

STATE BAR OF TEXAS  
**BANKRUPTCY LAW SECTION**  
**NEWSLETTER**

Summer 2006

Vol. 4., No. 3

**A Letter from the New Chair.....**  
**Deborah Williamson**

Most, if not all, of the lawyers reading this Newsletter have grimaced through comments about “not being real litigators.” We have gritted our teeth when referred to as vultures, dining on the carrion of dead companies. We have bit our tongues when our clients are referred to as “deadbeats.” Our practices have been dismissed by our children as “boring” – even by those offspring who claim to have law school in their future. And all of us have been asked, “Why in the world did you pick bankruptcy?”

As many of us were involuntarily drafted into bankruptcy and didn’t actually choose to become bankruptcy attorneys, that shouldn’t be the question. The more interesting question is – why are we still practicing bankruptcy? And the answer for me is found in this Section.

Over twenty years ago, I had my first out of town hearing in the big city of Dallas. Could I find the courthouse? Would I have enough money for a taxi? Would I be able to find the courtroom? Would I be hometowned? Fortunately for me, I was able to pay for the taxi, find the courtroom and appear for my hearing in front of Judge Abramson. It was the first of many such hearings over many years in front of almost two dozen different Texas bankruptcy judges. Sometimes I lost and sometimes I won and sometimes I wasn’t sure what happened, but the important things remained the same. I was expected to be prepared to argue both the facts and the law. I was expected to be reasonable in my positions. In return, I was treated the same as every other lawyer in the courtroom – regardless of the size of my firm, the city I lived in, or the fact that I wasn’t wearing a tie.

At my first out of town hearing, I learned that Judge Abramson required lawyers to talk **to** each other – not **at** each other. He required us to attempt to bring reason to our clients and to litigate with

integrity when we couldn’t. These basic requirements have carried over into the practice of bankruptcy throughout the state of Texas. Bankruptcy is often intellectually challenging and replete with opportunities for “real” litigation. We have a low “jerk” factor among our practitioners. While our Texas judges are human and sometimes a bit irascible – they are all extremely hardworking and still find the time to help improve our practice, as evidenced by their level of participation in our Bankruptcy Law Section.

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**CALL FOR ARTICLES AND  
CALENDAR EVENTS**

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 currently 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.

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 **kourtney.lyda@haynesboone.com** or mail it to the following address:

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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>**. We look forward to reviewing your submissions for potential publication in the next **STATE BAR OF TEXAS BANKRUPTCY LAW SECTION NEWSLETTER**.

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## BANKRUPTCY AND THE TEXAS BOARD OF LEGAL SPECIALIZATION: ARE YOU CERTIFIABLE?

*by Marvin E. Sprouse III*

Of the some 77,000 attorneys currently licensed in Texas, only 7,007 are “certified” by the Texas Board of Legal Specialization (the “Board”).<sup>2</sup> Currently, the Board offers certification in twenty practice areas, including Business Bankruptcy Law and Consumer Bankruptcy Law.<sup>3</sup> Becoming certified requires a substantial commitment, including a lengthy application process and a day-long examination. What is this certification thing? What exactly does it take to get Board certified? Is it worth it?

The Board is established by the State Bar of Texas to recognize “those attorneys who have competence in a particular area of law.”<sup>4</sup> Volunteer professionals within each practice area review and revise the specialty examinations annually.<sup>5</sup> In addition to the written examination, the generic requirements for Board certification include the following: the attorney must have been licensed for five years; a certain percentage of the applicant’s practice must have been dedicated to the specialty area for three years; the attorney must have a track record of experience and involvement in a variety of matters within the specialty area; the attorney must meet approved CLE requirements; and the attorney must be evaluated by judges and other lawyers.<sup>6</sup> The certification process, from application to examination, can take up to nine months to complete.<sup>7</sup>

The examination is administered once a year.<sup>8</sup> The statistics indicate that the examinations are no cake-walk. Of the 38 attorneys taking the examination for Board certification in bankruptcy law between 2003 and 2005, 17 did not pass – a passage rate of about 55%.<sup>9</sup> Applicants may re-take the exam once – the following year – upon approval of the Board.<sup>10</sup>

The prevalence of Board certification depends upon the practice area. In sheer numbers, Texas attorneys Board certified in Personal Injury Trial Law lead the pack, with 1,775 currently certified, followed by Civil Trial Law (1189), Criminal Law (826), and Family Law (697).<sup>11</sup> According to Gary McNeil, Executive Director of the Board, the recent liberalization of the advertising rules pertaining to specialization has not had an impact on the overall number of certification applicants.<sup>12</sup> The number of applicants for Board certification fluctuates from year to year, but in recent years no broad trends are indicated, except with respect to Board certification in Personal Injury Trial Law – tort reform appears to have lessened the demand for Board certification in that specialty.<sup>13</sup>

Currently, 165 Texas attorneys are certified in Business Bankruptcy Law, and 161 are certified in Consumer Bankruptcy Law.<sup>14</sup> Of these, 68 Texas attorneys are Board certified in both Business and Consumer Bankruptcy Law.<sup>15</sup>

The ranks of Texas attorneys Board certified in bankruptcy are growing slowly.<sup>16</sup> In 2005, the Board certified four attorneys each in Business and Consumer Bankruptcy Law.<sup>17</sup> For whatever reason, even that pace may be slowing down.<sup>18</sup> In 2006, only four attorneys total completed the application process for Board certification in bankruptcy law.<sup>19</sup>

Lubbock attorney Max Tarbox, certified in both Consumer and Business Bankruptcy Law, believes that Board certification is especially beneficial for young lawyers.<sup>20</sup> According to Tarbox, Board certification provides “instant credibility” that might otherwise be hard to come by.<sup>21</sup> Moreover, Tarbox’s clients routinely credit his Board certification as a reason he is hired – the local Yellow Pages provide a separate section for Board certified attorneys.<sup>22</sup> San Antonio attorney Michael Parker, certified in Consumer and Business Bankruptcy Law, is certain that his certification has made the difference when potential clients have had several lawyers from which to choose.<sup>23</sup> Certification can act as a “threshold” for prospective clients, says Parker, providing a “way to get you in the door.”<sup>24</sup>

Austin attorney Stephen Sather, Board certified in Business Bankruptcy Law, also recommends Board certification for younger lawyers looking to tout their competence.<sup>25</sup> For a younger lawyer, says Sather, Board certification “gives entrée into the club – credentials to say you’ve had good experience.”<sup>26</sup> Another benefit from Board certification, according to Sather, is the application process itself, as it provides an opportunity for a lawyer to think about discrete areas within a specialty in which one might want to gain additional experience.<sup>27</sup>

Board certification is not for everyone, but it does provide an objective and potentially valuable measure of proficiency. Most of us have the J.D. and a supply of sharpened No. 2 pencils. Do you have what it takes to get Board certified?

<sup>1</sup> Senior Counsel at Jackson Walker L.L.P., Austin, Texas (not certified by the Texas Board of Legal Specialization, but he has thought about it).

<sup>2</sup> Texas Board of Legal Specialization: General Questions, at <http://www.tbls.org/FAQs/General.asp>. The Board also provides certification for Legal Assistants in six specific areas). *Id.* Currently, 320 Legal Assistants are Board certified. *Id.*

<sup>3</sup> *Id.*

*Continued on page 6*

## CHANGES TO RECLAMATION LAW

by *Matthew R. Reed*  
*Thompson & Knight LLP*

Imagine you are sitting in your office and the telephone rings. On the other end of the line is your favorite seller-of-goods client. This client tells you that one of his regular customers – a buyer of goods – filed for bankruptcy the day before. Your client’s arrangement with the bankrupt buyer involves the sale of goods on an invoice-by-invoice basis. Five days ago, your client delivered \$50,000.00 worth of goods to the bankrupt buyer and obviously has not been paid yet. Then comes the question: “Can we get the goods back?” The answer to this question is found in the Bankruptcy Code’s reclamation provision, which was recently amended by the ubiquitous BAPCPA.

The old reclamation provisions of the Bankruptcy Code and the new reclamation provisions of the Bankruptcy Code preserve and enhance (the degree of enhancement being the difference between the old and new reclamation provisions) a seller of goods’ right to reclaim goods from an insolvent buyer of goods under § 2.702 of the Texas Business & Commerce Code (hereinafter “Business & Commerce Code”).<sup>1</sup> This article first explains the rights of sellers to reclaim goods outside of bankruptcy under the Texas Business & Commerce Code. Second, this article explains the rights of sellers to reclaim goods inside bankruptcy under the old Bankruptcy Code § 546(c). Third, this article explains the reclamation rights of sellers inside bankruptcy under new § 546(c). Finally, this article briefly describes some likely consequences of the new Bankruptcy Code § 546(c) to certain debtors and senior secured lenders.

### Outside of Bankruptcy

Outside of bankruptcy, Business & Commerce Code § 2.702 provides: “[w]here the seller discovers that the buyer has received goods on credit while insolvent he may reclaim the goods upon demand made within ten days after the [buyer’s] receipt [of the goods sold] . . . .”<sup>2</sup> The seller’s demand must be in writing, and the seller must be able to identify the goods subject to reclamation. The policy behind Business & Commerce Code § 2.702(b) is that any receipt of goods on credit by an insolvent buyer amounts to a tacit business misrepresentation of solvency and is therefore fraudulent as against the particular seller.<sup>3</sup> Effectively, there are two conditions to the exercise of the right to reclaim goods: (i) discovery of the buyer’s insolvency, and (ii) written demand of reclamation within ten days of the buyer’s receipt of goods.<sup>4</sup> The seller’s right to reclaim, however, is subject to the rights of a buyer in ordinary course or other good faith purchaser or

lien creditor.<sup>5</sup> Finally, successful reclamation of goods excludes all other remedies.<sup>6</sup>

### Inside Bankruptcy – *old* § 546(c)

Before it was amended, Bankruptcy Code § 546(c) enabled sellers of goods to exercise their state-law reclamation rights subject to the seller giving notice of reclamation: (i) within ten days following the debtor’s receipt of the goods or, (ii) if such ten-day period expires postpetition, then within twenty days of the debtor’s filing for bankruptcy protection.<sup>7</sup> One of the downsides to old § 546 was that bankruptcy courts could deny actual turnover of goods by granting an administrative expense equal to, or a lien to secure payment of, the value of those goods.<sup>8</sup> The problem with these alternate remedies is that sellers usually must then wait until much later in the case to be paid.<sup>9</sup> Thus, under old § 546(c), even if a seller timely noticed the debtor of its reclamation rights, the debtor could avoid turning over the seller’s goods by moving the court to grant the seller an administrative claim or a lien on property of the estate.

### Inside Bankruptcy – *new* § 546(c)

*New* § 546(c) changes the prior provision’s mere recognition of state-based reclamation law into an expanded substantive right in bankruptcy.<sup>10</sup> Under new § 546(c), the notice or “look-back” of ten days is expanded to forty-five days following the insolvent debtor’s receipt of the goods, or, if such forty-five-day period expires postpetition, to twenty days following the debtor’s filing for bankruptcy protection.<sup>11</sup> However, a seller’s reclamation rights under new § 546(c)(1) are “subject to the prior rights of a holder of a security interest in such goods or the proceeds thereof.” Importantly, new § 546(c) eliminates the debtor’s ability to mitigate the impact of reclamation by substituting a lien or an administrative priority expense for actual reclamation.<sup>12</sup> Additionally, new § 546(c)(2) provides: “If a seller of goods fails to provide [timely] notice [of reclamation], the seller *still* may assert the rights contained in section 503(b)(9).”<sup>13</sup> Bankruptcy Code § 503(b)(9) is a new section that grants a seller of goods an administrative expense claim of the value of any goods received by the debtor within twenty days *prior* to the petition date where the debtor purchased such goods in the debtor’s ordinary course of business. This priority is available even if the seller fails to give written notice of intent to claim reclamation.

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Therefore, a seller may reclaim goods under new § 546 by (i) giving notice of the exercise of such rights within forty-five days following the debtor's receipt of such goods, or (ii) if such forty-five-day period expires postpetition, to twenty days following the commencement of the bankruptcy case.<sup>14</sup> The seller's reclamation rights are subject to prior perfected security interests in such goods.<sup>15</sup> Finally, even if the seller cannot reclaim its goods because of a prior perfected security interest in such goods or fails to timely notice the debtor of its reclamation rights, the seller is entitled to an administrative expense claim of the value of any goods received by the debtor within twenty days *prior* to the petition date.<sup>16</sup>

A common question is whether the automatic stay precludes a seller from physically retaking its goods.<sup>17</sup> Bankruptcy Code § 362(b), which sets forth the exceptions to the automatic stay, has *not* been amended to provide specific authority to a seller to reclaim without first seeking court approval.<sup>18</sup> But new § 362(b)(24) excepts from the stay "any transfer that is not avoidable under section 544 and . . . section 549." And, new § 546(c) expressly provides that the "rights and powers of the trustee under sections 544(a), 545, 547, and 549 are subject to [a seller's reclamation rights]."<sup>19</sup> It is unclear whether new § 362(b)(24) will allow a seller's physical taking of its delivered goods without prior judicial consent. Either way, the seller-creditor apparently does not violate the stay by sending the debtor written notice of intent to reclaim identifiable goods. In the event the debtor does not immediately comply with the reclamation notice, consider filing an emergency motion under §§ 546(c), 362(b)(24), and 105(a) with a proposed form of order directing the debtor to turnover the delivered goods or enjoining the debtor from interfering with the seller-creditor's repossession of such goods.

### Consequences of new § 546(c)

New § 546 will probably cause an increase in reclamation claims, which in turn will probably give rise to a variety of attempts by debtors to reach a compromise with reclaiming sellers.<sup>20</sup> Such compromises will likely include an offer of cash, together with the granting of liens and administrative priority claims, each of which are available under old § 546.<sup>21</sup>

Debtors with ongoing inventory needs, like supply-chain participants in the grocery and other perishable businesses, and in just-in-time manufacturing will be particularly affected by new § 546.<sup>22</sup> The increased leverage of sellers under new § 546(c) will create a hardship on debtor-grocery distributors and debtor-retailers.<sup>23</sup> On the other hand, debtors with periodic or reasonable inventory needs should attempt to file late in their inventory cycle to mitigate reclamation claims and

avoid empty shelves postpetition.<sup>24</sup>

Senior secured lenders are also faced with a dilemma by new § 546(c), which codifies current case law holding that reclamation claims are subordinate to existing floating liens on the same goods.<sup>25</sup> Typically, the senior secured lender holds a security interest in effectively all of the debtor's assets, including a floating lien on inventory and accounts receivable.<sup>26</sup> To claim postpetition interest and other expenses, a senior secured lender will usually assert that it is fully secured or over secured.<sup>27</sup> But under new § 546(c), if the senior secured lender is in fact over secured, any unencumbered inventory collateral may be subject to reclamation, which will diminish the senior secured lender's collateral base.<sup>28</sup> Thus, reclaiming creditors under new § 546(c) enjoy a newfound leverage over debtors and senior-secured lenders. Such increased leverage is either a "good thing" or a "bad thing" depending on who you represent.

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<sup>1</sup> Chapter 2 of the Texas Business & Commerce Code codifies (with some minor changes beyond the scope of this article) Article 2 "Sale of Goods" of the Uniform Commercial Code.

<sup>2</sup> TEX. BUS. & COM. CODE § 2.702(b) (Vernon 1994).

<sup>3</sup> U.C.C. § 2.702 cmt. 2.

<sup>4</sup> *Id.*

<sup>5</sup> TEX. BUS. & COM. CODE § 2.702(c).

<sup>6</sup> *Id.*

<sup>7</sup> 11 U.S.C. § 546(c); *see also*, Peter S. Fishman, *Not So Fast: Assets Sales Under the New § 363*, AM. BANKR. INST. J., Sept. 2005, at 80 (hereinafter "Fishman").

<sup>8</sup> 11 U.S.C. § 546(c)(2); *see also*, Fishman, *supra* note 8, at 80.

<sup>9</sup> *See* Fishman, *supra* note 8, at 80.

<sup>10</sup> *See id.*

<sup>11</sup> *See* 11 U.S.C. § 546(c) (as amended); *see also*, Fishman, *supra* note 8, at 80.

<sup>12</sup> 11 U.S.C. § 546(c) (as amended).

<sup>13</sup> *Id.* § 546(c)(2) (as amended) (emphasis added).

<sup>14</sup> *Id.* § 546(c) (as amended).

<sup>15</sup> *Id.*

<sup>16</sup> *Id.* § 546(c)(2) (as amended).

<sup>17</sup> *See* Richard Levin & Alesia Ranney-Marinelli, *The Creeping Repeal of Chapter 11: The Significant Business Provisions of the Bankruptcy Abuse Prevention and Consumer Protection Act*, 79 AM. BANKR. L.J. 603, 606 (2005).

<sup>18</sup> *Id.*

<sup>19</sup> *Id.*; 11 U.S.C. § 546(c)(1) (as amended).

<sup>20</sup> *See* Fishman, *supra* note 8, at 80.

<sup>21</sup> *Id.*

<sup>22</sup> *Id.* at 81.

<sup>23</sup> *Id.*

<sup>24</sup> *Id.*

<sup>25</sup> *Id.*

<sup>26</sup> *Id.*

<sup>27</sup> *Id.*

<sup>28</sup> *Id.*

*Continued from 3*

<sup>4</sup> Texas Plan for Recognition and Regulation of Specialization in the Law (As Amended January 10, 2001), *available at* <http://www.tbls.org/Cert/Index.asp> (link to .pdf provided).

<sup>5</sup> Interview with Kathy Logue, Certification Analyst, Texas Board of Legal Specialization (July 18, 2006).

<sup>6</sup> Texas Board of Legal Specialization: General Questions, *at* <http://www.tbls.org/FAQs/General.asp>.

<sup>7</sup> Texas Board of Legal Specialization: Application Questions, *at* <http://www.tbls.org/FAQs/Applicant.asp>.

<sup>8</sup> Texas Board of Legal Specialization: Attorney Certification Process, *at* <http://www.tbls.org/Cert/AttGetStarted.asp>.

<sup>9</sup> Interview with Odessa Bradshaw, Associate Executive Director, Texas Board of Legal Specialization (July 18, 2006)(statistical table provided).

<sup>10</sup> Texas Board of Legal Specialization: Attorney Certification Process, *at* <http://www.tbls.org/Cert/AttGetStarted.asp>.

<sup>11</sup> Texas Board of Legal Specialization: General Questions, *at* <http://www.tbls.org/FAQs/General.asp>.

<sup>12</sup> Interview with Gary McNeil, Executive Director, Texas Board of Legal Specialization (July 18, 2006). Current Texas Rule of Professional Conduct 7.02(a)(6) provides that an attorney may not designate "one or more areas of practice in an advertisement in the public media or in a solicitation communication unless the advertising or soliciting lawyer is competent to handle legal matters in each such area of practice." Rule 7.02(b) states that "Rule 7.02(a)(6) does not require that a lawyer be certified by the Texas Board of Legal Specialization at the time of advertising in a specific area of practice, but such certification shall conclusively establish that such lawyer satisfies the requirements of Rule 7.02(a)(6) with respect to the area(s) of practice in which such lawyer is certified." Comment 11 to Rule 7.02 states that "competency may be established by means other than certification by the Texas Board of Legal Specialization."

<sup>13</sup> *Id.*

<sup>14</sup> Texas Board of Legal Specialization: General Questions, *at* <http://www.tbls.org/FAQs/General.asp>.

<sup>15</sup> Texas Board of Legal Specialization: Attorney Directory, *at* <http://www.tbls.org/Directory/AttList.asp>.

<sup>16</sup> Interview with Gary McNeil, Executive Director, Texas Board of Legal Specialization (July 18, 2006).

<sup>17</sup> Texas Board of Legal Specialization: News, *at* <http://www.tbls.org/News/Index.asp>.

<sup>18</sup> Interview with Gary McNeil, Executive Director, Texas Board of Legal Specialization (July 18, 2006).

<sup>19</sup> *Id.*

<sup>20</sup> Interview with Max Tarbox, Esq., McWhorter, Cobb and Johnson, L.L.P., Lubbock, Texas (July 18, 2006).

<sup>21</sup> *Id.*

<sup>22</sup> *Id.*

<sup>23</sup> Interview with Michael Parker, Esq., Fulbright & Jaworski L.L.P., San Antonio (July 20, 2006).

<sup>24</sup> *Id.*

<sup>25</sup> Interview with Stephen Sather, Esq., Barron & Newburger, P.C., Austin, Texas (July 18, 2006).

<sup>26</sup> *Id.*

<sup>27</sup> *Id.*

## TROOP MOVEMENTS

**Michelle A. Mendez** has moved to **Jenkins & Gilchrist**, located at 1445 Ross Avenue, Suite 3700, Dallas, Texas 75202.

**Michael P. Ridulfo** has joined the Bankruptcy, Reorganization and Creditor's Rights Section of the Houston office of **Brown McCarroll L.L.P.**, located at 1111 Bagby, 47th Floor Houston, Texas 77002-2543, Telephone: (713) 529-3110.

Effective June 1, 2006, McClain, Leppert & Maney, P.C. changed its name to **McClain, Maney & Patchin, P.C.**

**Tom Henderson** has set up his own solo practice and can be found at 711 Louisiana, Suite 3100, Houston, Texas 77002, Telephone: (713) 227-9500.

**Shari L. Heyen** has moved to **Greenberg Traurig, LLP** at 1000 Louisiana Street, Suite 1800, Houston, Texas 77002, Telephone: (713) 374-3564.

**Clifton R. Jessup, Jr.** has new contact information at **Greenberg Traurig, LLP** and can now be reached at 2200 Ross Avenue Suite 5200, Dallas, Texas 75201, Telephone: (214) 665-3638.

**Mark Weisbart** has moved to the **Law Offices of Mark Weisbart** located at 5000 Quorum, Suite 620, Dallas, Texas 75254, Telephone: (469)621-3700 ext. 213, Fax: (469) 621-3706, [weisbartm@earthlink.net](mailto:weisbartm@earthlink.net).

## BANKRUPTCY JURISDICTION UPHeld IN A STATE PROBATE RELATED MATTER

by H. Joseph Acosta<sup>1</sup>

In *Marshall v. Marshall*,<sup>2</sup> the U.S. Supreme Court recently reversed the Ninth Circuit Court of Appeals' extension of the probate exception to federal court jurisdiction. This exception bars federal courts, including bankruptcy courts, from adjudicating certain matters pending before a state probate court.

The case essentially involved a dispute over the assets of the late J. Howard Marshall II. In June 1994, a mature J. Howard married a young Vickie Lynn Marshall, also known as Anna Nicole Smith. A little over a year after their marriage, Mr. Marshall passed away. Notwithstanding lavish gifts during their marriage and alleged promises to bequeath half of his assets to his wife, his will did not include anything for his surviving spouse.

This sparked a ten-plus year controversy between Mrs. Marshall and E. Pierce Marshall, the son of the deceased and the principal beneficiary of his estate.

### Texas & California Courts

During the pendency of a 1995 Texas probate proceeding, where Mr. Marshall's will was being administered, Mrs. Marshall filed bankruptcy in California, presumably her place of residence. The decedent's son filed a proof of claim in the bankruptcy case, alleging that Mrs. Marshall had defamed him through allegations of fraud and other misconduct in connection with the elder Mr. Marshall's estate planning. As a consequence, the California bankruptcy court had jurisdiction over both the decedent's son's claim and Mrs. Marshall's resulting counterclaim that the decedent's son had tortiously interfered with a gift or bequest from her deceased husband.

The bankruptcy court summarily dismissed the decedent's son's claim and, after a five-day trial, ultimately ruled in favor of Mrs. Marshall on her tortious interference claim. Judgment was entered against the decedent's son in the amount of \$474 million, minus any award Mrs. Marshall might receive from the Texas probate proceeding.

On appeal, a California district court vacated the money judgment on the basis that Mrs. Marshall's claim did not present a "core" bankruptcy matter and, therefore, the bankruptcy court only had authority to recommend to the district court proposed findings of fact and conclusions of law. The district court nonetheless agreed with the merits of Mrs. Marshall's claim, but substantially reduced the award against the decedent's son.

Nearly a month prior to the entry of the California district court's judgment, the Texas probate court entered a judgment declaring the elder Mr. Marshall's will valid, despite Mrs. Marshall's challenges, and ordering that she was entitled to receive no distributions from his estate or related trust.

### The Ninth Circuit

On appeal to the Ninth Circuit from the California district court's decision, the decedent's son argued that, considering the pending Texas probate proceeding, the probate exception precluded the federal district court's adjudication of Mrs. Marshall's claim. Mrs. Marshall argued that her claim presented a "core" bankruptcy

matter, thereby requiring the reinstatement of the \$474 million judgment.

Although acknowledging that her claim did "not involve the administration of an estate, the probate of a will, or any other purely probate matter," the Ninth Circuit found that Mrs. Marshall had essentially lodged a collateral attack on the disposition of Mr. Marshall's postmortem estate and therefore raised "questions which would ordinarily be decided by a probate court." Accordingly, the Ninth Circuit held that the probate exception applied and, as a result, vacated the district court's judgment.

The Ninth Circuit did not otherwise address whether Mrs. Marshall's claim was a "core" bankruptcy matter.

### The U.S. Supreme Court

The U.S. Supreme Court agreed to review the Ninth Circuit's seemingly broad interpretation of the probate exception, giving it an opportunity to revisit *Markham v. Allen*.<sup>3</sup> In that case, the Court last found that "federal courts of equity have jurisdiction to entertain suits 'in favor of creditors, legatees and heirs' and other claimants against a decedent's death 'to establish their claims' so long as the federal court does not interfere with the probate proceedings or assume general jurisdiction of the probate or control of the property in the custody of the state court."

Attempting to clarify the *Markham* holding, the Supreme Court in *Marshall* reasoned that the above-quoted passage merely reiterated the general principle that when one court is exercising *in rem* jurisdiction over a *res*, the second court will not assume *in rem* jurisdiction over the same *res*.

Thus, after *Marshall*, the probate exception now should only preclude federal courts from attempting to adjudicate purely probate matters and the disposition of property that is in the custody of a state probate court.

In the *Marshall* case, because Mrs. Marshall's claim was not a purely probate matter, but rather represented a well-established tort (i.e., tortious interference with a bequest), and because the claim only sought to hold the decedent's son personally liable instead of seeking to reach *res* in the custody of a probate court, the Supreme Court found that probate exception did not apply.

### Future Sequel

This final determination, however, did not end the decade-long controversy. Mrs. Marshall does not automatically receive any money award, as her case was remanded to the Ninth Circuit, with instructions to address the "core" bankruptcy issue and the decedent's son's argument that, in light of the existing ruling on the validity of the father's will, claim and issue preclusion might bar Mrs. Marshall's claim.<sup>4</sup>

<sup>1</sup> Joseph Acosta is an associate in the Dallas office of Jones Day.

<sup>2</sup> 126 S.Ct. 1735 (May 1, 2006)

<sup>3</sup> 326 U.S. 490 (1946)

<sup>4</sup> On June 20, 2006, E. Pierce Marshall died at the age of 67.

### Judicial Estoppel

Judicial estoppel is a common law doctrine that prohibits a party from taking a position in a legal proceeding that is inconsistent with or contradictory to a position taken in a prior proceeding in the same case or in a previous case.<sup>1</sup> The purpose of the doctrine “is ‘to protect the integrity of the judicial process’ by ‘prohibiting parties from deliberately changing positions according to the exigencies of the moment.’”<sup>2</sup> The United States Supreme Court has recognized that judicial estoppel is a flexible doctrine, but has not laid down a specific test for applying it.<sup>3</sup>

The doctrine of judicial estoppel is particularly important in the bankruptcy context because the “integrity [and proper functioning] of the bankruptcy system depends on the full and honest disclosure by debtors of all of their assets. . . . The interest of both the creditors . . . and the bankruptcy court . . . are impaired when the disclosure provided by the debtor is incomplete.”<sup>4</sup> Thus, questions involving judicial estoppel may arise in several contexts in a bankruptcy case.<sup>5</sup> The most common of these is the debtor’s failure to disclose a claim in bankruptcy and a subsequent attempt by the debtor to prosecute those claims.<sup>6</sup> The circuits, however, are split on the proper application of judicial estoppel in such circumstances.<sup>7</sup>

As an initial matter, there are several broad observations that can be made regarding the application of judicial estoppel in the bankruptcy cases. First, judicial estoppel bars inconsistent statements made in the same case, as well as different cases.<sup>8</sup> Second, judicial estoppel is not designed to protect the litigants; it is designed to protect the integrity of the judicial system. Therefore, “detrimental reliance by the party opponent is not required.”<sup>9</sup> Similarly, judicial estoppel does not require privity among the litigants in relation to the prior inconsistent statement.<sup>10</sup> Finally, judicial estoppel does not apply to tort claims arising post-

confirmation.<sup>11</sup>

While the circuits are split regarding the application of judicial estoppel, most courts agree that at least two conditions must be met before the doctrine will apply in a given case. These conditions are (1) the inconsistent statements were made in a prior proceeding, and (2) the court in the prior proceeding accepted the previous inconsistent position.<sup>12</sup> The split revolves around the question of whether a third condition must also be met: intent or bad faith. Some courts require a showing that the nondisclosure or inconsistent positions were made intentionally, while other courts will bar prosecution of all undisclosed claims without regard for the debtor’s intent.

#### Intent Required

To apply judicial estoppel, the Fifth, Eleventh, and Third Circuits all require that the debtor’s failure to schedule or otherwise disclose the claims during the course of the its bankruptcy case have been intentional.<sup>13</sup> These circuits have held that judicial estoppel will not bar the assertion of claims where the “the debtor’s failure to satisfy its statutory disclosure duty” is based on a lack of “knowledge of the undisclosed claims” or where the debtor “has no motive for their concealment.”<sup>14</sup> For example, in *In re Coastal Plains* the Fifth Circuit barred a debtor from asserting previously non-disclosed claims on the basis that the debtor both knew about the claims during the pendency of its bankruptcy case and had reason to conceal the claims.<sup>15</sup> In that case it was undisputed that the CEO of the debtor knew about the cause of action when he signed the debtor’s bankruptcy schedules.<sup>16</sup> The court found that the debtor had motive for concealing its \$10 million claim because, had the creditors known about it, the unsecured creditors might have objected to the proposed course of action and other creditors might “have chosen to bid more at the foreclosure” sale of Coastal’s assets.<sup>17</sup> The court also stated that the application of judicial estoppel was necessary to avoid “encourag[ing] bankruptcy debtors to conceal claims, write off debts, purchase

debtor assets at bargain prices, and then sue on undisclosed claims and possibly recover windfalls.”<sup>18</sup>

In contrast, the Third Circuit refused to apply judicial estoppel in *Ryan Operations G.P. v. Santiam-Midwest Lumber Co.* because the party asserting judicial estoppel could not show that the debtor’s failure to disclose claims was intentional or in bad faith.<sup>19</sup> In *Ryan*, the debtor was a home builder who had a warranty claim against one of its suppliers.<sup>20</sup> While the debtor failed to specifically disclose this claim in its bankruptcy schedules, the court found that this was not done in bad faith or with intent to mislead the court.<sup>21</sup> First, the failure to list the cause of action as a contingent asset “was offset by its failure to list the corresponding claims of homeowners against Ryan” as liabilities.<sup>22</sup> Thus, there was no disruption of the balancing of assets and liabilities.<sup>23</sup> Second, Ryan specifically requested authorization from the bankruptcy court to pursue its homeowners claims.<sup>24</sup> Finally, the court noted that Ryan’s plan of reorganization specifically “authorized Ryan to retain and enforce claims against any entity and to adjudicate homeowners claims.”<sup>25</sup> Therefore, the court found that Ryan had not acted in bad faith when it failed to disclose the homeowners claims in its bankruptcy schedules, and was not barred from adjudicating those claims based on judicial estoppel.<sup>26</sup>

#### Intent Not Required

While several circuits have recognized an intent or bad faith requirement in the application of judicial estoppel, other circuits have not. The First, Second, and Ninth Circuits do not require a showing that the inconsistent statements were made intentionally or in bad faith.<sup>27</sup>

In *Payless Wholesale Distributors, Inc. v. Alberto Culver, Inc.*, the First Circuit did not establish a clear test for when the application of judicial estoppel was appropriate; however, it also did not consider the debtor’s intent in failing to disclose the claims.<sup>28</sup> Rather, the First Circuit simply stated that “Payless, having

*Continued on page 10*

## 2006 BANKRUPTCY SECTION CALENDAR OF EVENTS

### September

#### 22nd Annual Farm, Ranch & Agri-Business Bankruptcy Institute

- Lubbock, Texas
- September 14-15, 2006
- Holiday Inn Park Plaza Hotel
- For more information contact:  
Robert St. Clair at 806-744-1100  
or [rstclair@hardlaw.com](mailto:rstclair@hardlaw.com)

#### Consumer Bankruptcy Boot Camp 2006 (live)

- Houston, Texas
- September 20, 2006
- Westin Oaks Hotel Galleria
- Call 800-204-2222 (x1574) to Register

#### Advanced Consumer Bankruptcy Course 2006 (live)

- Houston, Texas
- September 21-22, 2006
- Westin Oaks Hotel Galleria
- Call 800-204-2222 (x1574) to Register

### October

#### Tenth Annual Texas Eastern Bench/Bar Conference

- Galveston, Texas
- October 12 - 13, 2006
- Moody Gardens Hotel
- For more information, see [www.edtexbar.com](http://www.edtexbar.com)

#### Consumer and Commercial Law Course (live)

- Dallas, Texas
- October 12 - 13, 2006
- Doubletree Hotel Campbell Centre
- For more information, see  
[www.TexasBarCLE.com](http://www.TexasBarCLE.com)

#### Bankruptcy Code Update: A Year Later (webcast)

- October 24, 2006
- For more information, see  
[www.TexasBarCLE.com](http://www.TexasBarCLE.com)

### November

#### 25th Anniversary of the University of Texas Bankruptcy Institute

- Austin, Texas
- November 16-17, 2006
- Four Seasons Hotel
- For more information, see  
<http://conferences.utcle.org/law/cle/conferences/fall2006>

#### Consumer and Commercial Law Course (video)

- November 30- December 1, 2006
- Holiday Inn Select- Greenway Plaza
- For more information, see  
[www.TexasBarCLE.com](http://www.TexasBarCLE.com)

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obtained judicial relief on the representation that no claims existed can not now resurrect them and obtain relief on the opposite basis.”<sup>29</sup>

Similarly, the Ninth Circuit in *Hamilton v. State Farm Fire & Casualty Company* stated that it “has restricted the application of judicial estoppel to cases where the court relied on, or ‘accepted,’ the party’s previous inconsistent position.”<sup>30</sup> Following this statement, the Ninth Circuit considered only whether Hamilton had in fact asserted inconsistent statements and whether the bankruptcy court had accepted those previous statements.<sup>31</sup> It did not require any showing that Hamilton acted intentionally or in bad faith.

In the case of *Rosenshein v. Kleban*, the District Court for the Southern District of New York reviewed the case law with respect to judicial estoppel and stated that “the standard established by the Second Circuit for the application of judicial estoppel makes no mention of intent.”<sup>32</sup> Instead, the court concluded that the Second Circuit test for judicial estoppel has only two prongs.<sup>33</sup> The party asserting judicial estoppel must show that “[1] that the party against whom the estoppel is asserted must have argued an inconsistent position in a prior proceeding; and [2] the prior inconsistent position must have been adopted by the court in some manner.”<sup>34</sup>

#### Judicial Estoppel Not Recognized

It is important to note that the Tenth Circuit does not recognize the doctrine of judicial estoppel.<sup>35</sup> In *In re BCD Corporation*, the Tenth Circuit stated that it “has rejected the doctrine of judicial estoppel as being inconsistent with the spirit of the Federal Rules of Civil Procedure.”<sup>36</sup> Thus, the doctrine does not apply to bankruptcy cases in the Tenth Circuit.

#### Special Cases to Note

There are a few additional cases that should be noted. In its decision in the case of *Bisek v. Soo Line Railroad Co.*, the Seventh Circuit rejected the application of judicial estoppel to a

case where the debtor had failed to list a FELA cause of action in his bankruptcy schedules and then attempted to pursue the cause of action.<sup>37</sup> The Seventh Circuit stated that the lower court’s application of the doctrine of judicial estoppel was inappropriate because the tort claim belonged to the Chapter 7 trustee and not the debtor.<sup>38</sup> Since the trustee had not abandoned the asset and the claim was not exempt, the debtor had no right to litigate the claim.<sup>39</sup> However, the Seventh Circuit did not dispose of the case without expressing an opinion on the application of judicial estoppel, which it criticized as having adverse effects on third parties who have not made any inconsistent statements. It went on to state that, instead, “district judges should discourage bankruptcy fraud by revoking the debtors’ discharges and referring them to the United States Attorney for potential criminal prosecution.”<sup>40</sup>

The Court of Federal Claims in the case of *Aaron v. United States* held that judicial estoppel does not bar the trustee from pursuing a cause of action on a claim that the debtor failed to list in its bankruptcy schedules.<sup>41</sup> The court’s reasoning was similar to that of the Seventh Circuit above. Once the debtor filed bankruptcy, the claim became property of the estate and belonged to the bankruptcy trustee.<sup>42</sup> Since the trustee never abandoned the claim and the inconsistent position was taken by the debtor, the court held that judicial estoppel would not bar the trustee from pursuing the cause of action on behalf of the estate.<sup>43</sup>

\* Heather Panko is a law student at SMU Dedman School of Law. She served as an intern to Bankruptcy Judge Hale in Spring 2006.

<sup>1</sup> Benjamin J. Vernia, *Judicial Estoppel of Subsequent Action Based on Statements, Positions, or Omissions as to Claim or Interest in Bankruptcy Proceeding*, 85 A.L.R. 5th 353 § 2[a]; see also *New Hampshire v. Maine*, 532 U.S. 742, 749 (2001).

<sup>2</sup> *Maine*, 532 U.S. at 749-50 (quoting *Edwards v. Atena Life Ins. Co.*, 690 F.2d 595, 598 (6th Cir. 1982) and *United States v. McCaskey*, 9 F.3d 368, 378 (5th Cir. 1993)).

<sup>3</sup> *Maine*, 532 U.S. at 750.

<sup>4</sup> *Rosenshein v. Kleban*, 918 F. Supp. 98, 104 (S.D.N.Y. 1996).

<sup>5</sup> For example, courts have applied judicial estoppel to statements regarding the insolvency of the debtor; statements regarding the secured status of creditors; and statements regarding the validity of claims. Vernia, *supra* note 1, at § 2[a].

<sup>6</sup> *Id.*

<sup>7</sup> *Id.*

<sup>8</sup> *Hamilton v. State Farm Fire & Casualty Co.*, 270 F.3d 778, 783 (9th Cir. 2001).

<sup>9</sup> *Superior Crewboats, Inc. v. Primary P & I Underwriters (In re Superior Crewboats, Inc.)*, 374 F.3d 330, 334 (5th Cir. 2004) (citing *In re Coastal Plains, Inc.*, 179 F.3d 197, 205 (5th Cir. 1999)); *Burnes v. Pemco Aeroplex*, 291 F.3d 1282, 1286 (11th Cir. 2002) (quoting *Ryan Operations G.P. v. Santiam-Midwest Lumber Co.*, 81 F.3d 355, 360 (3rd Cir. 1996)).

<sup>10</sup> *Ryan Operations G.P. v. Santiam-Midwest Lumber Co.*, 81 F.3d 355, 360 (3rd Cir. 1996).

<sup>11</sup> See *In re Carter*, 258 B.R. 526 (Bankr. S.D. Ga. 2001).

<sup>12</sup> *In re Superior Crewboats*, 374 F.3d at 335; *In re Coastal Plains, Inc.*, 179 F.3d at 206; *Hamilton*, 270 F.3d at 782 – 84; *Rosenshein*, 918 F. Supp. at 104.

<sup>13</sup> *In re Coastal Plains, Inc.*, 179 F.3d at 206 – 11; *In re Superior Crewboats, Inc.*, 374 F.3d at 335; *Burnes*, 291 F.3d at 1285; *Ryan*, 81 F.3d at 361; see also *Oneida Motor Freight, Inc. v. United Jersey Bank*, 848 F.2d 414 (3d Cir. 1988).

<sup>14</sup> *In re Coastal Plains, Inc.*, 179 F.3d at 210; see also *Burnes*, 291 F.3d at 1287 (quoting *In re Coastal Plains*, 179 F.3d at 210).

<sup>15</sup> *In re Coastal Plains, Inc.*, 179 F.3d at 212.

<sup>16</sup> *Id.*

<sup>17</sup> *Id.*

<sup>18</sup> *Id.*

<sup>19</sup> *Ryan*, 81 F.3d at 362.

<sup>20</sup> *Id.* at 357.

<sup>21</sup> *Id.* at 363.

<sup>22</sup> *Id.*

<sup>23</sup> *Id.*

<sup>24</sup> *Id.* at 364.

<sup>25</sup> *Id.*

<sup>26</sup> *Id.* at 365.

<sup>27</sup> See *Rosenshein*, 918 F. Supp. at 104 – 05; see also *Hamilton*, 270 F.3d at 783; see also *Payless Wholesale Distributors, Inc. v. Alberto Culver (P.R.), Inc.*, 989 F.2d 570 (1st Cir. 1993).

<sup>28</sup> *Payless*, 989 F.2d at 571 – 72.

<sup>29</sup> *Id.*

<sup>30</sup> *Hamilton*, 270 F.3d at 783.

<sup>31</sup> *Id.* at 784.

<sup>32</sup> *Rosenshein*, 918 F. Supp. at 105.

<sup>33</sup> *Id.* at 104.

<sup>34</sup> *Id.* at 104 (quoting *Bates v. Long Island Railroad Co.*, 997 F.2d 1028 (2d Cir. 1993)).

<sup>35</sup> See *Goffland Entertainment Centers, Inc. v. Peak Investment, Inc. (In re BCD Corp.)*, 119 F.3d 852 (10th Cir. 1997).

<sup>36</sup> *Id.* at 858.

<sup>37</sup> *Bisek v. Soo Line Railroad Co.*, 2006 WL 521903 (7th Cir. 2006).

<sup>38</sup> *Id.* at \* 2.

<sup>39</sup> *Id.* at \* 2 – 3.

<sup>40</sup> *Id.*

<sup>41</sup> *Aaron v. United States*, 65 Fed. Cl. 29 (Fed. Cl. 2005).

<sup>42</sup> *Id.* at 31.

<sup>43</sup> *Id.* at 32.

*continued from page 1*

This commitment to the practice is also evidenced by our Section. Today we have 1220 members, from all sides of the bankruptcy practice. The Council shares the commitment to continuing improvement of the Texas bankruptcy practice – often to the detriment of billable hours. Many of the initiatives are driven solely for the benefit of the members such as the Directory which is John Mitchell's project and the Newsletter which is primarily the result of the efforts of Elizabeth Guffy and Kourtney Lyda. Other initiatives are geared toward the improvement of the practice such as the law school outreach program begun by Chris Mott and now with the assistance of Lydia Protopapas, which helps law students understand what is entailed in a bankruptcy practice and to give a feel for the practical issues that may arise, such as filling out a proof of claim. Judge Hale leads the Section's efforts to provide extensive, creative and timely CLE. The MoneyWise program goes beyond the practice of law to help our high school students gain a basic understanding of financial issues such as compound interest. Long term, this may actually reduce the number of potential clients. New ideas are constantly surfacing. If you have an idea, contact me or any other Council member – but be prepared to go to work for the continuing good of the Texas bankruptcy practice.

## International Bankruptcy Seminar

The dates for the London State Bar of Texas Bankruptcy Law Section seminar have changed.

The seminar will be held from March 20, 2007 through March 27, 2007.

Full details should be e-mailed within the next two weeks. If you have any questions, please e-mail Susie Angle, Assistant to Janna Countryman, Chairperson International Seminar Committee, at [sangle@newbernlawoffice.com](mailto:sangle@newbernlawoffice.com).

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