The State Bar of Texas Advanced Business Bankruptcy Course in Houston, Texas from September 7-9, 2011, at the Westin Oaks Hotel. Lead by M. Jermaine Watson and Erin B. Shank as directors for the course. The program saw a significant increase in attendance and good feedback from the participants who brushed up on consumer and commercial bankruptcy law basics.

PRESENTATION SUMMARIES:

M. Jermaine Watson (Dallas) and **Erin B. Shank** (Waco) gave a thorough overview of consumer and commercial bankruptcy cases.

Demetra L. Liggins (Houston) and **Jeffrey P. Norman** (Columbus, OH), standing Chapter 13 Trustee, gave a thorough overview of consumer and commercial reorganization plans and confirmation.

Erin B. Shank (Waco) and **Valerie Wenger** (Austin), trial attorney for the U.S. Trustee's Office for the Western District of Texas, engaged in a lively discussion of the means test in consumer bankruptcy cases.

Michael V. Baumer (Austin) and **Timothy A. Million** (Houston) explained the basics of cash collateral in consumer and commercial bankruptcy cases.

The Honorable Richard S. Schmidt of the United States Bankruptcy Court for the Southern District of Texas (Corpus Christi) and **Erin B. Shank** (Waco) discussed the claims objection process in consumer bankruptcy cases.

Mary A. Daffin (Houston), **David Ritter** (Dallas), and **Pamela L. Stewart** (Houston) explained basic considerations when opposing and seeking relief from the automatic stay in consumer and commercial bankruptcy cases.

Frances A. Smith (Dallas) and **Weldon Reed Allmand** (Hurst) discussed best practices for developing and maintaining a successful consumer or commercial bankruptcy practice.

B. General Course

Following that program, The State Bar of Texas held its 29th Annual Business Bankruptcy Course on September 8-9th. **Johnathan C. Bolton** (Houston) and **Trey A. Monsour** (Dallas) served as course directors for this event. The Course took an innovative approach to historical programs. Jeffrey Toobin spoke to the participants as a keynote luncheon speaker. Presenters from within Texas and other states spoke about pressing issues facing the business bankruptcy bar. The speakers enjoyed an evening together at Ninfa's Restaurant on Navigation Boulevard. Participants got to enjoy Judge Richard Schmidt's live band in an enjoyable skyline reception overlooking the Houston. Attendance was at one of the highest levels the program has seen. Given its success in 2011, the program scheduled for September 13th and 14th, 2012 should be even more innovative and informative.

PRESENTATION SUMMARIES:

The Honorable Bruce Markell of the United States Bankruptcy Court for the District of Nevada (Las Vegas) and **Lenard M. Parkins** (New York) discussed *Plan Support Agreements, Exclusivity and Competing Plans in Chapter 11 Cases* and their impact on the Chapter 11 process. Their presentation was timely as more cases are resolved by pre-negotiated or pre-packed chapter 11 plans.

Continued on page 18.

GEORGE McELREATH, ASSISTANT U.S. TRUSTEE, RETIRES AFTER 29 YEARS

George F. McElreath retired after 29 years of service as Assistant United States Trustee for Region 6. George served in the Northern District of Texas. George graduated from The University of Texas School of Law in 1977, and practiced privately before joining the U.S. Trustee's office in 1983. George served as lead U.S. Trustee on many of the major chapter 11 cases filed in the Northern District.

On January 20, 2012, over 100 members of the bankruptcy bar in Dallas and Fort Worth, along with friends and former colleagues from across the country, held a reception at the Belo Mansion honoring McElreath's service. The event emcee was Joseph J. Wielebinski and it featured several speakers including bankruptcy judges Halin D. Hale, Robert C. McGuire, and Russell F. Nelms, as well as William T. Neary, U.S. Trustee for Region 6. The speakers honored McElreath's career with stories about his diligent and dedicated service, legal acumen, and professional and kind personality, while including a few humorous anecdotes. All commented how much George would be missed and wished him well.

George McElreath and the Honorable Rovert C McGuire, retired

George McElreath, Chrisiti Flanagan (center), and Melany Johnson

The Honorable Robert C. McGuire, the Honorable H. DeWayne Hale, George McElreath, and the Honorable Stace G. Jerrigan

George McElreath

TIMING IS EVERYTHING: CONSEQUENCES OF A POST-PETITION FARM SALE

By: Victoria Welch, Judicial Extern to the Honorable Harlin D. Hale and second-year law student at LSU Paul M. Hebert Law Center, (vgwelch@gmail.com)

INTRODUCTION

The United States Supreme Court recently granted certiorari in *Hall v. United States* (Docket No. 10-875), 2011 WL 2297804 (2011) to quiet the conflict between bankruptcy procedures and tax law. In particular, the high court will decide whether post-petition capital gains are administrative expenses under Chapter 12 of the Bankruptcy Code. The Supreme Court heard oral arguments on November 29, 2011.

BACKGROUND

The Halls, owners of a financially distressed farm in Arizona, filed a petition under chapter 12 of the Bankruptcy Code. *U.S. v. Hall*, 617 F.3d 1161, 1162 (9th Cir. 2010). Chapter 12 is a special chapter for family farmers, intended to make reorganization of their financial affairs easier. *Id*. Chapter 12 authorizes the sale of bankruptcy estate assets free and clear of secured creditor liens. *Id*. The Halls subsequently sold their family farm, which resulted in a post-petition tax liability of approximately $29,000. *Id*. The Halls proposed a plan for reorganization to treat this tax liability as an unsecured dischargeable claim. *Id*. The Internal Revenue Service ("IRS") objected to the treatment of the tax claim as a general unsecured liability under the Internal Revenue Code. *Id*.

After the bankruptcy court sustained the objection and held the Halls individually liable for the capital gains tax the district court reversed. *Id*. The government appealed the issue of whether capital gains taxes created by the sale of a family farm during the pendency of a chapter 12 bankruptcy proceeding are payable as an administrative expense under the bankruptcy reorganization plan. *Id*. at 1162.

Effective April 20, 2005, 11 U.S.C. § 1222(a)(2)(A) allows for a priority tax claim resulting from the sale of "any farm asset used in the debtor's farming operations" to be treated as an unsecured claim and discharged. *Id*. at 1163. But section 1222(a)(2)(A) only applies to government priority claims under section 507. Moreover, section 507 only contains two provisions regarding taxes. *Id*. at 1163. Section 507(a)(8) involves pre-petition unsecured claims by government units. *Id*. Section 507(a)(2) deals only with administrative expenses under section 503(b). *Id*. In connection, section 503(b) allows for "administrative expenses …including …any tax …incurred by the estate". *Id*. See 11 U.S.C. § 503(b)(1)(B).

NINTH CIRCUIT

Affirming the bankruptcy judge, the Circuit Court held that since the tax was incurred by the debtors, as opposed to the estate, post-petition, the claim was not an administrative expense and thus section 1222(a)(2)(A) was inapplicable. Basically, in relying on title 26 U.S.C. §§ 1398 and 1399, a chapter 12 estate is not a taxable entity. *Id*. at 1163. Therefore, the tax claim could not be treated as a general unsecured liability and must be paid outside of the reorganization plan. The Ninth Circuit thus found that chapter 12 debtors are liable for any taxes incurred following the filing of the bankruptcy petition because the trustee is not responsible for the tax. *Id*. at 1164.

Judge Paez, while focusing on Congress's intent, dissented. *Id*. at 1168. According to Judge Paez, Congress clearly sought "to help family farmers keep their farms by allowing them to sell farm assets to pay off debts without being liable for the full amount of any capital gains tax arising from the sale, regardless of whether they sold the assets before or after filing their Chapter 12 petition." *Id*.

Continued on page 19.

AS YOU MAKE YOUR CREDIT BID, MUST YOU LIE UPON IT?

By: Victoria Welch, Judicial Extern to the Honorable Harlin D. Hale and second-year
law student at LSU Paul M. Hebert Law Center (vgwelch@gmail.com)

INTRODUCTION

On December 12, 2011, the United States Supreme Court granted a petition for a *writ of certiorari* in *RadLAX Gateway Hotel, LLC v. Amalgamated Bank* (Docket No. 11-166), 2011 WL 3499633 (Dec. 12, 2011). The High Court will weigh in on the proper interpretation of section 1129(b)(2)(A) of the Bankruptcy Code for chapter 11 cases and, hopefully, resolve a circuit split.

RIVER ROAD HOTEL & RADLAX HOTEL

The Seventh Circuit's consolidated opinion was issued in connection with the chapter 11 cases of River Road Hotel Partners and RadLAX Gateway Hotel. *River Rd. Hotel Partners, LLC v. Amalgamated Bank*, 651 F.3d 642, 645 (7th Cir. 2011).

In order to build the InterContinental Chicago O'Hare Hotel, River Road Hotel Partners ("River Road Debtors") obtained a construction loan totaling about $155,500,000 from Longview Ultra Construction Loan Investment Fund ("Red River Road Lenders"). *Id*. at 643. Amalgamated Bank was designated as the administrative agent and trustee of the River Road Lenders. Id. In 2009, the River Road Debtors filed voluntary petitions for relief under chapter 11 of the Bankruptcy Code. *Id*. at 644. At the time of filing, the River Road Debtors owed at least $140,000,000 plus interest on the loan. *Id*.

Similarly, RadLAX Gateway Hotel ("RadLAX Debtors") obtained a construction loan for about $142,000,000 from Ultra Construction Loan Investment Fund ("RadLAX Lenders") in order to purchase and renovate the Radisson Hotel at Los Angeles International Airport. *Id*. Amalgamated Bank was also designated as the administrative agent and trustee of the RadLAX Lenders. *Id*. The RadLAX Debtors subsequently filed voluntary petitions for relief under chapter 11. *Id*. At the time of filing, they owed over $120,000,000 plus interest on the loans. *Id*.

The Debtors then submitted their reorganization plans for confirmation by the court. *Id*. at 645. Both plans proposed a sale of substantially all of the Debtors' assets, for which the proceeds would be distributed among creditors according to priority rules. *Id*. The Debtors also proposed asset sales through an auction to the highest bidder. *Id*. The Lenders filed objections to the proposed bid procedures. *Id*. Because the plans had not been accepted by the Lenders and they would impair the Lenders' interests, the Debtors' plans "could not be confirmed unless they qualified for one of the exceptions listed in Section 1129(b)(2)(A) of the Code." *Id*.

Agreeing with the Lenders, the Bankruptcy Court held that the plans could not be confirmed. *Id*. The Debtors appealed the Bankruptcy Court's order denying the bid procedures. *Id* at 643. After a direct appeal, the Seventh Circuit affirmed, holding that section 1129(b)(2)(A) "does not authorize debtors to use subsection (iii) to confirm a reorganization plan that seeks to sell encumbered assets free and clear of liens without providing secured creditors the right to credit bid." *Id*. at 646.

CRITERIA FOR CONFIRMATION

Section 1129 of the Bankruptcy Code lays out the criteria that a debtor's chapter 11 plan must satisfy in order to be confirmed. Ordinarily, each class of claimants must accept the reorganization plan, but section 1129(b) exempts certain plans from this requirement. Such plans are commonly referred to as cramdown plans. In particular, to be confirmed over the objection of creditors, a plan must be "fair and equitable, with respect to each class of claims or interests that is impaired under, and has not accepted, the plan" according to section 1129(b)(1). Section 1129(b)(2)(A) then describes the three different means by which a plan can be found to be "fair and equitable." Subsection (i) entails lender retention of liens securing the obligations and receipt of the present value of its secured claim. Subsection (ii) confers the sale of collateral free and clear of liens but subject to credit bidding. Lastly, subsection (iii) allows for the realization by the creditor of the "indubitable equivalent" of its secured claim.

PRIOR JURISPRUDENCE

Other circuits have faced similar issues. Importantly for Texas lawyers, in *Pacific Lumber*, the Fifth Circuit held that a reorganization plan proposing the sale of the debtor's encumbered assets for the judicially determined value qualified as "fair and

Continued on page 19.

RECHARACTERIZATION: NOT JUST FOR INSIDERS

By: Courtney Ortegon, Judicial Extern to the Honorable Harlin D. Hal, and currently completing her LL.M. in tax law at SMU's Dedman School of Law (cortegon@smu.edu).

INTRODUCTION

In its recent decision *In re Lothian Oil Inc.*, 650 F3d 539 (5th Cir. 2011), the Fifth Circuit ruled that a bankruptcy court's authority to recharacterize claims as equity rather than debt is not limited to cases involving corporate insiders. This issue of first impression arrived on the Fifth Circuit's docket by way of the U.S. District Court for the Western District of Texas, which applied a more restrictive *per se* rule against the application of recharacterization in all non-insider cases. Instead of relying on the equitable powers found in 11 U.S.C. §105, as several other circuits have done, the Fifth Circuit traced the bankruptcy courts' power to recharacterize claims back to 11 U.S.C. § 502. Under this approach, the Fifth Circuit applied state law to characterize property interests, with insider status as a relevant but not determinative factor in the analysis.

THE "LOAN"

In 2007, Lothian Oil filed for chapter 11 Bankruptcy. In June of 2008, the bankruptcy court confirmed a plan of liquidation and a settlement agreement was reached later that year. Appellant Israel Grossman was awarded $1.025 million in the settlement agreement, but he was also free to seek court determination of the value of his remaining claims against Lothian. Grossman promptly sought such a valuation and in December of 2008, the bankruptcy court rejected all of the remaining claims. The claims at issue in this appeal arose out of two 2005 agreements between Lothian and Grossman, whereby Grossman "loaned" a total of $350,000 to Lothian in exchange for a 1% royalty on certain Lothian oil production and a general promise to repay the borrowed funds. Recognizing substance over form, the bankruptcy court concluded that while the agreement included typical loan language, such as "loan" and "repay," the fact that Grossman would be paid from royalties and "equity placements," coupled with the absence of standard loan terms (*e.g.*, a specified interest rate or term of repayment), created a "common equity interest at best." *Id* at 541.

On appeal, the District Court refrained from applying the multi-factor recharacterization test and instead applied a strict rule prohibiting such considerations in cases not involving insiders. On appeal, the Fifth Circuit overruled the District Court, reinstating the bankruptcy court's decision to recharacterize the debt as equity.

AUTHORITY TO RECHARACTERIZE – THE FIFTH CIRCUIT CHOOSES SECTION 502 OVER SECTION 105

In reaching its decision, the Fifth Circuit relied on section 502 as the basis for bankruptcy courts' authority to recharacterize debt as equity. Under section 502(b), a claim shall be allowed "except to the extent that – (1) such claim is unenforceable against the debtor and property of the debtor, under any agreement or applicable law…" 11 U.S.C. §502(b). Next, the Fifth Circuit looked to the Supreme Court for a definition of "applicable law." In *Butner v. United States* the Supreme Court held that in bankruptcy, as in other areas of the law, "property interests are created and defined by state law." *Butner v. U.S.*, 440 U.S. 48, 55 (1979). Thus, by combining section 502(b) and *Butner*, the Fifth Circuit found adequate support for bankruptcy courts' authority to recharacterize claims according to state law principles. *Lothian* at 542-43.

After establishing this basis to support the use of recharacterization generally, it was a simple logical step for the court to extend the analysis to the question at hand – whether bankruptcy courts may recharacterize non-insider debts. Because, as the Fifth Circuit explains, there is no state law distinction between insiders and non-insiders in determining the proper classification of a property interest, no such distinction should be applied in the bankruptcy context. *Id* at 543-44.

Other circuits considering the same question have instead relied upon section 105(a) as a basis for bankruptcy courts' license to recharacterize debt. Section 105(a) endows bankruptcy judges with the authority to "issue any order, process or judgment that is necessary or appropriate to carry out the provisions of the Code." 11 U.S.C. § 105(a). However, while this may provide a valid legal justification for recharacterization, the Fifth Circuit embraces a general policy of restraint in the use of section 105(a), especially where, as in this case, alternative power-granting options exist. *Lothian* at 543.

Continued on page 20.

TEXAS STATE LAW GUIDES THE FIFTH CIRCUIT IN IMPORTANT HOMESTEAD CASE

Victoria Welch, Judicial Extern to the Honorable Harlin D. Hale and second-year law student at LSU Paul M. Hebert Law Center (vgwelch@gmail.com)

BACKGROUND

Michael McCombs ("McCombs") and his wife Alicia Atkinson McCombs ("Atkinson") purchased a home and adjacent vacant lot in Katy, Texas in 2004. *In Re McCombs*, 659 F.3d 503, 506 (5th Cir. 2011). Two years later, H.D. Smith Wholesale Drug Company ("H.D. Smith") obtained a judgment against McCombs for about $538,000 and then filed the abstract against McCombs's property. *Id*. Soon after, McCombs and Atkinson contracted to sell the property and agreed in writing that Atkinson would be entitled to the proceeds of the sale. *Id*. Later that year, McCombs filed a voluntary chapter 7 bankruptcy petition. *Id*. The house and vacant lot were listed as community property and McCombs claimed the $125,000 homestead exemption to which he was entitled under the 2005 amendments to section 522 of the Bankruptcy Code. *Id*. W. Steve Smith (the "Trustee"), filed an emergency application to sell the house free and clear of any encumbrances and the parties agreed to place the funds in escrow until the bankruptcy court determined their distribution. *Id*. The sale yielded proceeds of $514,000. *Id*. at 507.

H.D. Smith then filed an adversary proceeding against Atkinson and the Trustee. *Id*. The bankruptcy court granted summary judgment in favor of the judgment creditor. Id. After both the trustee and Atkinson appealed, the Fifth Circuit granted a direct appeal. *Id*. Since the grant of summary judgment is a question of law, the Fifth Circuit reviewed *de novo*. *Id*.

FIFTH CIRCUIT

The Fifth Circuit addressed the issue of whether the judgment creditor, H.D. Smith, had an enforceable lien against the proceeds of the sale of McCombs's homestead property in excess of the $125,000 statutorily limited homestead exemption. *Id*. at 506. The Circuit Panel responded in the negative. There were other issues in the case, including the non-filing spouse's homestead, but the panel pushed those issues to another day. Of note, the issues raised by the non-debtor spouse on appeal were not considered because she failed to preserve them by not including them in her statement of issues. *Id*. at 512.

HOMESTEAD EXCEPTION

Texas law provides an acreage limit for homestead protection, not a dollar limit. *Id*. at 507. However, in certain circumstances, the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA) limits the state exemption. *Id*. at 507-08. Section 522 of the Bankruptcy Code imposes a $125,000 cap upon McCombs' homestead exemption because the interest was acquired within 1,215 days of his bankruptcy filing. *Id*. at 508; *see also* 11 U.S.C.A. § 522(p)(1)(D). Therefore, the question presented was whether the abstract of judgment lien attached to the excess above the statutory cap.

TEXAS STATE LAW

In order to characterize the judgment creditor's interest, the Fifth Circuit looked to Texas law. *Id*. Under Texas law, a lien is unenforceable against homestead property. *Id*. However, this is not always the case. In particular, "the property or proceeds from the sale of property may be subject to seizure if the property ever ceases to be the debtor's homestead." *Id*. at 509. But the status of a lien is only relevant at the time of the bankruptcy filing. *Id*. At the time of the bankruptcy filing, the judgment lien did not encumber the homestead. Therefore, according to the appeals court, H.D. Smith did not possess an enforceable lien. *Id*.

IMPACT OF BAPCPA'S CAPS ON SOME HOMESTEADS

The court rejected H.D. Smith's argument "that the homestead cap in § 522(p) acts to convert the lien from its previously unenforceable status to an enforceable status" because the court must look to state law to define property interests. *Id*. In doing so, the court noted that the purpose of section 522(p) is to "limit the amount of a homestead exemption, thereby increasing the size of the bankruptcy estate available to creditors." *Id*. The court thus found no intent to "make an otherwise unenforceable lien on homestead property enforceable *instanter*." *Id*.

Continued on page 21.

IN RE MCCOY: DISCHARGEABILITY OF TAXES WHERE THE RETURN IS FILED LATE

By: Michael Baumer, Law Office of Michael Baumer, (michael@baumerlaw.com)

On January 4, 2012, the Fifth Circuit issued an opinion in *McCoy v. Mississippi State Tax Commission*, 2012 WL 19376 (5th Cir. 2012), in which the court interpreted the hanging paragraph at the end of section 523(a) which was added by BAPCPA. That paragraph provides:

> For purposes of this subsection, the term "return" means a return that satisfies the requirements of applicable nonbankruptcy law (***including applicable filing requirements***). Such term includes a return prepared pursuant to section 6020(a) of the Internal Revenue Code of 1986, or similar State or local law, or a written stipulation to a judgment or a final order entered by a nonbankruptcy tribunal, but does not include a return made pursuant to section 6020(b) of the Internal Revenue Code of 1986, or a similar State or local law. [Emphasis added.]

In *McCoy*, the Fifth Circuit held that "applicable filing requirements" includes the requirement that a return be timely filed. If a "return" is not timely filed, it does not qualify as a "return" under section 523(a). Congress has now defined "return" so that a real, actually filed return is not a "return" if it was filed so much as one day late. (Even if it was actually filed more than two years prior to the bankruptcy filing.)

Although *McCoy* involved state income tax returns, there is no basic difference between the Mississippi tax code and the Internal Revenue Code as far as filing requirements. (The Mississippi tax code also requires that returns be filed by April 15th.)

Literally one week after *McCoy* on January 11, 2012, Judge Lief Clark issued an opinion in *Hernandez, v. U.S. (IRS)*, 2012 WL 78668, Adv. No. 11-5126C (Bankr. W.D. Tex. 2012), which made the same analysis with respect to the Internal Revenue Code. Judge Clark citing extensively to *McCoy* stated that it was "dispositive."

To make sure that the client's tax returns were timely filed, you should order a "tax account transcript" (not a tax transcript) for each year in question as it will show the date of filing of the return and whether an extension was filed. (If the taxpayer filed an extension and then filed the return prior to expiration of the extension, the return was timely filed.)

I think *McCoy* is "correct" only in the sense that it correctly interprets what congress said, not necessarily what it intended. Section 523(a)(1)(B)(ii) says you can discharge taxes if the return was filed at least two (2) years prior to the petition date. That appears to conflict with the hanging paragraph, which says the return must "satisf[y] the requirements of applicable nonbakruptcy law(including applicable filing requirements." ***Except*** (and this is the really big except) it starts with **"the term "return" means..."** Congress defined "return" to exclude a return which was not timely filed.

As far as I can tell, there is no real legislative history on the hanging paragraph at the end of 523(a). In *McCoy*, the Fifth Circuit acknowledges as much as it cites only H.R. Rep. No. 109-31 explaining that BAPCA was "motivated by four factors: the 'recent escalation of consumer bankruptcy filings,' the 'significant losses ... associated with bankruptcy filings,' the fact that the 'bankruptcy system has loopholes and incentives that allow and - sometimes - even encourage opportunistic filings and abuse,' and 'the fact that some bankruptcy debtors are able to repay a significant portion of their debts.'" *McCoy* at *3. I don't see anything in those four factors that even vaguely mentions taxes. If congress really wanted to change prior law, shouldn't they have put the hanging paragraph at the end of section 523(a)(1)(B)(ii) [instead of after the other 17 unrelated sub-paragraphs and sub-sub-paragraphs in 523(a)] or wouldn't they have changed the existing wording of 523(a)(1)(B)(ii)?

If I was inclined to hazard a guess, it would be that the hanging paragraph was intended to address the issue of whether a "return" prepared by the IRS under IRC 6020 was a "return" for the purposes of section 523(a)(1)(B)(ii), as at one time there was a fair amount of litigation on that point. [The hanging paragraph clearly distinguishes between 6020(a) and 6020(b).]

As recently as September, 2010, in a Notice titled "Litigation Position Regarding the Dischargeability in Bankruptcy of Tax Liabilities Reported on Late-Filed Returns and Returns Filed After Assessment," the IRS took the position that "Read as whole, section 523(a) does not provide that every tax for which a return was filed late is nondischargeable." The IRS did take the position that taxes assessed prior to the filing of a return are nondischargeable, but if the taxes had not been assessed, the taxes would be dischargeable.

That notice was dated only 16 months ago. Times, they are a changing.

PIERCING THE CORPORATE VEIL – WHAT IS IT AND DOES IT CHANGE IN BANKRUPTCY?

By: Peter Hall, (lawyer.hall@gmail.com)

I. INTRODUCTION

Piercing a corporate veil is not complicated but is frequently improperly raised as a cause of action rather than as a remedy. To succeed in piercing, a litigant must understand what a chosen piercing theory requires and what other obstacles may arise. Additionally, the unique circumstances of bankruptcy cases may significantly affect who may seek to pierce and who will reap the benefits if successful. A superficial understanding is a fast way to fail at a relatively simple concept. This article takes a close look at the relevant case law on this topic.

Texas offers several ways for individuals to limit personal liability when doing business. The most commonly known is the corporation with stock, directors, and publicly traded shares. Texas also has the Limited Liability Company, the Limited Liability Partnership, and a few more. Legally, all of these business forms are considered completely distinct from their owners and, with the exception of partnerships, their existence continues with or without the people who created them. This legal distinction acts as a shield providing financial and legal protection to the people owning and running the business.

There are, however, chinks in the corporate armor. Businesses are not animate creatures. They cannot do anything for themselves and thus rely on their agents to execute contracts, pay the bills, create profits, *et cetera*. *See generally Nat'l Med. Enter. v. Godbey*, 924 S.W.2d 123, 124 (Tex. 1996). Because of this, courts have used equitable concepts to look past the business form and reach the people behind the company and hold them personally liable for business obligations. This is called piercing the corporate shield or "veil".

This article will explain the various theories of veil piercing, how it is properly raised, and how it changes in bankruptcy. The primary focus will be upon the most common situation known as "alter ego."

II. UNDERSTANDING THE THREE THEORIES OF PIERCING

Although the Texas Business Corporations Act has created some limitations to the concept, Texas law provides three broad theories under which a corporate existence can be disregarded and directors and/or shareholders held personally liable. *Fid. & Deposit Co. of Md. v. Commercial Cas. Consults., Inc.*, 976 F.2d 272, 274 (5th Cir. 1992). All three have similar characteristics and may tend to look like the first theory of *alter ego*. There are, however, important distinctions that require different evidence in order to succeed.

A. *Alter Ego*

The *alter ego* theory provides a basis for disregarding the corporate fiction when there is such unity between a corporation and an individual, or between a subsidiary and its parent corporation, that the separateness of the corporation has ceased to exist and holding only the corporation liable would be unjust. *Leon Ltd. v. Albuquerque Commons P'ship*, 862 S.W.2d 693, 707 (Tex.App.-El Paso 1993, no writ). What, exactly, does that mean? Put simply, if a person treats his business as if it was nothing more than a sole proprietorship, freely using business money and assets for personal benefit, he will be hard pressed to argue he should not be personally responsible for the business's liabilities.

Alter ego is a particular kind of rationale for corporate disregard. The focus is on the legal adequacy of the corporation's existence and the relationship between the corporation and its controlling corporation or individual. "[I]f the shareholders themselves disregard the separation of the corporate enterprise, the law will also disregard it so far as necessary to protect individual and corporate creditors." *Castleberry v. Branscum*, 721 S.W.2d 270, 272 (Tex.1986). Nothing more is required than "the failure of the owners to maintain the corporation as a distinct legal entity. The focus of alter ego proper is on the relation between the corporation and its owners and not on the relation between the corporation and [a] claimant." *In re Guyana Dev. Corp.*, 168 B.R. 892, 908 (Bankr.S.D.Tex. 1994) (*citing Pan E. Expl. Co. v. Hufo Oils*, 855 F.2d 1106 (5th Cir. 1988)).

Continued on page 21.

Member Publications

Omar J. Alaniz, *et. al.*, will be publishing quarterly summaries and analyses of cases interpreting *Stern v. Marshall* with the American Bar Association.

Troop Movement

Rachel L. Smiley joined Gardere Wynn Sewell LLP (Dallas) as an associate.

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Call For Articles and Announcements

The State Bar of Texas Bankruptcy Law Section is dedicated to providing Texas practitioners, judges, and academics with comprehensive, reliable, and practical coverage of the evolving field of bankruptcy law. We are constantly reviewing articles for upcoming publications. We welcome your submissions for potential publication. In addition, please send us any information regarding upcoming bankruptcy-related meetings or events. We also invite any announcements for our "Troop Movement" section.

If you would like an article or event to be considered for publication please send it by email to **tmillion@munsch.com**, **evanhorn@romclawyers.com**, or **rkingrey@gardere.com**.

Please format your submission in Microsoft Word. Citations should conform to the Blue Book and Texas Rules of Form and the Manual on Usage, Style & Editing.

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Calendar of Upcoming Events

February 22 – 24, 2012	**5th Circuit Bench-Bar Bankruptcy Conference** New Orleans Louisiana – more information available at http://www.cailaw.org/cle__Bankruptcy_12.html
February 24 – 26, 2012	**Elliot Cup Moot Court Competition** New Orleans Louisiana
March 10 – 12, 2012	**Duberstein Moot Court Competition** New York
April 13, 2012	**Starting Out Right** Austin, Texas
April 19 – 22, 2012	**ABI Annual Spring Meeting** Gaylord National Resort & Convention Center National Harbor, Md. (D.C.)
May 15 – 18, 2012	**ABI Litigation Skills Symposium** SMU Dedman School of Law
June 14 – 15, 2012	**State Bar Annual Meeting** Houston, Texas
June 14, 2012	**Bankruptcy Section Annual Meeting**
June 21 – 22, 2012	**Southern District of Texas Bench Bar Conference** Moody Gardens, Galveston, Texas

Young Lawyers Committee

The Young Lawyers Committee for the Bankruptcy Section is a group of motivated young attorneys from across the State who have volunteered their time and talent. The purpose of the Committee is to increase the involvement of and integrate young lawyers on a State-wide basis into the Section at all levels, promote participation of young lawyers in seminars and events at all stages, and raise the visibility of our young lawyers by assisting them in professional networking and promoting professional development on a State wide basis. The Committee holds monthly conference calls on the second Wednesday of each month, and has a variety of exciting opportunities in which young bankruptcy professionals can become involved. If you are interested in joining, please contact one of the Committee's new officers below.

The Committee's Leadership Is Comprised Of:

Jermaine Watson of Dallas, Chair (jwatson@coxsmith.com)
Eric Van Horn of Dallas, Vice-Chair (evanhorn@romclawyers.com)
Vanessa Gonzalez of Austin as Secretary (vgonzalez@mhba.com).

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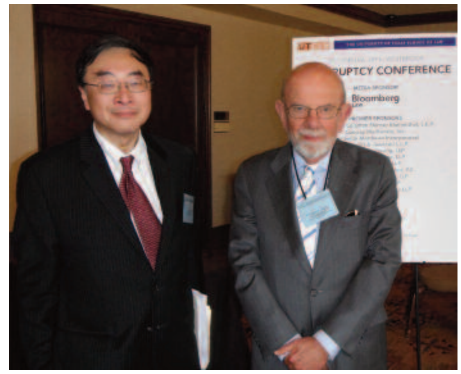
Liaison – Communications – Rachel Kingrey
Liaison – Consumer Division – Lloyd Kraus
Liaison – Membership – Angie Offerman

Review of the 30th Annual Jay L. Westbrook Bankruptcy Conference
Continued from page 2.

Empty Creditors, Empty Voters and Hidden Interests: An Overview of "Decoupling"

Prof. Henry T. Hu (Austin) introduced the concept of "decoupling," which refers to the separation of voting rights from economic interest in a corporation. Prof. Hu stated that decoupling undermines the very core mechanisms of the economy. The long-standing legal and economic theory that voting rights are held in proportion to economic interests is no longer a foundational assumption but instead, a matter of choice. Decoupling leads to empty creditors, empty voters, and hidden interests, which are not fully disclosed to either equity holders or creditors.



Prof. Henery Hu and Prof. Jay Westbrook

Mortgages: New Rules, Continued Problems—Where Are We Now?

Hilary B. Bonial (Dallas) and Dean G. Pawlowic (Lubbock) presented a discussion on the mortgage morass and provided an informative overview of MERS, securitization, and the effect of bankruptcy of the borrower. MERS is a private nation-wide electronic registration system that serves as "mortgagee of record and nominee" for beneficial owners of mortgage loans registered on the MERS system. Some accuse MERS as being in the center of the foreclosure crisis. With MERS, the note and mortgage are split, and MERS holds the mortgage, which is immobilized despite transfer of the note. MERS participants have encountered challenges arising from a peculiar mix of local recording statutes, foreclosure laws, and the UCC. Upon borrower bankruptcy, the mortgage is transferred out of MERS and assigned to a securitization trustee, who may file a proof of claim and seek relief from stay. Assignment to the securitization trustee presents questions of standing in that the trustee must prove that he or she is the real party in interest (Bankruptcy Rule 7017). To establish standing, the trustee must be able to establish chain of title, which can prove difficult within the MERS system.

Emerging Issues in Bankruptcy Litigation: Fraudulent Transfers and Preferences

Michael Sutherland, Vickie Driver, and John Baumgartner

J. Michael Sutherland (Dallas) served as the moderator of a panel comprised of John D. Baumgartner (Houston) and Vickie L. Driver (Dallas) discussing fraudulent transfers and preference litigation. According to the panelists, avoidance actions are a key component of the bankruptcy system. A trustee must analyze transfers that occurred with 90 days of the petition day to determine if such transfer qualifies as a preference payment, a fraudulent transfer, or both. Debtor's intent is key: immaterial when considering preferences, but crucial when looking at fraudulent transfers. After determination of the nature of the action, one must determine whether or not the claim belongs to the bankruptcy estate. The panel discussed the Fifth Circuit's 2010 opinion, *In re Moore*, 608 F.3d 253, which represents a possible departure from the strict rule that a debtor must have owned the claim as of the petition date in order for the claim to belong to the bankruptcy estate.

Mass Preference Actions: Pros, Cons and Strategies

Henry J. Kairn (Houston) moderated a lively panel discussion between Patricia Baron Tomasco (Austin) and Francis L. Carter (Miami) regarding mass preference actions from the perspective of the trustee versus that of the creditors. In mass preference actions, the court often enters procedural orders and requires creditors to participate in court-ordered mediation. Mass preference actions are designed to encourage creditors to settle without tremendous expense to the estate. Mrs. Tomasco raised concerns about the fairness to creditors against whom the preference action lacks merit. Creditors often have to incur the expense of mediation in order to even have a chance to speak to the trustee regarding the basic foundation of the claim.

Francis Carter, Patricia Tomasco, and Henry Kaim

Continued on page 15.

Review of the 30th Annual Jay L. Westbrook Bankruptcy Conference
Continued from page 14.

Privilege Issues and Bankruptcy Litigation

Scarlett E. Collings (Houston) provided insight on evidentiary privileges from a non-bankruptcy lawyer's perspective, while George A. Quesada, Jr. (Dallas) commented on how privilege or work product issues are treated differently in bankruptcy. Complications arise in distinguishing to whom the privilege extends – trustee, debtor in possession, joint clients, creditors' committees, buyers and sellers, examiners, litigation trusts, accountants, and restructuring consultants. The panelists advise seeking guarantees of confidentiality in unequivocal writing, from parties, from other counsel, and from the court if possible.

Scarlett Collings and George Quesada

Thursday afternoon's sessions were divided into consumer and business tracks. Hon. John C. Akard (Lubbock) served as presiding officer of the consumer portion, and William A. Trey Wood, III (Houston) presided over the business sessions.

BUSINESS TRACK

Intercreditor Agreements; The Basics and Beyond

Omar Alaniz (Dallas) explained that intercreditor agreements are used to establish respective rights and remedies of two or more creditors of a common borrower and are not standardized, the scope depending largely on the credit structure and negotiating leverage. Intercreditor agreements may include lien subordination, payment subordination, or hybrids of the two. Alaniz discussed how issues such as liquidity needs, protection of collateral, exercise of lien remedies, sale of collateral, and plan reorganization interact with intercreditor agreements. Finally, he provided a useful reference to cases important to consider when a bankruptcy involves intercreditor agreements.

The Impact of United Operating: Preserving Causes of Action in the Fifth Circuit and Other Circuits

Darren B. Watts (Chicago)and Mark W. Wege (Houston) provided an update on the application of *United Operating's* standard for the retention of causes of action under 11 U.S.C. § 1123(b)(3). Three years ago, the Fifth Circuit adopted a "specific and unequivocal" standard for the post-confirmation retention of causes of action. However, subsequent decisions applying *United Operating's* "specific and unequivocal" standard have proven it is more unpredictable and complicated than the words imply. Watts and Wege stressed how important it is to know your judge, know the standards, and realize the potential wide variety of standards that may impact your situation.

Darren Watts and Mark Wege

Issues and Challenges in Real Estate Cramdown Confirmation Cases

Davor Rukavina (Dallas) and Joseph J. Wielebinski (Dallas) discussed cramdown confirmation cases and issues and challenges of cramdown in real estate bankruptcies. The issues may include good faith, classification, unfair discrimination, artificial impairment, valuation, pendency claims, cramdown interest rates, new value exceptions, and prepetition loan documents. The current lending climate adds extraordinary difficulties in making cramdowns plans "fair and equitable."

Continued on page 16.

Review of the 30th Annual Jay L. Westbrook Bankruptcy Conference
Continued from page 15.

Buyer's Remorse: Successor Liability After the Sale

Stephen Pezanosky and Bruce White

Stephen M. Pezanosky's (Fort Worth) and Bruce H. White's (Dallas) presentation focused on issues a purchaser of a debtor's assets, both inside and outside of bankruptcy, may encounter particularly, exposure to "successor liability." Generally, a buyer may purchase the assets free and clear of all liabilities other than valid security interests. However, there are four recognized exceptions to this general rule. Pezanosky and White examined these exceptions, as well as Texas courts' disfavor of successor liability. Finally, they discussed 363 sales as a tool for free and clear purchases in bankruptcy cases.

CONSUMER TRACK

Schwabbing Exemptions: The Other Supreme Court Opinion – Hon. Robert L. Jones, U.S. Bankruptcy Court, Northern District of Texas, Lubbock, TX

The Honorable Robert L. Jones provided an interesting discussion of the cases that led to the Supreme Court decision of *Schwab v. Reilly*, as well as the decision itself. Judge Jones discussed the Court's analysis of the code provisions in the Schwab opinion as compared to earlier Supreme Court opinions, as well as the Court's reasoning in the different cases. Judge Jones also discussed his opinion in the *In re Salazar* case, and how *Schwab v. Reilly* may affect both federal and state exemption claims going forward.

Exceptions to 727's and 523's – Michael V. Baumer, Daniel J. "Corky" Sherman

Michael Baumer and Daniel "Corky" Sherman discussed various factors to be considered when trying section 727 and section 523 actions, including considering the judge's previous decisions in similar cases, the costs to the client to prosecute and defend the actions, as well as the potential benefit to creditors. The specific provisions of sections 523 and 727 were addressed in detail, and practical tips were given to help attorneys avoid common pitfalls and proceed successfully in these cases.

Chapter 7 Dismissals for Totality of Circumstances Abuse – Hon. H. Christopher Mott, U.S. Bankruptcy Court, Western District of Texas, Austin, TX

The Honorable H. Christopher Mott discussed different factors that may be considered by the court when reviewing a bankruptcy case for dismissal due to totality of the circumstances, such as what a debtor may be able to pay in a hypothetical chapter 13 case, the reasonableness of expenses, as well as a number of other factors. Judge Mott provided a helpful discussion of various cases in Texas where there was a finding of abuse, as well as the code provisions that may be applicable in consumer versus business bankruptcy cases.

Disaster Preparedness: Business Continuity for Law Offices – Zollie C. Steakley

Attorney Zollie C. Steakley of Sweetwater, Texas provided a compelling discussion, from personal experience, as to what attorneys should consider when preparing for, or responding to, a disaster, such as a fire or weather event. Mr. Steakley provided practical tips for how to respond to a disaster, including addressing immediate needs of the office, how to address client needs in the midst of reconstruction, how to work with insurance companies and contractors, and the importance of keeping in mind the disciplinary rules for attorneys while continuing their practice in the midst of chaos. Mr. Steakley encouraged all attendees to remember during the rebuilding phase that "this too shall pass."

Continued on page 17.

Review of the 30th Annual Jay L. Westbrook Bankruptcy Conference
Continued from page 16.

FRIDAY PRESENTATIONS

Barry D. Spears (Houston) and Patricia Baron Tomasco (Austin) presided over Friday's sessions.

Bankruptcy Jurisdiction After Stern v. Marshall

Friday morning began with a much-anticipated session dedicated to *Stern v. Marshall*, which was moderated by Prof. Westbrook. Panelists Ralph Brubaker (Champaign, IL), Kenneth N. Lee (Los Angeles), and Gerald K. Smith (Phoenix) provided their respective opinions about *Stern's* effect on the future of bankruptcy jurisdiction. Prof. Westbrook described *Stern v. Marshall* as the case of the year, if not the decade. The U.S. Supreme Court sent shivers through the bankruptcy world when it held that bankruptcy judges cannot enter a final judgment in a lawsuit filed by a trustee or debtor in possession against a third party who has not filed a claim in the bankruptcy case. The panelists noted that two out of three judges pretend Stern never happened, and the others look to the narrow holding. Smith noted that *Stern* is not about jurisdiction, but rather it is about power, and he urged that the time has come to give bankruptcy judges Article III status.

Alphabet Soup of Receivership and Similar Proceedings

James J. Lee (Dallas), Sylvia A. Mayer (Houston), and Joseph T. Verdesca, Jr. (New York) detailed five non-bankruptcy solutions for companies in distress, including state insurance proceedings, FDIC receiverships, Securities Investor Protection Act of 1970 proceedings, Orderly Liquidation Authority receivership proceedings, and Dodd-Frank section 165(d) resolution planning or living wills process. Each of these alternatives are effectively non-bankruptcy bankruptcies as they contemplate the liquidation or reorganization of a distressed company subject to statutory or regulatory schemes.

Municipalities in Distress

Bill Brandt (Chicago) and Patrick Darby (Birmingham) provided insight on the potential wave of municipal bankruptcies that commentators have predicted since 2008. They stated that fulfillment of those predictions depends, in part, on the distinctions between chapter 9 and chapter 11. Chapter 9 borrows many concepts from chapter 11, but the uniqueness of municipal debt presents a distinct set of issues to consider.

Does the Stay Protect Foreign Assets of U.S. Debtor

Professor Harry Rajak (London) visited the conference from the United Kingdom to discuss the effect of the automatic stay on foreign assets of a U.S. debtor. With the charm of his English accent, Rajak explained the difference in the attitude and practice of bankruptcy in the U.S. and across the pond. Prof. Rajak provided his perspective of the U.K.'s "universalism" approach, which until recently had little application to U.S. bankruptcy cases.

How to Try a Case before a Judge

During the lunch hour, Hon. W. Royal Furgeson Jr. advised conference attendees on the practical nuances of trying a case before a judge. Hon. Furgeson listed eight rules of trial etiquette, including do not wear a toupee and do not chew gum, as well as twelve rules of trial presentation. He concluded with this advice: "Thoughtful persuasion is still the name of the game."

Mediation: When Does it Work

Michael A. McConnell (Fort Worth) and Thomas A. Collins (Austin) gave their respective opinions as to the effectiveness of mediation not only in bankruptcy cases, but the adversarial system as a whole. McConnell and Collins provided 10 tips for mediation. Most importantly, McConnell and Collins agreed that mediation works best when all parties are willing participants who have a true desire to resolve the case.

Judges Panel

The conference concluded with the judges panel of Hon. Marvin Isgur (Houston), Hon. D. Michael Lynn (Fort Worth), Hon. H. Christopher Mott (Austin), moderated by Hon. Brenda T. Rhoades (Plano). The judges fielded questions submitted by conference attendees. As expected, there were a number of questions regarding the judges' interpretation and application of *Stern v. Marshall*.

Review of rhe 29th Annual Advanced Business Bankruptcy Course in Houston Texas
Continued from page 4.

The Honorable Richard Schmidt of the United States Bankruptcy Court for the Southern District of Texas (Corpus Christi), **Sander L. Esserman** (Dallas) and **Martin A. Sosland** (Dallas) discussed recent case law developments related to channeling orders, asbestos, environmental, and mass tort issues. In particular, the panel discussed implementing alternative dispute resolution procedures and retaining other professionals well-trained in real estate and environmental law.

Henry J. Kaim (Houston) and **Robin E. Phelan** (Dallas) discussed structured dismissals, gifting and third-party releases. The panelists discussed problems that can arise in situations where a plan includes third-party releases in chapter 11 cases. The presentation compared approaches taken by the 5th Circuit, Texas bankruptcy courts, and courts in other circuits.

Paul H. Asofsky (Houston) and **William H. Caudill** (Houston) explained various bankruptcy related tax consequences associated with the purchase or sale of distressed companies. In particular, the presenters explained how debt modification can trigger significant tax consequences for distressed companies and their creditors. There are common tax efficient strategies for maintaining net operating losses, carryovers, and excess credit carryovers to benefit companies post-restructuring.

David P. Goch (Washington, D.C.) discussed sixteen bankruptcy bills recently introduced in the House and the Senate during the 112th Congress. Given the status of the current economic climate, many of the bills introduced address consumer bankruptcy related issues such as foreclosure fraud, mortgage modifications, and student loans. With respect to commercial bankruptcies, H.R. 2533 was introduced to limit the venue considerations of chapter 11 debtors.

Louis M. Phillips (Baton Rouge, LA) gave a thoughtful analysis of significant bankruptcy cases decided in 2011. Louis gave considerable attention to the recent *Stern v. Marshall* decision decided by the Supreme Court and the limitations it places on bankruptcy judges. He also discussed recent 5th Circuit decisions and reviewed key decisions in other circuits.

The Honorable Stacy G. C. Jernigan of the United States Bankruptcy Court for the Northern District of Texas (Dallas), **Gregory M. Gordon** (Dallas), and **Diane G. Livingstone** (Houston) discussed the hiring and appointment of independent fiduciaries in chapter 11 cases. Increasingly, independent third parties are necessary to bridge the gap between stakeholders, reduce litigation, and permit companies to successfully reorganize.

Thomas Watkins (Austin) and **Demetra L. Liggins** (Houston) discussed common conflicts issues in large commercial bankruptcy cases. Specifically, the panelists addressed concurrent representations, disclosure requirements, and offered suggestions, such as advance waivers, to minimize such conflicts.

Hank Holmes (Houston), **Thomas A. Howley** (Houston), and **Michael Scott** (Dallas) gave a thoughtful discussion of the dearth of commercial chapter 11 filings by analyzing the current Texas economy and the future implications for more workout and commercial insolvencies.

The Honorable Judge Marvin Isgur of the United States Bankruptcy Court for the Southern District of Texas (Houston) and **Clifton R. Jessup, Jr.** (Dallas) gave an enlightened and timely overview of the chapter 9 bankruptcy process. The presentation highlighted differences between chapter 11 and chapter 9 proceedings and touched on the politics associated with filing a proceeding under chapter 9.

William A. Wood, III (Houston) and **John P. Melko** (Houston) gave a thorough analysis of the factors (debtor eligibility, venue, and jurisdiction) commercial debtors consider when selecting a forum for a new chapter 11 proceeding. The panelists also analyzed common venue challenges raised by creditors and other parties-in-interest.

Rhett G. Campbell (Houston) and **John F. Higgins** (Houston) discussed energy issues common in oil and gas bankruptcies with an emphasis on issues related to bankruptcy sales under confirmed plans.

Continued on page 19.

Review of rhe 29th Annual Advanced Business Bankruptcy Course in Houston Texas
Continued from page 18.

Roger S. Cox (Amarillo), **Berry D. Spears** (Austin), and **Deborah D. Williamson** (San Antonio) discussed "cram ups" described as chapter 11 plans confirmed over the objection of a secured lender, which in some instances relies upon the reinstatement of senior debt. The panelists carefully analyzed the *In re Charter Communications* case and the use of reinstatement to cure non-monetary defaults under a plan.

David G. Epstein (Richmond, VA), Allen Professor of Law at the University of Richmond School of Law, analyzed the recent trend towards incorporating state law concepts to interpret and apply the bankruptcy code.

The Honorable Craig A. Gargotta of the United States Bankruptcy Court for the Western District of Texas (Austin), **Frank R. Monroe** (Austin), and **Eric Behrens** (Austin) gave a thorough analysis of the *Stern v. Marshall* case and its impact on bankruptcy court jurisdiction.

Loretta Cross of Grant Thornton LLP (Houston) and **Dan B. Lain** of Lain Faulkner & Co. (Dallas) discussed the tendency of borrowers during financial distress to fabricate financial statements and due diligence tools used by financial professionals to identify fraud.

Charles A. Beckham (Houston) and **Jack L. Kinzie** (Dallas) discussed valuation of causes of action for the purpose of selling them to third parties as assets of the bankruptcy estate.

Jeffrey Toobin, Senior Legal Analyst at CNN, (New York) gave a thoughtful analysis of the current Supreme Court and insight into the lives of the sitting justices.

Eric J. Taube (Austin), **Harrel L. Davis** (El Paso), and **Frank R. Monroe** (Austin) analyzed the types of valuation professionals commonly used in commercial bankruptcy cases, and the types of bankruptcy applications, such as cram downs, where valuation is determinative.

Finally, **Judith W. Ross** (Dallas) and **William F. Stutts** (Dallas) discussed the history and subsequent enactment of Chapter 15 and analyzed its impact on cross-border bankruptcy proceedings.

Timing is Everything: Consequesnces of a Post-petition Farm Sale
Continued from page 6.

CONFLICT

The Ninth Circuit's opinion creates a conflict in the circuits. *Id*. at 1165. In *Knudsen v. IRS*, 581 F.3d 696, 710 (8th Cir. 2009), the Eighth Circuit held for the chapter 12 debtors in a proposed reorganization plan treating the income taxes arising from certain post-petition sales as unsecured claims under section 1222(a)(2)(A) and therefore filed the taxes to be dischargeable. In its view, the taxes qualified as section 506(a)(2) administrative expenses because they were a "tax … incurred by the estate" under section 503(b), which is merely a "tax … incurred post-petition." *Id*. at 708. In contrast to the court in *Hall*, the *Knudsen* court expressly refused to give credit to sections 1398 and 1399 of the IRC and instead relied on the fact that the Bankruptcy Code did not indicate that a chapter 12 estate could not incur taxes. *Id*. at 708-10.

CONCLUSION

The case will likely not affect chapter 11 cases because a chapter 11 estate is a taxable entity. *Hall*, 617 F.3d at 1163. However, because of the large number of farmers and ranches in Texas the case should be of interest to Texas practitioners. Finally, the Supreme Court's decision could have broader implications than just resolving the question of the application of section 1222(a)(2)(A) to post-petition tax claims. It could also affect the treatment of post-petition tax claims under chapter 13, which treats taxes similarly.

As You Make Your Credit Bid, Must You Lie Upon It?
Continued from page 7.

equitable" under section 1129(b)(2)(A)(iii). *In re Pacific Lumber, Co.*, 584 F.3d 229, 249 (5th Cir 2009). Subsequently, in *Philadelphia Newspaper*, the Third Circuit held that a reorganization proposing the sale of the debtor's encumbered assets free and clear of liens in an auction could qualify as "fair and equitable" under section 1129(b)(2)(A)(iii) even though credit bidding would not be allowed. *In re Philadelphia Newspaper*, 599 F.3d 298, 318 (3d Cir. 2010). Interestingly, Judge Ambro dissented in Philadelphia Newspaper, reasoning that secured creditors whose claims would be crammed down should have a right to bid their credit. *Id*.

Continued on page 20.

As You Make Your Credit Bid, Must You Lie Upon It?
Continued from page 19.

THE INSTANT CASE: SEVENTH CIRCUIT WEIGHS IN

Applying strict statutory construction, the Seventh Circuit found for the creditors because subsections (i) and (ii) would be rendered superfluous otherwise. *Amalgmated Bank* 651 F.3d at 653. The panel held that subsection (iii)'s requirement that secured creditors are entitled to the "indubitable equivalent" of their claims means they must be able to credit bid. *Id*. By fully embracing Judge Ambro's dissent, the Seventh Circuit held that a reorganization plan could not abrogate a secured creditor's right to credit bid in a free and clear sale of assets under the plan. *Id*. The Court noted that "the Code has an expressed interest in insuring that secured creditors are properly compensated." *Id*.

ON TO THE SUPREME COURT

The question presented in the instant case is central to any chapter 11 case involving a sale. What approach will the Supreme Court take in resolving the circuit split on credit bidding? If the Supreme Court sides with RadLAX, then lenders will most likely move to protect themselves with credit bids eliminating the reason for going forward with the sale in the first place. In any event, the issue resulted in a split among the circuit courts. Hopefully, the Supreme Court will provide practitioners clear guidance on conditioning such sales in the future.

Recharacterization: Not Just For Insiders
Continued from page 8.

APPLYING THE "APPLICABLE LAW"

To complete the recharacterization analysis, bankruptcy courts must apply the applicable state law. Texas courts have adopted one of several multi-factor tests from federal tax law for this purpose. *Id* at 544. While the Fifth Circuit cited a Texas case applying a sixteen-factor test from *Fin Hay Realty Co. v. United States*, the court also mentioned several other multi-factor tests which have been utilized in similar circumstances. Regardless of the particular test chosen, the inquiry does not produce mathematical certitude and instead depends on the overall "feel" of the property interest. *See Lothian* at 544 ("In applying these tests, we 'consider all the factors and weigh the evidence favoring characterization of the [interest] as debt or equity, while realizing that the various factors are not of equal significance and that no one factor is controlling.' *Estate of Mixon v. U.S.,* 464 F.2d 394, 402 (5th Cir. 1972)."). In *Lothian*, the bankruptcy court found that the loan felt more like equity and therefore recharacterized it as such.

RECHARACTERIZATION, EQUITABLE SUBORDINATION AND DISALLOWANCE, OH MY!

Interspersed within its holding, the Fifth Circuit included a brief discussion of the distinction between recharacterization, equitable subordination and straight disallowance of a claim. While the three generally produce a similar effect for the creditor, each has a different use and purpose. In a recharacterization analysis, if an advance of capital is found by the court to be equity rather than debt, then it will be recharacterized as such and thus subordinated in the liquidation process. Equitable subordination, on the other hand, may be employed where a valid creditor has engaged in inequitable conduct. In this case, the remedy is to subordinate the creditor's debt to the extent necessary to offset the associated damage to the debtor. *See In re AutoStyle Plastics, Inc.*, 269 F.3d 726, 748-49 (6th Cir. 2001). Finally, when a claim is disallowed, it is completely discharged. This remedy produces an improper outcome where recharacterization is appropriate because where a debt is actually equity, the claimant still maintains some rights against the bankrupt. *Lothian* at 543-44.

CONCLUSION

The *Lothian* opinion offers an elegant approach to a question that has split the circuits. Instead of resorting to a catch-all equitable approach as is offered in section 105(a), the Fifth Circuit found a more targeted source of recharacterization authority that easily dispenses of the distinction between classes of creditor.

Texas State Law Guides the Fifth Circuit in Important Homestead Case
Continued from page 9.

The limits placed on homestead exemptions by 2005 amendments to the Bankruptcy Code continue to create litigation, particularly in cases where one spouse does not file. For example, pending before the Fifth Circuit at the time of this summary is a case with similar issues. *Kim v. Kim*, 405 B.R. 179 (Bankr. N.D. Tex. 2009). In that case the question is "whether the changes brought about by [BAPCPA] of 2005 affect a Debtor's spouse's homestead exemption claim." *Id*. at 182.

The instant case begins to shed light on the approach that courts of all levels should take—start with state law amounts and then apply the Bankruptcy Code.

Piercing the Corporate Veil – What Is It and Does It Change in Bankruptcy?
Continued from page 11.

When a plaintiff seeks to reach a corporate shareholder or director there is no fixed list of improper actions that will justify a finding of *alter ego*. Instead, the court will look to the complete set of circumstances and see if it is reasonable to believe the corporate form is simply being ignored by the shareholder in question. Some examples of actions that have lead courts to find *alter ego* are: 1) using corporate assets such as trucks or equipment by parent or subsidiary corporation, *Castleberry v. Branscum*, 721 S.W.2d at 272; 2) using a corporate bank account for both business and personal money, *Rose v. Intercont'l Bank, N.A.*, 705 S.W.2d 752 (Tex.App.-Hous. [1 Dist.] 1986, writ refused n.r.e)(Corporate officer/shareholder was liable, on *alter-ego* theory, for overdrafts on corporate accounts; officer/shareholder knew payments on his personal property had been made from corporate account, and, absent his personal use of account, corporation could have successfully wound up its business); and 3) paying personal bills or taking cash for personal use from the business account. *Id*. Commingled business and personal finances are generally a strong indication that the corporate form is being ignored.

Although piercing is traditionally sought in order to hold individuals personally liable for corporate obligations, Texas does recognize the concept of reverse piercing where a *corporation's* assets may be reached to satisfy the *personal* obligations of a shareholder or director. *E.g. Permian Petro. Co. v. Petroleos Mexicanos*, 934 F.2d 635, 643 (5th Cir. 1991). The concept is the same but applied in reverse, using corporate assets to satisfy the debts or obligations of an individual officer or shareholder. Reverse piercing is most commonly used in closely held corporation cases where the *alter ego* theory is raised and adequately proven after proving the underlying substantive cause of action. *In re Schimmelpenninck*, 183 F.3d 347 (5th Cir. 1999).

Reverse piercing has even been employed in divorce actions. The Court of Appeals in San Antonio explained that "[p]iercing the corporate veil in a divorce case allows the divorce court to characterize as community property corporate assets that would otherwise be the separate property of one spouse. . . . Unlike traditional piercing in which the stockholder is held liable for debts of the corporation, piercing in the divorce context allows the trial court to move assets out of the corporation and divide them between spouses as part of the shareholder's community estate. The concepts of alter ego and piercing are applied in divorce cases to achieve an equitable result, that is, a just and right settlement of the marital estate." *Lifshutz v. Lifshutz*, 61 S.W.3d 511, 516 (Tex.App.-San Antonio 2001, no writ)(internal citations omitted).

Piercing is not limited to reaching shareholders or directors. It may be applicable as between a business and a subsidiary. In a subsidiary situation, Texas courts have determined that there is one factor in particular, undercapitalization of the entity sued, that is required in order to pierce. The Court of Appeals in Houston explained "in a tort case where the issue of alter ego is to be determined the test is whether 'the corporation responsible for the plaintiff's injury is capable of paying a judgment upon proof of liability.' If the corporation sued is not reasonably capitalized in light of the nature and risk of its business, the need might arise to attempt to pierce the corporate veil and hold the parent corporation liable." *O'Berry v. McDermott, Inc.*, 712 S.W.2d 206, 207 (Tex.App.-Hous. [14 Dist.], 1986, writ refused n.r.e.) (*citing Lucas v. Texas Indus.*, 696 S.W.2d 372 (Tex.1985)).

B. *Illegal Purpose*

The illegal purpose doctrine examines whether the corporate form is being used to avoid legal limitations upon a natural person or corporation. *Pan E. Exp'l. Co. v. Hufo Oils*, 855 F.2d 1106 (5th Cir. 1988). This theory is different from alter ego in that it can be used even when all corporate legal formalities have been kept. "There are few cases that illustrate this theory of corporate disregard in any pure form; in practice, the illegal purpose rationale is usually an alternative basis in an alter ego or sham to perpetrate fraud case." *Gibraltar Sav. v. LDBrinkman Corp.*, 860 F.2d 1275, 1288 (5th Cir. 1988).

Continued on page 22.

Piercing the Corporate Veil – What Is It and Does It Change in Bankruptcy?
Continued from page 21.

Some examples of this situation could be described as where the corporate fiction is used to circumvent a statute, where the corporate fiction is employed to achieve or perpetrate monopoly, or indirectly and possibly overlapping the other theories, where the corporate fiction is relied upon as a protection of crime or to justify a wrong or where the corporate fiction is resorted to as a means of evading an existing legal obligation. *Castleberry v. Branscum,* 721 S.W.2d at 272.

C. *Sham to Perpetuate a Fraud*

The third category is use of a corporate form as a "sham to perpetuate a fraud." Here, the corporate form is used to evade an existing legal obligation or perpetuate a fraudulent scheme. *Gibraltar Sav. v. LDBrinkman Corp.*, 860 F.2d at 1288. For example, it may apply when an individual owes debts and, with intent to avoid liability for those debts, creates a new corporation and seeks to interpose the new corporation between the original debtor and the preexisting creditor. *See In re Blanton*, 105 B.R. 811 (Bankr.W.D.Tex. 1989).

Only a few cases in Texas have discussed this last concept; the most well known is *Castleberry v. Branscum*, 721 S.W.2d 270 (Tex. 1986). In *Castleberry*, two of three business partners bought the holdings of the third partner with a corporate promissory note. Through business manipulations and forming new entities, the remaining two partners ensured the corporate note had no chance of being paid. The court disregarded the corporate form and held the two partners individually liable for the full amount of the note.

The Texas Supreme Court discussed the relationship of fraud to an *alter ego* claim in *Castleberry*. "The basis used here to disregard the corporate fiction, a sham to perpetrate a fraud, is separate from alter ego. It is sometimes confused with intentional fraud; however, neither fraud nor an intent to defraud need be shown as a prerequisite to disregarding the corporate entity; it is sufficient if recognizing the separate corporate existence would bring about an inequitable result." *Castleberry v. Branscum*, 721 S.W.2d at 272 (*citing Fletcher*, Cyclopedia Corporations § 41.30 at 30 (Supp.1985)). The court elaborated, "[t]o prove there has been a sham to perpetrate a fraud, tort claimants and contract creditors must show only constructive fraud. . . . Actual fraud usually involves dishonesty of purpose or intent to deceive, whereas constructive fraud is the breach of some legal or equitable duty which, irrespective of moral guilt, the law declares fraudulent because of its tendency to deceive others, to violate confidence, or to injure public interests." *Id*. Here, the court determined that siphoning off corporate revenues, selling assets, and other acts that hindered the on-going business and its ability to pay debts, then starting a new business that was basically a continuation of the old with the same shareholders, officers, and directors amounted to constructive fraud sufficient to pierce the corporate veil.

Castleberry was partially superseded by the Texas Business Corporation Act art. 2.21 in 1993. One significant change was the elimination of constructive fraud for contract claims, but not for tort claims. Now, the statute requires actual fraud. Tex.Bus.Corp.Act Ann. art. 2.21 (1993).

III. PIERCING IN BANKRUPTCY

The impact of a bankruptcy case on a state court action seeking to pierce the corporate veil is somewhat complicated. State court actions typically become subject to the automatic stay of the bankruptcy code upon the filing of a petition for bankruptcy relief. 11 U.S.C. § 362. The case may also be removed to the bankruptcy court and become a part of the bankruptcy estate. 11 U.S.C. §§ 1334, 1452. Once bankruptcy has been filed by a state-court defendant everything changes and the case may or may not remain in the hands of the original plaintiff.

The bankruptcy estate consists of all of the debtor's legal or equitable property interests as of the commencement of the case. 11 U.S.C. § 541. Under bankruptcy law, anyone in possession, custody, or control of property of the debtor's estate must turn it over to the trustee. 11 U.S.C. § 541(a)(1).

Adversary proceedings in bankruptcy cases frequently allege *alter ego* theories against defendant debtors. If the theory is proven, the assets of the alter ego may be treated as those of the debtor regardless of whether the debtor is a business or the individual behind the business. "It is well established that property of the Debtor in the possession, custody and control of its *alter ego* comprises property of the estate at the commencement of the case, and that bankruptcy courts have the power to disregard separate corporate entities so as to reach the assets of its non-debtor alter ego to satisfy debts of the Debtor. It is also a settled

Continued on page 23.

Piercing the Corporate Veil – What Is It and Does It Change in Bankruptcy?
Continued from page 22.

principle of law that when one legal entity is but an instrumentality or alter ego of another . . . a court may look beyond form to substance and may disregard the theory of distinct legal entities in determining ownership of assets in a bankruptcy proceeding." *In re Sklarin*, 69 B.R. 949 (Bankr.S.D.Fla. 1987)(internal citations omitted).

In corporate bankruptcy situations, ownership of a cause of action against the debtor is an important determination. The answer depends upon whether the debtor could have raised the claim at the commencement of the case under applicable state law. "If a cause of action alleges only indirect harm to a creditor (i.e., an injury which derives from harm to the debtor), and the debtor could have raised a claim for its direct injury under the applicable law, then the cause of action belongs to the estate. . . . Conversely, if the cause of action does not explicitly or implicitly allege harm to the debtor, then the cause of action could not have been asserted by the debtor as of the commencement of the case, and thus is not property of the estate." *Matter of Educators Group Health Trust*, 25 F.3d 1281 (5th Cir. 1994). For estate actions, only the trustee has authority to seek veil piercing. *See In re Porras*, 312 B.R. 81 (Bankr.W.D.Tex. 2004); *In re Amberjack Interests, Inc.*, 326 B.R. 379 (Bankr.S.D.Tex. 2005). This seems somewhat counter-intuitive. The suggestion is the estate might sue itself and this is essentially correct. The estate stands to gain additional assets from, or have existing liabilities shifted to, the debtor's *alter ego* identity. The possibility of piercing and reaching shielded assets *increases* the estate assets and allows for a better return to creditors. The Fifth Circuit Court of Appeals, construing Texas law, held that an *alter ego* theory, under circumstances described above, was property of the estate to be asserted by the debtor corporation. The Court explained, "[s]ince the corporation has an independent existence at law, we do not believe it is inconsistent . . . to say that *a corporation may pierce its own corporate veil* and hold accountable those who have misused the corporation in order to meet its corporate obligations." *Matter of S.I. Acquisition, Inc.*, 817 F.2d 1142, 1152 (5th Cir. 1987) (emphasis added). In *Matter of S.I. Acquisition*, creditors of a corporate debtor sought to pierce the corporate veil and reach the principals in satisfaction of a contractual debt. However, because the corporation was the entity that was misused by its principals and sustained a loss of assets, the Court determined the cause of action properly belonged to the corporate debtor's bankruptcy estate.

After the trustee pierces the veil, another question arises. To which creditor does the benefit inure? Because a successful piercing action will add additional assets to the estate, all creditors, not just the one particularly aggrieved, will potentially see an increase in their return. *See In re Schimmelpenninck*, 183 F.3d 347 (5th Cir. 1999). This was also discussed in *Matter of S.I. Acquisition, Inc.*. There the court explained, "[t]he remedy of alter ego under Texas law appears to be available to *all creditors* of the corporation so long as the requisite melding of the corporation and its control entity are established. The doctrine of alter ego does not rest upon a particular creditor's dealings with or reliance on the control entity, nor does the doctrine require a showing of fraud on a particular creditor." *Matter of S.I. Acquisition, Inc.*, 817 F.2d at 1152 (emphasis added). The holding in that case was that the piercing action belonged to the estate and the automatic stay provision prevented the debtor's creditors from bringing a state court action against the debtor and its non-bankruptcy co-defendant based on the alter ego doctrine because the action was not personal to any one creditor. The court explained the impact of the action on bankruptcy creditors.

> [The plaintiff creditor's] action is not one that is personal to it. Its action is based upon allegations that if proven would benefit all of S.I.A.'s creditors, i.e., making more assets available to satisfy S.I.A. debts. But Eastway is proceeding alone, only for its benefit, and without giving notice to other creditors of S.I.A. Thus it seems clear that to allow Eastway's actions to proceed would undercut the general bankruptcy policy of ensuring that all similarly-situated creditors are treated fairly. If Eastway's action is not stayed it would collect its claim from a pool of assets that should be available to all creditors.

Id. at 1153-4.

The court even discussed the concept mentioned previously that the debtor corporation was effectively suing itself. Acknowledging the lack of authority on the concept, the court offered this explanation:

> Of most importance to our decision, however, is whether a corporation could assert an action against itself based upon alter ego. Not surprisingly, we have found no Texas law suggesting that a corporation could or could not itself bring an alter ego claim. Even so, we note that the predominate policy of Texas alter ego law is that the control entity that has misused the corporation form will be held accountable for the corporation's obligations. . . . Since the corporation has an independent existence at law, we do not believe

Continued on page 24.

Piercing the Corporate Veil – What Is It and Does It Change in Bankruptcy?
Continued from page 23.

> it is inconsistent in light of the above policy to say that a corporation may pierce its own corporate veil and hold accountable those who have misused the corporation in order to meet its corporate obligations.

Id. at 1152.

If a debtor corporation is the primary victim of alter ego actions, a piercing theory will belong to the estate, be assertable only by the trustee, and, if successful, recover assets to the benefit of all creditors.

IV. RAISING THE PIERCING ISSUE

The first thing to understand is that piercing is a remedial action and *not* a substantive cause of action. In a 2005 opinion, the Court of Appeals in Dallas, discussed piercing and gave a good explanation of its limitations and purpose.

> The doctrines that support piercing the corporate veil do not create substantive causes of action. The claim is purely remedial. Piercing the corporate veil merely expands the scope of potential sources of relief by extending to individual shareholders or other business entities what is otherwise only a corporate liability. The single business enterprise and alter ego exceptions for disregarding the corporate entity are equitable theories.

In re Texas American Exp., Inc., 190 S.W.3d 720 (Tex.App.-Dallas 2005, no writ)(internal citations omitted). Citing some of the same cases as cited by the Dallas court, the Court of Appeals in Beaumont put it very succinctly, "[w]ithout an underlying cause of action creating corporate liability, evidence of an abuse of the corporate form is immaterial." *In re StarFlite Management Group, Inc.*, 162 S.W.3d 409 (Tex.App.-Beaumont 2005, no writ).

A second consideration is that, under an *alter ego* theory, Texas courts will not directly or reversely pierce the corporate veil unless one of the "alter egos" owns stock in the other. *See Permian Petro. Co. v. Petroleos Mexicanos*, 934 F.2d 635 (5th Cir.1991). This is important where there is a parent/subsidiary business relationship or other entity-to-entity relationship. The Fifth Circuit remanded a Texas case to determine whether an interest in a trust that owned shares of stock equated with stock ownership by the alleged *alter ego*. *Zahra Spiritual Trust v. United States*, 910 F.2d 240 (5th Cir.1990). Upon rehearing, the U.S. District Court for the Western District of Texas determine the answer to be no. The Court said federal tax liens could not attach to the corporations' real property to satisfy the tax liability of individual taxpayers who exercised extensive control over the corporations and commingled funds and the taxpayers were not the corporations' *alter ego* because the stock was not held by the taxpayers but by a trust, even though the taxpayer-husband was the trust's sole beneficiary. The taxpayers' beneficial ownership interest in the trust did not meet the Texas requirement of a present ownership interest in the corporate entity. The government counsel's trial statements clearly admitted the trust was a valid recognizable entity. *Zahra Spiritual Trust v. U.S.*, 1992 WL 739456 (W.D.Tex. 1992).

V. CONCLUSION

Piercing the corporate veil is an attractive remedy when the corporate defendant does not appear to have the ability to satisfy a judgment. However, these theories are too frequently misapplied by attempting to pursue them as the substantive causes of action and misunderstanding their concepts. Although these are complex legal theories, they are not complicated. A good understanding is critical to their successful use. There is a wealth of case law to assist in outlining the use of these theories and it should not be overlooked when preparing a veil piercing case.