STATE BAR OF TEXAS
BANKRUPTCY LAW SECTION
NEWSLETTER

October 2007 Volume 6 — No. 1

INSIDE THIS ISSUE:

MEET OUR NEW BANKRUPTCY JUDGE: CRAIG A. GARGOTTA

JUDGE'S CORNER

On September 19, 2007, the Fifth Circuit Court of Appeals appointed Craig A. Gargotta as a United States Bankruptcy Judge for the Western District of Texas. Judge Gargotta will be serving in the Austin Division. His appointment is effective October 1, 2007.

Judge Gargotta was born June 30, 1958 in Pittsburgh, Pennsylvania. He graduated in 1981 from Texas A & M University with a Bachelor of Arts in History. He obtained his Master of Arts in History from Texas A & M in 1984. After graduation, he worked as a paralegal in the Houston offices of Baker Botts L.L.P. and Weil, Gotshal & Manges LLP. Deciding to pursue a law degree, Judge Gargoa entered Saint Mary's University School of Law in 1986. During law school, Judge Gargotta interned with Bankruptcy Judges Glen Ayers and Ronald King.

After graduation, Judge Gargotta served as Judge King's law clerk from 1989 - 1990. He thereafter became an assistant United States Attorney in San Antonio, primarily representing federal agencies before the bankruptcy courts in the Western District of Texas, but also representing federal agencies in litigation before the district courts, as well. Immediately prior to becoming a Bankruptcy Judge, Judge Gargotta served as the Deputy Chief of the Civil Section of the United States Attorney's office where he also supervised the law student internship program for the Civil Division.

In addition to his regular duties, Judge Gargotta served as president of the San Antonio Chapter of the Federal Bar

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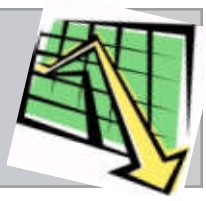
CHAPTER 11 PRACTICE:
IN THE ZONE - THE MIMS V. FAIL DECISION



*By Laura Schultz**

I. The Facts

The Chapter 7 Trustee asserted numerous claims against Defendant, Kevin W. McCleer ("McCleer"), for breach of fiduciary duties in his position as an officer of VarTec Telecom, a Texas Corporation, and as a managing Trustee of VarTec Business Trust ("VBT"), a business trust chartered in Delaware. The Bankruptcy Court considered the Motion to Dismiss Zone of Insolvency Claims ("Motion to Dismiss") filed by McCleer and joined by other defendants. The Motion to Dismiss addressed the Chapter 7 Trustee's claims for breach of fiduciary duties to the creditors of VarTec Telecom and VBT while those entities were insolvent or within the zone of insolvency.

II. What Is the Present State of the Law in These "Zone Of Insolvency" Cases?

VarTec Telecom is a Texas corporation. As such, the duties owed by VarTec Telecom's officers and directors are governed by Texas law. Similarly, VBT is a Delaware chartered

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A Message From The Chair

By Debbie Langenhening, State Bar of Texas Bankruptcy Section Chair

WOW! It has already been four months since we all got together at the Bench Bar.

Section committees are actively pursuing projects to benefit our members and others impacted by the bankruptcy system. The following are reports from our vice presidents, updating our current initiatives. If you would like to be involved, please contact a member of the council.

Professional Education

This year the section was a co-sponsor of the Farm and Ranch seminar in Lubbock with Texas Tech Law School and the West Texas Bankruptcy Bar Association. The seminar was held in mid-September and was well attended. Several members of the section board attended the seminar.

The advanced consumer seminar is set for mid-October in San Antonio.

The advanced business seminar will be held next spring. Mark Andrews will be the Chairman. Tom Howley will be the assistant chairman.

The advanced, pretrial litigation seminar is in the works also for next spring. The planning committee will shortly be formed. Right now the probable location will be San Antonio or Dallas.

The young lawyers committee is up and running. We have held two meetings and plans for the upcoming year are in the works, including submissions to the newsletter, participation in mock trials, and contributing to seminars. Jonathan Bolton of Houston is the chairman.

Public Education

We continue to expand our outreach to high school students around Texas and have also started work on an adult

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Consumer Corner: *Is it Better to Surrender or Die? The Milligan v. Trautman Decision*[1]

*By Laura Schultz**

Husband and wife Charles and Carol Trautman got into financial trouble. In 2004, Charles surrendered a whole-life insurance policy that he owned which insured his life with the death benefit payable to his wife, Carol. Although the policy had a cash surrender value of about $95,000, Charles only received a check for $27,913 since there had been an outstanding loan balance of about $67,000. The couple filed for bankruptcy soon after. The debtors elected to exempt property from the estate under Texas law rather than federal law, and claimed as exempt the uncashed check. The Chapter 7 Trustee objected, but after a hearing the Bankruptcy Judge denied this objection and upheld the exemption. The Trustee appealed, and the District Court reversed. The Trautmans appealed to the Fifth Circuit.

The Insurance Code Exemption

This case deals with Texas Insurance Code § 1108.051 which applies to "any benefits, including the cash value and proceeds of an insurance policy, to be provided to an insured or beneficiary under an insurance policy." Furthermore, § 1108.051 states that these benefits "inure exclusively to the benefit of the person for whose use and benefit the insurance . . . is designated in the policy . . . and are fully exempt from: (1) garnishment, attachment, execution, or other seizure; (2) seizure, appropriation, or application by any legal or equitable process or by operation of law to pay a debt or other liability of an insured or of a beneficiary, either before or after the benefits are proved; and (3) a demand in a bankruptcy proceeding of the insured or beneficiary.

The Fifth Circuit panel began by noting the peculiar differences between whole-life policies and term-life policies. Term-life policies are simple-the owner pays a regular premium to the insurer, who pays a death benefit to the beneficiary on the death of the insured if the premiums were current. With whole-life policies, the owner pays the insurer more than the cost of premiums, and the excess money goes into a sort of interest-bearing savings account, against which the owner can borrow money or pay the premiums if he ever chooses to pay less than the regular premium. Additionally, the owner of a whole-life insurance policy can surrender the policy and consequently withdraw the entire cash value. Here, the Fifth Circuit panel held that money paid to the owner of a surrendered whole-life policy is not exempt under Texas law.

A Careful Look at the Statute

First, the Court looked to the text of Section 1108.051 to determine

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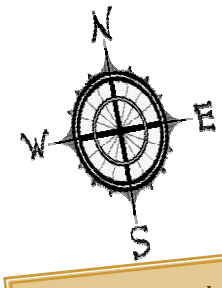
DUE SOUTH: *Pro Bono Bankruptcy Representation Program Reinstated in Houston*



The first in a regular series focusing on news and initiatives of a particular district.

The Houston Volunteer Lawyers Program (HVLP), a committee of the Houston Bar Association, is reinstating its Pro Bono Bankruptcy Representation Program to provide bankruptcy representation to qualified Harris County residents. From 1999 until the effective date of the Bankruptcy Abuse Prevention and Consumer Protection Act (BAPCPA), HVLP was able to match hundreds of low-income debtors with attorneys who could assist them with their bankruptcies. After the effective date of BAPCPA, however, HVLP's pool of pro bono bankruptcy attorneys dried up, leaving HVLP with the difficult decision to suspend its services in this area.

On September 11, 2007, the United States Bankruptcy Court for the Southern District of Texas held in an Amended Standing Order that legal counsel providing pro bono bankruptcy representation are not debt relief agencies on account of such pro bono representation. As a consequence, lawyers and law firms have begun to ease their previous policies against accepting referrals of these cases. Given this holding in the Amended Standing Order and the subsequent renewed interest in pro bono bankruptcy representation in the Houston legal community, HVLP is once again accepting bankruptcy cases for referral.

A number of lawyers have committed to assist HVLP and other agencies in an effort to secure funding for their revitalized pro bono consumer bankruptcy referral serv

ices from a combination of law firm donations as well as bar association and foundation grants. As a result of this assistance, HVLP's bankruptcy program recently received generous support from the State Bar of Texas Bankruptcy Section, which awarded HVLP a $5000 grant to assist it with its immediate goals for the project. These goals include renewing its bankruptcy volunteer panel, preparation of a "how to" manual and a form book, and development of short seminars to educate firm members willing to accept referrals.

For this program to be an outstanding success, HVLP will need additional support from firms in the form of donations and volunteers. For more information about HVLP's Pro Bono Bankruptcy Representation Program, please contact HVLP Executive Director David Mandell, 713-228-0735, ext. 108, david.mandell@hvlp.org, or Paul Mott, HVLP Senior Attorney and Program Coordinator, 713-228-0735, ext. 110, paul.mott@hvlp.org.

Editor's Note: *The referenced Amended Standing Order of the United States Bankruptcy Court for the Southern District of Texas can be found at http://txbankruptcylawsection.com*

FROM The Young Lawyers Committee:

Tips for Financial Professionals and Attorneys when working together in Bankruptcy Cases

By Eli Columbus and Roberto Cortez***

While every bankruptcy case is governed by the same fundamental set of rules, the legal and financial professionals are typically different in each case. Given this dynamic, effective communication among the professionals during a bankruptcy case can be a determining factor between success and failure.

Financial professionals interact with lawyers every day, but the financial professional and lawyer do not necessarily speak the same language or have a full appreciation for what each other knows or needs to know during a case. Recognizing and understanding the differences in how financial professionals and lawyers view and approach issues in a bankruptcy case leads to the creation of a beneficial relationship, where case issues are effectively and efficiently evaluated with respect to the potential impact of the issues on the analyses performed by the financial professional. Below are some guidelines financial professionals and lawyers should follow in order to foster an effective working relationship during a bankruptcy case.

Financial advisors should keep the following guidelines in mind as a bankruptcy case proceeds:

1. Do not expect counsel to review the case docket for you. While attorneys may apprise you of significant filings, it is important to understand the positions that all parties are taking, as it can impact the financial assumptions that need to be made. The information that counsel gives you may also be limited to what they consider to be legally, but not necessarily financially, significant or relevant. By periodically reviewing the case docket and pleadings, you will have a better understanding of the financial position the parties have taken and the potential impact they have on any assumptions you made in your analyses.

2. Make counsel aware of the scope of your work. Financial advisors are not all the same and do not focus on or specialize in the same areas. Make sure that the attorneys that you are working with have a specific understanding of what you are doing

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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 and/or CLE events for inclusion in the newsletter calendar, as well as any items for our "Troop Movements" section (changes in practices).

If you are interested in submitting an article to be considered for publication or to calendar an event, please either e-mail your submission to chufft@velaw.com or eborrego@whc.net or mail it to a member of the Editorial Staff (addresses below).

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

Should you have any questions, please visit our website at http://txbankruptcylawsection.com.

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DON'T MISS THE . . . .

THE UNIVERSITY OF TEXAS AT AUSTIN | SCHOOL OF LAW

UTCLE

26th Annual
Jay L. Westbrook
BANKRUPTCY CONFERENCE
Austin, Nov 15-16, 2007 - Four Seasons Hotel, Austin

Standard Registration - $495 | $545 after Nov. 7, 2007

The Young Lawyer Committee will host a post-dinner cocktail meeting during the conference.

For details and registration, go to
http://www.utcle.org/conference_overview.php?conferenceid=709

UPCOMING EVENTS

November 15-16, 2007:	UT/Jay L. Westbrook Bankruptcy Conference, Four Seasons Hotel, Austin
February 23, 2008:	Elliott Cup Competition (Bankruptcy Moot Court), Dallas. Judges Needed. *See page 6.*
March 4-11, 2008:	"Distance" Seminar in Barcelona, Spain, with an extension in Madrid (see below). For more information regarding cost and availability, contact Susie Angle at sangle@newbernlawoffice.com or call (817) 870-2647.

LOCAL EVENTS

Fort Worth - Tarrant County

Bankruptcy Section - monthly CLE luncheon meetings on the third Monday of each month to its members. Contact - Marilyn Garner at (817) 462-4075 or marilyndgarner@flashwave.com. Meetings are normally held at the Ft. Worth Petroleum Club.

San Antonio

The San Antonio Bankruptcy Bar Association meets on the 4th Tuesday of every month at the San Antonio Country Club. Social begins at 5 p.m. with program beginning at 5:30 p.m. Participants receive 1 hour CLE credit.

A Brown Bag lunch with Judge Clark, Judge King, the Bankruptcy Clerk, and members of the Bankruptcy Bar is held quarterly at the Adrian Spears Judicial Training Center.

Dallas

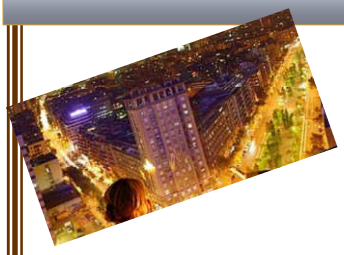
The Dallas Bar Association Bankruptcy and Commercial Law Section meets the first Wednesday of each month at the Belo Mansion. Social begins at 5 p.m. with program beginning at 5:30 p.m.

Houston

The Houston Area Young Bankruptcy Lawyers is hosting a happy hour on October 24, 2007 from 6-8 p.m. at Hans' Bier Haus, off Kirby & Quenby (parking available on street and in IBC bank ground lot). Go to http://hansbierhaus.com for further details.

Please RSVP to Allison Byman at allison.byman@tklaw.com or Patrick McCarren at pmcarren@hwa.com.

INTERNATIONAL EVENTS



The State Bar of Texas Bankruptcy Law Section
Announces Its Fifth Annual

International Bankruptcy Law Seminar

March 4-11, 2008

$2,300.00 per person, double occupancy**

Optional Madrid Extension—$851.00

**Fee includes: round-trip coach airfare; 6 nights accommodation in Barcelona Gran Torre Hotel; round-trip airport-hotel transfers; breakfast daily; porterage of 2 bags per person; CLE seminar for attorneys; air taxes and fuel surcharges calculated as of 7/20/07 (subject to increase)

For more information regarding cost and availability of triple accommodations or land only, contact Susie Angle at sangle@newbernlawoffice.com or call 817.870.2647

EXPERIENCED BANKRUPTCY LAWYERS NEEDED AS JUDGES FOR ELLIOTT CUP - BANKRUPTCY MOOT COURT

The Bankruptcy Section is seeking experienced bankruptcy lawyers to serve as judges for the third annual Texas/Fifth Circuit Bankruptcy Moot Court Event for the 2008 Elliott Cup. The event is sponsored by the Bankruptcy Section of the State Bar of Texas, and is named in honor of the late Joseph C. Elliott, U.S. Bankruptcy Judge for the Western District of Texas. This year, the Elliott Cup event has been expanded to include law schools in the entire Fifth Circuit, as well as Texas. The Elliott Cup event is designed to serve as a formal practice competition for law school teams that will compete in the National Duberstein Moot Court Competition at St. John's University School of Law in New York City.

This year, the Elliott Cup event will be held on Saturday, February 23, 2008, at the U.S. Bankruptcy Courthouse in Dallas, Texas (1100 Commerce Street). Lawyers will need to be at the Bankruptcy Courthouse by *8:30 a.m. on Saturday, February 23, 2008* to judge the rounds, which should be completed by 1:00 p.m. that day. Scoring for the Elliott Cup event will be based solely on oral argument. Lawyers will be requested to score each competitor and provide constructive input to the teams following each preliminary round. A trophy (the Elliott Cup) will be awarded to the first place team, and awards given to the second place team and best oral advocate.

Participating lawyers are also invited to attend the Team Dinner, where awards will be presented (to be held that Saturday night, February 23) and a Welcoming Cocktail Reception (to be held on Friday night, February 22, from 6:00 p.m. to 8:00 p.m.).

Please consider participating in this event for the benefit of future bankruptcy lawyers in the State of Texas and Fifth Circuit.

If you are willing to serve as a judge for the 2008 Elliott Cup, please mark your calendar with the date of February 23, 2008, and provide your name, phone number, and email address to the Elliott Cup Chairperson:

H. Christopher Mott
Gordon & Mott P.C.
4695 N. Mesa St.
El Paso, Texas 79912
Tel. 915-545-0888
email: cmott@gordonmottpc.com

Tips for Financial Professionals

(Continued from page 3)

and why you are doing it. Even though the client is ultimately managing the professionals, you can help the case proceed more efficiently by making sure that lawyers and financial advisors are aware of what information the other has and what they can get, so as to avoid walking down divergent paths. The professionals need to identify the common goal that we are working towards.

3. Do not prepare your analysis in a vacuum. It is important to consider the legal issues that may impact your analysis, and frequently attorneys need to make legal interpretations or evaluations before you proceed. As you prepare your analysis, discuss any underlying assumptions with counsel (and the client, as appropriate) in order to make the assumptions consistent with the legal arguments that counsel has made or is preparing to make.

4. Inform counsel of the key elements and assumptions of your analysis. Every analysis is meant to answer a question. Each question may have different answers depending on the assumptions made. Varying assumptions can change any financial analysis, so it is important to make counsel aware of the sensitivity of your conclusion to the assumptions that you are making. Understanding which assumptions have the largest impact on an analysis helps to identify which legal arguments may arise from third parties and may help counsel more fully evaluate the legal implications of the financial picture.

5. Talk…often. Frequent communication avoids surprises and allows all parties to resolve open items before they become problems or, even worse, all-nighters. Different perspectives stimulate creativity and create solutions to questions the other party may not have even known existed.

Attorneys should keep the following guidelines in mind as a bankruptcy case proceeds:

1. Keep the financial professionals informed during the case. As outlined above, attorneys do not always know when certain issues or information might impact the financial professional's analysis or assumptions. In this day of electronic filing and instant communication, it is easy to automatically forward all case filings and notices to your financial professionals via e-mail. This allows your financial professional to review all case proceedings and determine what information is necessary to evaluate in connection with their engagement.

2. Know your financial advisor's role and limits. It is important from the outset of the case to establish specific expectations and roles for the financial advisors. This will help avoid surprises during the case. Although a financial professional's role may change based on the development of events during the case, it is important to identify what fundamental role the financial professional is hired to perform during the case. This also allows the parties to discuss and evaluate whether the financial

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Meet Our Judge

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Association and remains on the Board of Directors. He is currently Editor-in-Chief of the Federal Bar Association's *The Federal Lawyer*, a monthly scholarly legal magazine circulated to all members of the Federal Bar Association in the United States. Judge Gargotta also taught legal research and writing at Saint Mary's School of Law, and spoke at seminars at the United States Attorneys training center in South Carolina. He has also published numerous legal articles in the *American Bankruptcy Institute Law Journal* and in the *San Antonio Lawyer*.

Judge Gargotta is married to Susan Gargotta and has two sons who are currently in fifth and ninth grades. He is active with his sons in the Boy Scouts of America and has long been a runner and marathoner, but has more recently cut back his running to "only" 20 to 30 miles per week.

The Bankruptcy Section of the State Bar of Texas welcomes Judge Craig Gargotta to the Bench and wishes him all the best in his new career!

INTERESTED IN PRO BONO WORK?

THE COUNCIL FOR THE BANKRUPTCY SECTION IS CONSIDERING REACTIVATING THE SECTION'S PRO BONO SUBCOMMITTEE. IN THE EVENT YOU HAVE AN INTEREST IN ASSISTING WITH THIS IMPORTANT SUBCOMMITTEE, PLEASE CONTACT BERRY D. SPEARS AT BSPEARS@FULBRIGHT.COM.

A Message from the Chair

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initiative. Judge Parker pitched the program during the Eastern District Bench/Bar to recruit volunteers and line up high schools in the Eastern District. Mary Daffin presented a luncheon program on Money Wise during the Advanced Consumer Bankruptcy Conference in October. The Section anticipates adding an adult program, based on the presentation used in the high school program.

The Young Lawyers committee has adopted Money Wise as a focus for their committee, to encourage more participation by young bankruptcy lawyers across the state.

The Section is currently seeking permission from the distributors of the Maxed Out video to use clips from this widely-regarding documentary. If you have not seen the Maxed Out movie, it is available now on DVD – a must see for bankruptcy professionals.

Law School Relations

This year, the Law School Relations Committee will conduct two primary events for the benefit of law school students. First, the Bankruptcy Section will sponsor the Elliott Cup Bankruptcy Moot Court Event for the third straight year. The event is named in honor of the late Joseph C. Elliott, U.S. Bankruptcy Judge for the Western District of Texas. The Elliott Cup event has been expanded to include law schools in the entire Fifth Circuit, as well as Texas. This year, the Elliott Cup event will be held on Saturday, February 23, 2008, at the U.S. Bankruptcy Courthouse in Dallas, Texas. The Section is seeking experienced bankruptcy lawyers to serve as judges for the 2008 Elliott Cup; if you are interested in serving as a judge, please contact the Elliott Cup Chairman, Chris Mott (*cmott@gordonmottpc.com*). Second, the Law School Relations Committee conducts bankruptcy career programs at law schools in the State of Texas for law students. If you are interested in assisting with presentation of a bankruptcy career program, please contact Lydia Protopapas (*lydia.protopapas@weil.com*).

Publications

Directory: The Section has targeted May - June 2008 for publication of the next directory. The Section will evaluate the distribution of the directory in electronic format (i.e. - PDF file or CD ROM) to enhance use of the directory (sorting, searching, etc.) as well as to reduce the cost of publication and mailing. Currently, Greg Hesse of Dallas has agreed to serve as editor of the Directory; however, an assistant editor is still needed. Any interested individuals should contact John Mitchell.

Newsletter: The Newsletter continues to evolve. Edgar Borrego of Tanzy & Borrego in El Paso has agreed to serve as Assistant Editor, Consumer. Clay Hufft of Vinson &

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A Message from the Chair

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Elkins, Dallas, has agreed to serve as Assistant Editor, Business. Article submissions are always welcome (and needed). Articles can be submitted to any editor. Further, the Newsletter wants to announce your bankruptcy related event and wants to start publication of regular, periodic columns on specific topics. If you are interested in being a columnist for a particular subject, please contact John Mitchell. Lastly, if you don't have time to write an article, but want to be heard, the Newsletter will now feature a "letters to the editor" section. Sound off in a few sentences or a few words.

Consumer Committee

We look forward to the Advanced Consumer Bankruptcy conference on October 16-17 in San Antonio. Also, a committee of consumer attorneys has been formed to assist the Judges with the Eastern District Bench Bar conference on October 4-5 in Frisco. That conference is weighted to chapter 7 and 13 practitioners in the Eastern District. Attendance is estimated at 140 participants.

Business Committee

The UT Bankruptcy Conference will be held November 15 – 16 at the Four Seasons hotel in Austin. Register now! The State Bar of Texas is beginning to plan for the Advanced Business Bankruptcy Conference, which will be held next spring.

That's all for now. I hope everyone has a great holiday season.

Debbie

TROOP MOVEMENT

Timothy A. Million has become an associate of Munsch Hardt Kopf & Harr PC, 700 Louisiana Street, Suite 4600, Houston, TX 77002.

Richard N. Berberian has transferred to the Beijing office of Vinson & Elkins LLP, 20/F, Beijing Silver Tower, No. 2 Dong San Huan Bei Lu, Chaoyang District, Beijing 100027 China.

P. Beth Lloyd has become an associate of Vinson & Elkins LLP, 2001 Ross Avenue, 3700 Trammell Crow Center, Dallas, Texas 75201.

H. Joseph Acosta has become a partner in Hermes Sargent Bates, LLP, 901 Main Street, Suite 5200, Dallas, Texas 75202.

Henry J. Kaim has become a partner and **Jerry McDaniel** and **Mickey Sheinfeld** have become Of Counsel at King & Spalding, 1100 Louisiana, Suite 4000, Houston, Texas 77002.

Omar J. Alaniz has become an associate of Baker Botts L.L.P., 2001 Ross Avenue, Dallas, Texas 75201.

Harry A. Perrin has become a partner of Vinson & Elkins LLP, First City Tower, 1001 Fannin Street, Suite 2500, Houston, Texas 77002.

The following attorneys have joined the Houston office of Barrett Burke Wilson Castle Daffin & Frappier, LLP, 1900 Saint James Place, Suite 500, Houston, Texas 77082:

Mitchell J. Buchman has become a supervising attorney.
Eric B. McAnelly has become a bankruptcy associate attorney.
H. Gray Burks IV has become senior bankruptcy litigation attorney.

The following attorneys have joined the Austin office of Barrett Burke Wilson Castle Daffin & Frappier, LLP, 610 W. 5th Street, Austin, Texas 78701:

Brian S. Engle has become senior litigation attorney.
Steven P. Turner has become Chief Counsel, Western Division.

Tips for Financial Professionals

(Continued from page 6)

professional is qualified to perform the job they are being hired to do prior to the start of the case. No attorney likes to hear during a deposition, or even worse, at trial, that their financial professional is not qualified to provide the analysis they were hired to perform. It is also important to discuss and explain the role and legal differences of a testifying expert versus a consulting expert as well as privilege issues when the financial professional is employed.

3. Explain legal theories to your financial advisor. Do not always expect your financial advisor to fully understand the legal theories involved in the case or relevant to the analysis the financial advisor is providing. Even if your financial advisor is well versed on the legal theories involved, since all cases involve unique facts and circumstances, it helps all the professionals to discuss the legal theories of the case and how the facts impact the legal positions taken by the parties and the financial analysis relevant to such theories.

4. Discuss and evaluate case strategy with your financial professional. Discuss and analyze your legal strategy with your financial professional. Financial professionals often provide valuable insight into strategy decisions related to the case. Financial professionals often provide strategy suggestions and comments related to practical business and financial issues that the attorneys may have overlooked in their focus on legal and procedural issues.

5. Communication is the key. Communicate early and often with your financial professional. Communication is especially important prior to depositions, trials/hearings, or meetings where the financial professional will be called upon to explain or defend their analysis. It is important to spend time in advance discussing and evaluating all potential areas of inquiry or concerns related to the financial analysis and the financial professional's presentation of their analysis.

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*Eli Columbus is an Associate Attorney in the Business Restructuring/Bankruptcy Practice Group at Winstead PC.

**Roberto Cortez is a senior manager in the Reorganization Services Group of Deloitte Financial Advisory Services LLP.

Editor's Note: *This is the first of a new series from the Bankruptcy Section Young Lawyers Committee.*

In the Zone: The Mims v. Fail Decision

(Continued from page 1)

business trust. The laws of Delaware govern the duties owed by McCleer, as a managing trustee of the VBT. Based on a thorough reading of the case law, the Bankruptcy Court held that a cause of action based on a company's directors' and officers' fiduciary duty to creditors when the company is in the "vicinity" or "zone" of insolvency was recognized in both states.

A. "Zone of Insolvency" Claims Under Texas Law

In *Mims v. Fail*, 2007 WL 2872283 (Bankr. N.D. Tex. Sept. 24, 2007), the Trustee sought to assert claims on behalf of the corporation as well as the creditors of VarTec Telecom, while the corporation was either insolvent or in the "vicinity of insolvency." Movants relied heavily on the decision in *Floyd v. Hefner*, 2006 WL 2844245 (S.D. Tex. Sept. 29, 2006), and argued that, in Texas, officers and directors do not have a fiduciary duty in favor of a corporation's creditors when the corporation enters the vicinity of insolvency. The Bankruptcy Court, however, did not find that decision controlling because: (1) the unpublished decision was not binding precedent; and (2) the decision lacked continuing validity.

Floyd v. Hefner relied heavily on *Conway v. Bonner*, 100 F.2d 786 (5th Cir. 1939), which the Bankruptcy Court found distinguishable since it dealt significantly with the issue of when a corporation is insolvent thereby giving rise to a fiduciary duty. In that case, "much testimony was introduced to prove insolvency at the time of the transfer, on the theory that the corporation was insolvent if its total assets were less than its debts," but insolvency in fact did not require the directors to act as fiduciaries for the corporation's creditors. *Id* at 787. Subsequent to the 1939 panel decision in *Conway v. Bonner*, the Texas Legislature changed the permissible definition of insolvency to include a company's projection of near term insolvency, which somewhat undermines *Conway's* continuing validity. Additionally, the end of the *Conway* decision noted that "[t]he appellee predicated his suit entirely upon the trust fund doctrine, and relied for recovery solely upon the right of the creditors. If he had sought to recover in the right of the corporation, and the appellee had consented or had not objected to federal jurisdiction, there would have been a different case." *Conway*, 100 F.2d at 786.

The Bankruptcy Court was more inclined to follow recent Fifth Circuit precedent which recognizes that a corporation's creditors are able to bring a cause of action against the corporation's officers and directors when the corporation enters the zone of insolvency. *See Carrieri v. Jobs.com, Inc.*, 393 F.3d 508, 534 n.24 (5th Cir. 2004). The Bankruptcy Court recognized that the statement in *Carrieri* was dicta; however, the reasoning was highly persuasive in light of other case law, particularly case law in Delaware.

B. "Zone of Insolvency" Claims Under Delaware Law

As stated recently by Judge Leif Clark, "Courts across the nation have looked to Delaware for further developments and clarification regarding this cause of action." *I.G. Services v. Wells Fargo Bank*, 2007 WL 2229650 *2 (Bankr. W.D. Tex. July 31, 2007). A seminal case from Delaware for the proposition that the duties of officers and directors expand to include creditors and that creditors may bring derivative claims against a corporation's

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Is it Better to Surrender or Die?

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whether the check represented "benefits," which are protected under the law. The Court found that it does not because "benefits" are things "to be provided to an insured or beneficiary," and the cash from a surrendered whole-life insurance policy goes not to the insured or beneficiary, but the owner of the policy. Further that "benefits" "inure exclusively to the benefit of the person whose use and benefit the insurance . . . is designated in the policy" enhances this conclusion since the surrendered check goes not to the beneficiary, but the owner.

Second, the Court looked to the statutory history of Section 1108.051. Before a 1991 amendment, courts did not exempt even the cash value of *existing* whole-life policies because such policies were essentially savings accounts to which debtors had constant access. However, in order to protect the named, contingent beneficiaries of whole-life policies, the statute was amended to include "cash values." Therefore, contingent beneficiaries could receive a death benefit later since debtors were unable to garnish, seize, or claim in bankruptcy the cash value of an existing policy.

Additional Policy Considerations

Finally, the Court noted the problems of exempting money traceable to a whole-life insurance policy. People could place their money in a whole-life policy with the cheapest possible premium and sometime later could withdraw some or all of the money thereby shielding it from creditors. Also, even people who actually desired having a whole-life policy, even for insurance reasons, could put extra money into the account to shield it from creditors.

In their appeal, the Trautmans cited to a bankruptcy case from Texas, *In re Young*,[2] which exempted two assets under § 1109.051: (1) the cash value of an existing whole-life policy owned by the debtor; and (2) "life insurance proceeds access accounts." The Trautmans argued that their money from the surrendered policy was similar to the "proceeds" from the access accounts, however, the Court disagreed stating that the value of the surrendered whole-life policy is different from the proceeds in *Young* since there was never a proceeds-producing event, like death thereby sending money to the beneficiary. More clearly, there is a difference between a policy dispersing money because the insured died and a policy dispersing money because its owner surrendered it.

Therefore, holding that money from a surrendered whole-life policy is not exempt under § 1108.051, the Fifth Circuit panel affirmed the District Court decision.

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[1]Milligan v. Trautman (*In re Trautman)*, 2007 WL 2258804 (5th Cir. 2007).

[2]*In re Young*, 166 B.R. 854 (Bankr. E.D.Tex. 1994).

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In the Zone: The Mims v. Fail Decision

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officers and directors when the corporation is in this grey area is *Credit Lyonnais Bank Nederland, N.V. v. Pathe Communications Corp.*, 1991 WL 277613 (Del. Ch. Dec. 30, 1991). While many recent opinions that have been issued from the Delaware Court of Chancery have backed away from the premise attributed to the *Credit Lyonnais* decision, *see, e.g., Production Resources Group, L.L.C. v. NCT Group, Inc.,* 863 A.2d 772, 788 -89 (Del. Ch. 2004), "it was not until just this late spring that the Delaware Supreme Court finally helped to clear what have been for many years very muddy legal waters." *I.G. Services*, 2007 WL 2229650 at *2.

In *North American Catholic Educational Programming Foundation, Inc. v. Gheewalla*, 930 A.2d 92 (Del.Supr., 2007), creditors sought to sue directors for breach of fiduciary duties. The Delaware Supreme Court ruled that the creditors did not have a direct action against the directors, because the essential nature of their action was a derivative suit on behalf of the corporation. *Id.* at 100-101. In *Gheewalla,* the Court clarified that directors owe fiduciary duties to the corporation. *Id.* When a corporation is solvent, those duties may be enforced by its shareholders, who have standing to bring derivative actions on behalf of the corporation because they are the ultimate beneficiaries of the corporation's growth and increased value. When a corporation is insolvent, however, its creditors take the place of the shareholders as the residual beneficiaries of any increases in value, and consequently the creditors of an insolvent corporation have standing to maintain *derivative* claims against debtors on behalf of the corporation for breaches of fiduciary duties. *Id.* at 103.

The essence of a derivative action is that it is brought in the stead of a direct action brought by the corporation itself. Consistent with the holding in *Gheewalla*, the Chapter 7 Trustee brought such a derivative action on behalf of the corporation's creditors. Thus, the Bankruptcy Court held that Delaware law also recognizes the cause of action brought by the Trustee in this case.

III. Conclusion

The Bankruptcy Court recognized that extending officers' and directors' duties to creditors when a corporation nears insolvency created many issues for such officers and directors and the professionals providing them advice. However, the Bankruptcy Court determined that both Texas and Delaware law recognize a cause of action for breach of fiduciary duty against the directors or officers of a corporation brought by the creditors of a corporation when the corporation is either insolvent or in the "zone" or "vicinity of insolvency" which is what the Trustee has pled in this case. Accordingly, Defendant's Motion to Dismiss was denied.

This decision and Judge Clark's decision in *I.G. Services* shall provide some guidance to practitioners in litigation against officers and directors of failed companies.

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