# SECTION III: SPECIAL ISSUES

**Chapter 9** 

# LEGALLY DEFINING MANAGEMENT OF THE LIQUIDATION TRUST

This chapter provides an introduction to a number of key points involved with legal requirements for establishing the management of the trust. Important issues will involve the segregation of funds, the use of governing committees, management of information and reporting, authorizing the trustee to act, and reporting issues involving the U.S. Trustee. Issues regarding the retention and prosecution of claims and jurisdiction are addressed in Chapter 11.

anagement of the liquidation trust is helped or hindered by key provisions in the governing documents. The trust agreement, disclosure statement, plan and any side agreements are critical to outlining financial and regulatory reporting requirements, authority of the trustee to make and execute decisions (both for dealing with assets as well as settling liabilities), and for keeping a governing committee informed about major decisions and the financial progress of the trust. Well-defined documents allow the trustee to act, as well as protect the trustee from adverse actions brought by opposing parties or disgruntled participants in the trust.

#### A. Confirmation Date and Effective Date

Several key dates must be defined by the bankruptcy plan and confirmation order to establish the legal commencement of the liquidation trust. The "confirmation date" is the date when the bankruptcy court approves the plan and enters its confirmation order indicating that the plan has fulfilled the requirements of § 1129. The "confirmation order" authorizes the debtor to consummate the transactions contemplated in the plan.

Although the "effective date" is not a defined term, it appears in multiple places within the Bankruptcy Code. It is generally agreed that the "effective date' of a plan is the date on which the provisions of such plan become effective and binding

on the parties."<sup>81</sup> It is the date on which the various transactions contemplated by the plan occur and when the plan becomes "substantially consummated."<sup>82</sup> In particular, the financial requirements of the plan and the legal transfers of authority occur on the effective date, including the commencement of the liquidation trust. Therefore, the effective date is typically specified in chapter 11 plans and in liquidation trust agreements as occurring after a defined period of time following the bankruptcy court's confirmation of the plan through a final confirmation order. Courts have invalidated effective dates that were distant, indefinite or that otherwise violated provisions of the Bankruptcy Code.<sup>83</sup> Other courts have approved effective dates keyed to when substantial consummation of the plan occurs, rather than when the confirmation order is entered or becomes final.<sup>84</sup> In complex chapter 11 cases, there may be preceding conditions that must be satisfied prior to the occurrence of the effective date.<sup>85</sup>

Critically, the effective date is the point at which the debtor emerges from chapter 11, the official committee of unsecured creditors dissolves, and DIP lenders are repaid or the DIP loans are refinanced as exit financing. After the effective date, the reorganized debtor is no longer subject to bankruptcy court oversight, and the rights and duties of the liquidation trustee as specified in the plan commence.

# B. Authority to Wind Up the Debtor in Possession<sup>86</sup>

Although the liquidation trust normally handles affairs regarding the post-confirmation trust's assets and its beneficiaries, liquidation trustees are often tasked with winding up the debtor in possession and the bankruptcy estate. Tasks may include updating books and records, paying allowed administrative and priority claims, filing U.S. Trustee reports, filing taxes, filing corporate dissolution papers,

Novikoff, H.S. and Jacobs, A.S., Post-Confirmation Issues: Ascertaining The Effective Date; Post-Confirmation Jurisdiction; Serial Filing; Post-Confirmation Litigation Vehicles, SK092 ALI-ABA 631, 635, June 2005 (quoting Klee, K.K., "Adjusting Chapter 11: Fine Tuning the Plan Process," The American Bankruptcy Law Journal, Vol. 69, 551, 560-61, Fall 1995 ("Post-Confirmation Issues").

<sup>82</sup> Bankruptcy Code § 1101(2).

<sup>83</sup> See "Post-Confirmation Issues," supra at 638.

<sup>84</sup> See Thau, A.M., Friedland, J.P. and Geekie Jr., E.J., "Post-Confirmation Liquidation Vehicles (Including Liquidation Trusts and Post-Confirmation Estates): An Overview," Norton Journal of Bankruptcy Law and Practice, Vol. 16, No. 2, fn. 20, April 2007 ("Post-Confirmation Liquidation Vehicles").

<sup>85</sup> See "Post-Confirmation Liquidation Vehicles," supra fn. 21.

<sup>86</sup> Based in part on Freeman, S.M., Some Considerations in Preparing a Liquidation Trust Agreement, ABI 26th Annual Spring Meeting, Spring 2008 ("Some Considerations").

and winding up payroll and benefit plans. These roles may or may not be handled by a separate designated agent or plan administrator. Therefore, each trust agreement and plan should be designed to address the issues that need to be resolved in the particular bankruptcy.

In general, the assets and functions of the liquidation trust must be limited to the assets in which creditor-beneficiaries are treated as the grantors and deemed owners. A liquidation trustee can be designated in the plan and trust agreement as a disbursing agent.<sup>87</sup> Other plans separately identify the tasks and the funds needed to accomplish them as a way to ensure that trust assets are not used for non-trust beneficiaries, even though the same person/trustee may actually perform both roles.<sup>88</sup> A liquidation trustee may also be designated in the plan and trust agreement as the appointed representative of the estate.<sup>89</sup> Note, however, that an estate representative can typically only be endowed with authority over estate causes of action, and not as a representative to handle operating affairs of the debtor.

In one example, the Refco Litigation Trust Agreement states:

Pursuant to section 1123(b) of the Bankruptcy Code, the Plan appointed the Litigation Trustee as the duly appointed representative of the Estates, and, as such, the Litigation Trustee succeeds to all of the rights and powers of a trustee in bankruptcy with respect to prosecution of the Contributed Claims for the ratable benefit of the Litigation Trust Beneficiaries. To the extent that any Contributed Claims cannot be transferred to the Litigation Trust because of a restriction on transferability under applicable non-bankruptcy law that is not superseded or preempted by section 1123 of the Bankruptcy Code or any other provision of the Bankruptcy Code, such Contributed Claims shall be deemed to have been retained by the

See, e.g., Declaration of Trust, Estate Administration and Liquidation Trust Agreement ResMAE Mortgage Corporation ("ResMAE Liquidation Trust Agreement"), section 3.1 (Dkt. 415, Ex. 9), In re ResMAE Mortgage Corp., No. 07-1077 (Bankr. D. Del.), available through PACER at ecf.deb.uscourts.gov; Crown Pacific Estate Administration and Liquidation Trust Agreement and Declaration of Trust ("Crown Pacific Liquidation Trust Agreement"), Section 3.3(e), (f), (k) (Dkt. 653 Ex. A); In re CP Acquisition Co., No. 2-03-11258-PHX-RJH (Bankr. D. Ariz.).

<sup>88</sup> See, e.g., USA Commercial Mortgage Estate Administration and Liquidation Trust Agreement and Declaration of Trust ("USACM Liquidation Trust Agreement") Section 3.5(e) (Dkt. 3335), and Amended Disbursing Agent Agreement (Dkt. 4044), In re USA Commercial Mortgage Company, No. BK-S-06- 10725, (Bankr. D. Nev.).

<sup>89</sup> Bankruptcy Code § 1123(a)(5), (a)(7), (b)(3)(B).

Reorganized Debtors and RCM, as applicable, and the Litigation Trustee shall be deemed to have been designated as a representative of the Estates pursuant to section 1123(b)(3)(B) of the Bankruptcy Code to enforce and pursue such Contributed Claims on behalf of the Estates. Notwithstanding the foregoing, all net proceeds of the Contributed Claims shall be transferred to the Effective Beneficiaries consistent with the provisions of the Plan and this Litigation Trust Agreement.<sup>90</sup>

# C. Trust Funding

The governing documents of the trust must ensure that sufficient funds will be available to administer the trust properly and to keep it administratively solvent.<sup>91</sup> Administrative expenses generally include professional fees and expenses as they are necessary to maximize the value of any property held by the trust prior to a sale or distribution of the property.

Often, the plan will provide for a source of initial funding obtained from the reorganized debtor or a secured creditor designated for repayment from proceeds realized by the trust from the liquidation of its assets. Frequently, priority of recoveries and distributions of those recoveries from the liquidation of assets are designated in the plan, disclosure statement and trust agreement to govern the use of funds. In many cases, funding is segregated by designated use, or source, in order to clarify and carefully track the use and distribution of proceeds.

Liquidity and the presence or absence of adequate financial resources can have an effect on retaining qualified professionals to administer the trust, and their freedom to make decisions that maximize trust recoveries. Careful planning using budgets, estimates and monitoring actual results of the trust's operations will help ensure that critical resources are well managed in accordance with the oversight provided by the trust's governing committee.

<sup>90</sup> Refco Litigation Trust Agreement Section 1.7, *In re Refco Inc.*, Case No. 05-60006 (Bankr. S.D.N.Y.) (Dkt. 3688, Ex. F).

<sup>91</sup> Ayres, J., "Liquidation Trust Structure is Key to Maximizing Payouts," *TMA Journal of Corporate Renewal*, October 2006.

To the extent that there are any unclaimed distributions at the conclusion of the trust, the governing document should indicate their resolution. Often, distributions that have not been claimed within a certain period of time, frequently specified as a year, are forfeited after the trustee's initial efforts to locate the beneficiary. The returned funds are forfeited back to the trust for the benefit of the other beneficiaries if subsequent distributions are made. Small pools of unclaimed distributions remaining at the end of a case can also be donated to charity. Use of an unclaimed distribution provision provides clarity, eliminates ambiguity over whether to perform secondary distributions, and reduces the administrative expenses of the trust by eliminating the need to maintain the records regarding potential violations of escheat laws.

# D. Reporting Requirements

The regularity and frequency of reporting to the governing committee and beneficiaries should be specified in the trust agreement and plan. Failure to provide reporting can be criticized.<sup>95</sup> The trust's governing documents should clearly specify the reporting obligations of the trustee with respect to taxes and interim communications with the oversight committee and the beneficiaries. For large cases, a website can minimize the costs of communication and permit more timely and complete information to be communicated to beneficiaries.

#### E. Authorization for the Trustee to Act%

Trustees will need authorization to undertake decisions. The specific authority for a trustee to act should be specified in the trust agreement and plan, and also described in the disclosure statement. The plan and liquidation trust agreement should accordingly provide for bankruptcy court access and bankruptcy court jurisdiction.

<sup>92</sup> Basler, C. and Campbell, M., "Everything Your Disbursing Agent Wants You to Know Beyond 'How Much' and 'When," *ABI Journal*, Vol. 25, No. 8, p. 28 October 2006 ("Everything Your Disbursing Agent").

<sup>93</sup> Singerman, P.S. and Brand, J.T., "Doing Good' in Chapter 11 Liquidating Plans," *ABI Journal*, Vol. 25, No. 10, p. 48, December/January 2007.

<sup>94</sup> See "Everything Your Disbursing Agent," supra; see, e.g., 11 U.S.C.A. § 347(b).

<sup>95</sup> See Consolidated Pioneer, 264 F.3d 803, 805-06 (9th Cir. 2001) (discussing PCLV that refused to provide significant information regarding liquidation process for almost five years).

<sup>96</sup> Based in part on "Some Considerations," supra.

#### A PRACTITIONER'S GUIDE TO LIQUIDATION AND LITIGATION TRUSTS

Generally, neither the Internal Revenue Code nor the Bankruptcy Code requires a trustee to obtain court approval for all decisions. However, § 363(b) does require a trustee or debtor in possession to obtain court approval for actions outside the ordinary course of business. Since it is impractical and costly to require frequent court approval of every liquidation trustee decision, the trustee is typically granted powers to act within certain limitations, under the review and oversight of the trust's governing committee.

Nevertheless, the trustee, oversight committee and beneficiaries of the trust may still want the liability protection of having court approval for major transactions and decisions. Examples of transactions typically requiring court approval in a trust agreement include sales of substantial property interests, major settlements of significant causes of action, or court oversight of professional fees incurred on behalf of a liquidation trust. An oversight committee can also seek bankruptcy court resolution of disputes between its members over trust decisions.

The post-confirmation jurisdiction of the bankruptcy courts is limited. Some courts have concluded that bankruptcy court jurisdiction does not encompass disputes over the operations of the reorganized debtor.<sup>97</sup>

Reorganization and liquidation plans must expressly provide for the means by which the plan will be implemented.<sup>98</sup> The liquidation or litigation trust serves as a successor entity to a debtor whose purpose is to liquidate causes of action and other assets for distribution to creditors. Therefore, plans and confirmation orders generally include provisions for the bankruptcy court to retain jurisdiction over litigation to enforce and implement plan terms. (Refer to Chapter 11 for a discussion of jurisdictional issues in retaining and prosecuting claims.)

The Bankruptcy Code also provides statutory authority for a bankruptcy court to "direct the debtor and any other necessary party ... to perform any other act ... that is necessary for consummation of the plan," and to "collect and reduce to money"

<sup>97</sup> See In re Pegasus Gold Corp., 394 F.3d 1189, 1198 (9th Cir. 2005) (upholding such jurisdiction); In re Resorts Int'l Inc., 372 F.3d 154, 169 (3d Cir. 2004) (no post-confirmation jurisdiction over accounting malpractice action).

<sup>98</sup> See Bankruptcy Code § 1123(a)(5).

<sup>99</sup> See Bankruptcy Code § 1142(b). Note, however, that the statute does not specify where the bankruptcy court can direct post-confirmation litigation.

the property of the estate."<sup>100</sup> A district court sitting in a bankruptcy case may also have ancillary jurisdiction over such litigation through the federal supplemental jurisdiction statute, which at least one circuit has held may be exercised by the bankruptcy court.<sup>101</sup>

Circuit courts have analyzed whether bankruptcy courts have "related to" jurisdiction over litigation by a post-confirmation trust established under a reorganization plan using the widely adopted test from *Pacor Inc. v. Higgins*. <sup>102</sup> The Supreme Court approved, and even broadened, the *Pacor* test in *Celotex*. <sup>103</sup> The U.S. Supreme Court's 2006 decision in *Katz* on sovereign immunity may reach even further than *Pacor* and *Celotex*, given the types of connections encompassed by ancillary jurisdiction in nonbankruptcy cases and in receivership and pre-Code bankruptcy cases. <sup>104</sup>

The authority granted to the liquidation trustee should be broad enough to handle the unexpected. For example, contemplated asset sales may derail upon discovery of unexpected environmental issues, or property may become damaged or destroyed due to unexpected storms, hurricanes or fire. In these situations, a subcommittee consisting of a few key individuals may work jointly with the trustee to quickly evaluate options and to rapidly authorize the necessary actions needed to resolve, or responsibly handle, the situation within the bounds of the trust agreement and plan documents. Additional authority may or may not be made available by petitioning the court to request expanded powers that might be necessary to fulfill the purpose of the trust and meet the trustee's fiduciary duties to protect assets. The better approach is to handle these contingencies through the design of the initial trust documents and the plan.

Concerns about the liability risks to the trustee that may stem from authorizing decision-making powers can be limited through the use of indemnifications as discussed in chapter 13. However, no indemnification can protect against gross negligence.

<sup>100</sup> See Bankruptcy Code § 704 (chapter 7 trustee), incorporated by reference as duty of chapter 11 trustee in 11 U.S.C. § 1106(a)(1); § 1123(b)(3)(B) (plan may provide for retention and enforcement by debtor, trustee, or representative of the estate of any estate claim or interest).

<sup>101 28</sup> U.S.C. § 1367; Pegasus Gold, 394 F.3d at 1195.

<sup>102</sup> Pacor Inc. v. Higgins, 743 F.2d 984 (1984), discussed in Pegasus Gold, 394 F.3d at 1193-94; Resorts Int'l., 372 F.3d at 163-65.

<sup>103</sup> Celotex Corp. v. Edwards, 514 U.S. 300, 308 (1995), approving Pacor.

<sup>104</sup> See Freeman, S. and Marvin, R., The Scope of Bankruptcy Ancillary Jurisdiction After Katz as Informed by Pre-Katz Ancillary Jurisdiction Cases, 15 ABI Law Review 155, Spring 2007, analyzing Cent. Va. Cmty. Coll. v. Katz, 546 U.S. 356 (2006).

# F. Governing Committees

Generally, liquidation trustees operate under the authority of a governing or oversight committee. Members of the committee typically include former members of the unsecured creditors' committee or members of the former secured creditors' committee. Efficiency necessitates limiting the number of members on the oversight committee to minimize administrative costs and to streamline decision-making.

The governing committee is typically responsible for monitoring the trustee's operations and for granting authority to enter into settlement agreements, sale agreements and other actions. The governing committee may require quarterly review and reporting. The need for a governing committee will depend on the case, and the range of discretionary authority granted to the trustee will also depend on the case, but this should be carefully specified in the trust agreement and the plan in order to avoid later confusion or uncertainty. In some cases, subcommittees will be granted the authority to monitor and decide about specific matters or issues. In other cases, informal committees of key parties or large creditors will stay more involved, receive timely updates and offer consultation on major decisions.

As indicated in the preceding section, major actions that will affect the financial outcome of the trust typically also require the approval of the bankruptcy court, either as required under the plan and trust agreement or by the prerogative of the trustee who is seeking to limit his, and the committee's, professional liability for their decisions.

# G. U.S. Trustee Reporting Requirements

Requirements for U.S. Trustee reporting after the confirmation of a plan of liquidation or upon the commencement of a liquidation trust will vary by jurisdiction. Some circuits require the liquidation trustee to continue filing quarterly financial reports with the Office of the U.S. Trustee. These reports may also be required by the bankruptcy court. Although seemingly burdensome, the reporting requirements can be viewed as part of the checks and balances and the oversight of the trust. They also serve to protect the trustee from later allegations that the beneficiaries were not informed of the level of trust recoveries, cost of the trust and distributions made. In this sense, the financial reports issued to the U.S. Trustee serve as a public record of the trust's operation. Note that the required reports prepared for

the U.S. Trustee are compiled on a cash basis and do not represent audited financial results, which are typically presented on an accrual basis.

Depending on the circumstances and size of the case, cash or accrual basis may be accepted as the regular means of financial reporting with the consent of the U.S. Trustee and the court. As the trust's activities are completed and the trust is ready to close, a final report will also be required by the U.S. Trustee in those jurisdictions where regular financial reporting is mandated. The final report will provide the final interim period, but will also report on the overall activities of the trust and the final distribution to beneficiaries.

#### H. Conclusion

This chapter introduced a number of key concepts underlying the legal requirements necessary to establishing the management of the trust. Important issues involve the segregation of funds, the use of governing committees, the management of information and reporting, authorizing the trustee to act, control over key decisions on property sales, methods for resolving claims, authorization for the trustee to manage unexpected items, and reporting issues involving the U.S. Trustee.