

# Bankruptcy Litigation Committee

## ABI Committee News

In This Issue

Volume 9, Number 1 / February 2012

- [Trustee's Standing to Assert Creditors' Causes of Action Against Third Parties: \*In re Tribune\*](#)
- [Twombly/Iqbal: Extracting More From Bartertown](#)
- [Friedman's Inc. v. Roth Staffing Services Inc.: An Indication of How Delaware Courts Will Rule on Bankruptcy Code § 503\(b\)\(9\) Goods as Subsequent New Value?](#)
- [Educational Materials from Recent ABI Conferences are Available Online](#)
- [ABI Assumes CARE Program](#)

### Trustee's Standing to Assert Creditors' Causes of Action Against Third Parties: *In re Tribune*

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Consider the case of a failed leveraged buy-out (LBO) of a large public company in which the company, due to the LBO, incurs debt that it is unable to service. As a result, the company files for bankruptcy. Certain stakeholders—shareholders, bondholders, trade creditors, etc.—have causes of action against the commercial and investment banks that participated in the LBO. The proposed reorganization plan contains a provision establishing a litigation trust, to which these creditors will assign their causes of action to be pursued by the litigation trustee.

This fact pattern is based on a recent decision by the Delaware bankruptcy court, *In re Tribune Co.*<sup>[1]</sup> Typically, a bankruptcy trustee lacks statutory authority to assert private causes of action belonging to creditors. Nonetheless, the *Tribune* court approved assignment of the stakeholders' claims to the litigation trust, joining a growing line of courts permitting the assignment of causes of action belonging to a debtor's creditors to a trustee to prosecute the claims on behalf of the creditors.

In *Tribune*, competing plan proponents objected to a litigation trust plan provision, arguing that it was precluded by *Caplin v. Marine Midland Grace Trust Co. of New York*.<sup>[2]</sup> In *Caplin*, the Supreme Court held that a bankruptcy trustee lacked standing to assert claims on behalf of creditors against third parties.<sup>[3]</sup> The *Tribune* court acknowledged *Caplin*, but approved the litigation trust plan provision, concluding that the provision was "not inconsistent with *Caplin*."<sup>[4]</sup>

The *Tribune* court cited *Grede v. Bank of New York Mellon*<sup>[5]</sup> (*Caplin* does not apply to plan-created litigation trusts because "[a]lthough the terms of the Bankruptcy Code govern the permissible duties of a trustee *in* bankruptcy, the terms of the plan of reorganization (and of the trust instrument) govern the permissible duties of a trustee *after* bankruptcy") and *Semi-Tech Litigation LLC v. Bankers Trust Co.*<sup>[6]</sup> (distinguishing *Caplin* because creditors assigned their claims to the trust in that case). The court held that the concerns raised in *Caplin* were not implicated because the assignment of claims was voluntary, there was no greater risk of inconsistent litigation than if the creditors had pursued their claims individually, and the litigation trustee was not acting as a representative of the estate.<sup>[7]</sup>

However, not all courts agree that assignment alone is sufficient to avoid *Caplin*. See, e.g., *Williams v. California 1st Bank*<sup>[8]</sup> (holding that under *Caplin*<sup>[9]</sup> the assignment of creditor claims to the chapter 7 trustee was impermissible).<sup>[10]</sup> *Williams* did not deal with assignment to a litigation trust created pursuant to a chapter 11 plan present in *Tribune*, which the court cited as an additional reason for its ruling. Whether this latter distinction is one that will justify the assignment to a litigation trust in jurisdictions following *Williams* is an open question.<sup>[11]</sup>

#### Can a Plan Provide for Nonconsensual Assignment of Causes of Action?

The applicable assignment provisions in the *Tribune* plan required creditors to affirmatively opt out of the assignment on their ballot.<sup>[12]</sup> The assignment election form accompanying the ballots in *Tribune* provided that creditors that did not affirmatively opt-out, or that failed to submit the election form, would be deemed to consent to the assignment of their causes of action.<sup>[13]</sup>

An issue not directly addressed by the *Tribune* decision is whether a plan can require non-consenting creditors to transfer their causes of action simply through inaction. While the plan was ultimately not confirmed for other reasons, the *Tribune* decision approved of such a process.<sup>[14]</sup> Whether such a provision for assignment of causes of action would be enforceable if challenged remains an open question.

#### Consensual Retention of Jurisdiction

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Another provision of the plan in *Tribune* provided that the bankruptcy court retain relatively broad jurisdiction with respect to matters arising under the confirmed plan. While apparently not raised by the parties, this provision could arguably be read as conferring jurisdiction on the bankruptcy court over the causes of action assigned by creditors to the litigation trustee.

The creditor claims assigned in *Tribune* were likely premised upon state law, between non-debtor entities, over which the bankruptcy court would lack subject-matter jurisdiction in the absence of any assignment related to the confirmed plan. Since parties cannot jointly create subject-matter jurisdiction by consent, a party cannot unilaterally create subject-matter jurisdiction by assigning its cause of action to a plan-created litigation trustee. In *Premium of America LLC v. Sanchez*, [15] the bankruptcy court held that a confirmed plan does not confer jurisdiction in the bankruptcy court over causes of action prosecuted by a plan-created litigation trust that did not belong to the debtor or the debtor's estate prior to confirmation.

### Conclusion

Parties potentially affected by a litigation trust similar to that in *Tribune* should consider the mechanism of assignment of causes of action and ultimate jurisdiction for the litigation of those causes of action. An inattentive creditor may be surprised to find that it has assigned its claim due to inaction, likely resulting in additional litigation over the rights to the cause of action. The more cautious approach to ensure the validity of the assignment process may be to have assignment through an "opt-in," as opposed to an "opt-out," procedure.

1. No. 08-13141 (KJC), 2011 WL 5142420 (Bankr. D. Del. Oct. 31, 2011).
2. 406 U.S. 416 (1972).
3. *Id.* at 435.
4. *Tribune*, 2011 WL 5142420, at \*47-49.
5. 598 F.3d 899, 901-02 (7th Cir. 2010).
6. 272 F.Supp.2d 319 (S.D.N.Y. 2003).
7. 2011 WL 5142420, at \*49. The *Caplin* Court focused on three factors in its ruling: first, bankruptcy trustees lack statutory authority to collect money not owed to the estate; second, allowing the trustee to pursue creditor causes of action created a risk of duplicative and/or inconsistent litigation; and finally, third-party defendants may be able to subrogate themselves and pursue their claims against the estate, resulting in no net benefit for the estate. *Id.* at \*48.
8. 859 F.2d 664, 666-67 (9th Cir. 1988).
9. See *Tribune*, *supra* note 7 (identifying factors analyzed in *Caplin*).
10. *Tribune* implicitly rejected this position through its reliance on *Semi-Tech*, in which the court expressly declined to follow *Williams*, finding no basis to strip assignments of their legal effect merely because the "assignee is a creature of bankruptcy." *Semi-Tech Litig. LLC*, 272 F.Supp. at 323-24.
11. Congress contemplated overruling *Caplin* with proposed § 544(c) to the Code. H.R. 8200, 95th Cong., 1st Sess. 416-17 (1977). The proposed § 544(c) was omitted from the final version of the Code, and some courts have interpreted its omission as congressional ratification of *Caplin*. See, e.g., *In re Ozark Rest. Equip. Co. Inc.*, 816 F.2d 1222, 1228 (8th Cir. 1987) ("... [W]e believe Congress' message is clear—no trustee, whether a reorganization trustee as in *Caplin* or in a liquidation trustee as in the present case, has power under Section 544 of the Code to assert general causes of action ... on behalf of the bankrupt estate's creditors").
12. 2011 WL 5142420, at \*47.
13. *In re Tribune*, Case No. 08-13141-KJC, Dkt. No. 8926, Exhibit F.
14. A failure to vote for a plan is not acceptance. Fed. R. Bankr. P. 3018(c); *In re Townco Realty*, 81 B.R. 707, 708 (Bankr. S.D. Fla. 1987). Therefore, a non-voting creditor that does not submit the election form, while not accepting the plan and not consenting to assignment, will nonetheless have its cause of action assigned under the plan if the assignment provision stands.
15. 342 B.R. 390, 399-400 (Bankr. D.D.C. 2006).

