

# AMERICAN BANKRUPTCY INSTITUTE JOURNAL

Issues and Information for Today's Busy Insolvency Professional

## “Doing Good” in Chapter 11 Liquidating Plans

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Our title is not an example of bad grammar. As the number of liquidating chapter 11 cases increase across the country, meaningful amounts of funds may remain undistributed notwithstanding the best efforts and compliance with the terms of the confirmed plan by liquidating plan administrators and trustees of trusts formed under liquidating plans. “Undistributed funds”<sup>2</sup> can present dilemmas for the plan or trust fiduciaries. This article proposes a simple suggestion for plan proponents to facilitate the use of these funds for *pro bono* or other charitable purposes to enhance the good work of bankruptcy bar associations and to facilitate the efficient winding down of liquidating plans and trusts.

### Falling Through the Cracks of 11 U.S.C. §347

Section 347 addresses the treatment of unclaimed funds in all cases under Title 11.<sup>3</sup> This article focuses on the disposition of funds at or prior to the conclusion of the five-year period

<sup>1</sup> Special thanks to Court Clerk Karen Eddy of the U.S. Bankruptcy Court of the Southern District of Florida for her help on this article. Ms. Eddy and her staff, and Jose Rodriguez in particular, helped to gather some of the quantitative data referred to herein. In addition, Court Clerk David Bird of the U.S. Bankruptcy Court for the District of Delaware was most helpful in providing data from his district. Errors in respect of the data are exclusively ours.

<sup>2</sup> The undistributed funds discussed in this article are distinguished from the “unclaimed funds” subject of 11 U.S.C. §347. By the term “undistributed funds,” we mean funds not ultimately distributed to and accepted by creditors pursuant to the terms of a liquidating plan (or resulting liquidating trust) and which do not otherwise fit within the provisions of §347. Sometimes these funds are deposited into the registry of the bankruptcy court in a manner consistent with 28 U.S.C. §2401 *et seq.*

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prescribed in 11 U.S.C. §§347 and 1143. These sections are designed to achieve finality, judicial economy and the avoidance of disruptive wasteful litigation over funds that remain unclaimed five years after confirmation. *In re Goldblatt Bros. Inc.*, 132 B.R. 736, 738 (Bankr. N.D. Ill. 1991).

Section 347(a) applies only to cases under chapters 7, 12 and 13, and directs the deposit of unclaimed funds into the

## Feature

bankruptcy court registry trust account 6047BK. If the funds remain on deposit in the court registry for five years, Chapter 129 of Title 28 of the U.S. Code<sup>4</sup> provides that the funds held in 6047BK are to be transferred to the Treasury trust account 6133 in the name and credit of the United States as a statutory trustee. *See In re Moneys Deposited in and Now under the Control of the U.S. District Court for the Western District of Pa.*, 243 F.2d 443 (3rd Cir. 1957). The funds will remain in the Treasury trust account indefinitely, pursuant to Chapter 129,

<sup>3</sup> Section 347 has its roots in §66 of the Bankruptcy Act of 1898. *See S. Rep. No. 989*, 95th Cong., 2d Sess. 47 (1978). Section 66 originally dealt with unclaimed dividends. In the 1938 Chandler Act, §66 was expanded to provide direction for the disposition of all unclaimed money to assist trustees in closing their cases. In 1956, §66 was substantially revised in Public Law 868, approved Aug. 1, 1956, for the purpose of eluding state escheat laws. *See Colliers on Bankruptcy*, ¶347.LH (15th ed. 2006). The 1956 amendment clarified that unclaimed funds would escheat to the Treasury rather than to the states. While the 1978 Bankruptcy Reform Act added §347(b), §347(a) remains substantially unchanged from the 1956 revisions.

<sup>4</sup> Chapter 129 was enacted in 1948 and is based on former Title 28 U.S.C., 1940 ed., §851 *et seq.* (R.S. §995; May 29, 1920, c. 214, §1, 41 Stat. 654).

until a claimant applies for the recovery thereof.<sup>5</sup>

Section 347(b)<sup>6</sup> applies to unclaimed funds in chapter 11 cases. Section 347(b) provides, in pertinent part, that funds remaining undistributed at “expiration of the time allowed” (referring to 11 U.S.C. §1143) for the presentment or surrender of a security or the performance of any other act required as a condition of participation in distributions under the plan “become property of the debtor or of the entity acquiring the assets of the debtor.” 11 U.S.C. §347(b). Section 1143 provides that any act required to participate in a distribution under a chapter 11 plan must be completed “not later than five years after the date of entry

of the confirmation order.” Neither §1143 nor 347 provides guidance concerning where chapter 11 unclaimed funds should be held in the interim, and presumably this issue would be addressed in the plan or liquidating trust (or other liquidating entity) if one were established by the liquidating plan.

In practice, in the case of liquidating chapter 11 plans, unless the debtor entity is dissolved or extinguished under the chapter 11 liquidating plan, the debtor entity continues to exist. Clearly, no

<sup>5</sup> As of Sept. 30, 2006, unclaimed funds in the amount of \$138,823,986.42 were on deposit in the Treasury trust account. The balance increased by \$3,148,983.66 in the third quarter of this year. This data pertains to transfers of funds from all federal courts, not exclusively transfers from bankruptcy courts. The cumulative amount of unclaimed funds transferred from all bankruptcy court registries to the Treasury trust account was unavailable.

<sup>6</sup> Section 347(b) provides:  
Any security, money or other property remaining unclaimed at the expiration of the time allowed in a case under chapter...11...of this title for the presentation of a security or the performance of any other act as a condition to participation in the distribution under any plan confirmed under §§1129 [and] 1173...of this title, as the case may be, becomes the property of the debtor or of the entity acquiring the assets of the debtor under the plan, as the case may be.

creditor or party in interest would deliberately craft a plan by which undistributed money or property became assets of the debtor entity five years after entry of the confirmation order. If the liquidating plan provided for the sale of all or substantially all of the debtor's assets, it is similarly unlikely that the creditor constituents would deliberately craft a plan that transferred the money and property that remained undistributed five years after the confirmation order to the asset buyer. And what about those liquidating 11 cases in which the debtor's assets are sold in a series of sale transactions to multiple buyers? Arguably, §347(b) provides no guidance at all. In our experience, not once has an asset buyer in a sale-based liquidating chapter 11 plan negotiated for the payment of these funds five years after the date of the confirmation order. These undistributed funds, sometimes meager and sometimes not, that fall through the cracks of §347(b) are the focus of this article.

If the disposition of undistributed funds is not addressed by the plan proponents in the liquidating plan, and notwithstanding that §347(a) does not apply to cases under chapter 11, it seems that in practice undistributed funds in liquidating chapter 11 cases are often disposed of in accordance therewith and Chapter 129, and such funds are frequently deposited into the registry of the court. *See, e.g., In re TLI Inc.*, 213 B.R. 946 (N.D. Tex. 1997), *aff'd*, 159 F.3d 1355 (5th Cir. 1998) (the liquidating trustee transferred unclaimed funds to court registry even though the reorganization plan did not provide for such disposal. The funds remained in the court registry until the court determined disposition). We are advised that as of

Oct. 25, 2006, the U.S. Bankruptcy Court for the District of Delaware had more than \$500,000 in its court registry relating to liquidating chapter 11 cases.<sup>7</sup>

We have not uncovered procedures that bankruptcy clerks use to distinguish between chapter 7 and 13 unclaimed funds and chapter 11 funds held in bankruptcy court registries. Generally, chapter 11 funds deposited in a court registry are commingled with chapter 7 and 13 unclaimed funds.<sup>8</sup> Therefore, in some courts, the chapter 11 unclaimed funds may be inappropriately transferred to the Treasury trust account 6133. *See supra* notes 4-5. Additionally, in one instance, a court ordered that a substantial amount of undistributed funds held in its court registry from a reorganization were subject to forfeiture to the federal government.<sup>9</sup>

Examples of cases in which undistributed funds might fall through the cracks of §347(b) include, but are certainly not limited to, (1) liquidating chapter 11 cases that do not involve a single entity that purchased substantially all of the debtor's assets, (2) liquidating chapter 11 cases that sell substantially all of the debtor's assets to one entity that itself is not in existence or in a position to accept the unclaimed funds five years from the date of the confirmation order, (3) liquidating chapter 11 cases in which the party entitled to a distribution rejects the distribution due to it because, *inter alia*, it has determined that it is not cost-effective to locate and make distribution to the parties beneficially entitled thereto, and (4) liquidating chapter 11 cases in which the debtor entity has been legally extinguished and the funds remaining on hand five years from the date of the confirmation order are the proceeds of litigation claims (and not the proceeds from the sale of the debtor's assets).

Utilization of undistributed funds for good causes is not without precedent. District and appellate courts have provided a blueprint for doing so, and recently, a bankruptcy court has done so, too.<sup>10</sup>

### **The Cy Pres Doctrine**

We believe that the disposition of undistributed funds to charitable causes

can be accomplished by the inclusion of provisions in the liquidating plan directing that funds and property remaining undistributed after a specified period of time after entry of the confirmation order are to be donated to one or more specified charitable or other organizations. While we have not seen a plan so providing, it seems to us that the liquidating plan could even leave until the time of proposed distribution the selection of the donees.

A chapter 11 reorganization plan or liquidation is in essence a contract. *Ernst & Young LLP v. Baker O'Neal Holdings Inc.*, 304 F.3d 753, 755 (7th Cir. 2002). If the provisions of the liquidating plan are clear, adequately disclosed in the related disclosure statement and accepted by the requisite number and percentage of creditors entitled to vote on the plan, and the plan is confirmed by the bankruptcy court, the donative provisions should be enforceable. No provision in §1129 would be implicated by such provisions and such provisions do not appear to contravene §1123.

Additional support for the efficacy of these types of provisions in liquidating plans may be found in the *cy pres* doctrine, briefly described below. We believe the *cy pres* doctrine may be a source of authority for parties wishing to donate undistributed funds on hand after administration of liquidating chapter 11 plans even if the confirmed plans did not provide therefore. *See supra* n. 9.

The term *cy pres* originates from the Norman French term "*cy pres comme possible*," which means "as near as possible." *Democratic Cent. Comm. v. Washington Metro. Area Transit Comm'n*, 84 F.3d 451, 455 n. 1 (D.C. Cir. 1996). The *cy pres* doctrine allows courts to distribute funds to the "next best" use. The *cy pres* doctrine is a creature of common law that was intended to assist with the fair distribution of a trust *res* in a probate case. The doctrine assists with the distribution of probate estate assets when a trust's original purpose fails in some respect. Federal courts have expanded *cy pres* to unclaimed or undistributed funds in class action litigations. In one case, the court directed the funds to charitable organizations that indirectly benefited the class members.

<sup>7</sup> Data provided by David Bird, clerk of the U.S. Bankruptcy Court for the District of Delaware.

<sup>8</sup> Conversations with representatives of the Office of the Clerk of the Bankruptcy Courts for the Southern District of Georgia and Southern District of Florida.

<sup>9</sup> *See In the Matter of Farrington Manufacturing Co.*, Case No. 17-71A (Bankr. E.D. Va. Sept. 17, 2003). *Farrington Manufacturing* was a chapter X case commenced in 1971 under the Bankruptcy Act. SunTrust Bank, as the successor in interest to Crestar Bank, held \$3,263,083.91 on deposit 31 years after the commencement of the case in 2003. The funds were to be held for redemption by presentation of "bearer bonds" issued by the debtor corporations. In 2003, the court reopened the case and ordered these funds to be deposited into the court registry pursuant to Chapter 129. Thereafter, after court costs and administrative expenses, the court found that only \$64,086.98 of the funds on hand represented unclaimed funds, which it transferred to Treasury trust account 6133. The court ordered that the balance of \$3,198,996.93 be forfeited to the United States because "there is no reorganized debtor and there was no successor to the debtor." *See id.* (emphasis added).

<sup>10</sup> *In re Xpedior*, \_\_\_ B.R. \_\_\_, 2006 WL 3017330 (Bankr. N.D. Ill. Oct. 23, 2006).

See, e.g., *Jones v. National Distillers*, 56 F.Supp. 2d 355 (S.D.N.Y. 1999) (the court used *cy pres* where the cost of distribution was projected to be greater than the amount held in court registry). Numerous circuit courts support and affirm this equitable solution.<sup>11</sup>

Courts that have deviated from the scheme for disposition under Chapter 129 have found that Chapter 129 does “not limit the discretion of the district court to control the unclaimed portion of a...judgment...” *Id.* at 358. These courts have found that Chapter 129 “will control when a court so orders or when [a] court failed to make any disposition of this type of fund.” *Van Gernert v. Boeing Co.*, 739 F.2d 730, 735 (2d Cir. 1984). Courts that use the *cy pres* doctrine to support a disposition of funds in a manner other than as contemplated by Chapter 129 base their decision and analysis on equitable grounds.

*Jones v. National Distillers* is an example of a case in which frustration of purpose in respect of the proposed distribution of funds caused the court to exercise its equitable powers and to deviate from the disposition of funds prescribed by Chapter 129. The class counsel reported that \$18,400.80 was left unclaimed and undistributed for over 20 years. See *Jones*, 56 F.Supp. at 356. The court determined that the amount of the funds was negligible in light of the 17,198 shareholders represented in the class action and that the administrative costs and postage expenses involved in distributing the funds to the thousands of claimants effectively prohibited distribution. *Id.* at 357. Following other courts that had relied on the *cy pres* doctrine, the court authorized the distribution of the funds to the Legal Aid Society Civil Division. The *Jones* court recognized that:

The problem of distributing a

<sup>11</sup> The following circuit courts support distributing unclaimed funds in a manner different from that prescribed by Chapter 129: *Powell v. Georgia-Pacific Corp.*, 119 F.3d 703 (8th Cir. 1997) (approved creating a scholarship to provide employment opportunities for African Americans living near Georgia-Pacific’s facilities); *Democratic Cent. Comm. v. Washington Metro Area Transit Comm’n*, 84 F.3d 451 (D.C. Cir. 1996) (distributed funds to current bus riders in litigation involving overcharges for bus services); *In re Folding Carton Litigation*, 934 F.2d 323 (7th Cir. 1991) (approved distribution of \$2.3 million of remaining antitrust funds to the National Association of Public Interest); *In re “Agent Orange” Product Liability Litigation*, 818 F.2d 179 (2d Cir. 1987) (approved class settlement with distribution of funds significantly outside of the class); *Nelson v. Greater Gadsden Hous. Auth.*, 802 F.2d 405 (11th Cir. 1986) (class action case in which the court approved payment of utility allowances to tenants of public housing complex for damages not claimed in the case).

common fund among class members, some of whom cannot be found, is typical. Despite best efforts, it remains virtually certain—especially when large classes are involved—that not all class members will share in an aggregate class recovery. This situation may or may not result in a residue remaining after individual claim distribution.

*Id.* at 356.

The *Jones* court went on to discuss the duty owed by counsel and the administrator of the funds:

While class counsel and class fund administrators have a duty to try to find missing class members, they need not continue searching forever for those who have “followed Judge Crater into the mists of the unknown.”<sup>12</sup>

*Id.* at 356-57.

Although a majority of cases require that the donee of the undistributed funds bear some thematic relation to the mission of the class,<sup>13</sup> some courts have directed the funds to unrelated charitable causes. See *Superior Beverage Co. v. Owens-Illinois*, 827 F.Supp. 477 (N.D. Ill. 1993). In *Superior Beverage*, the court expanded *cy pres* to permit distribution to charitable organizations whose missions were not directly related to the claims that gave rise to the class action.

*Superior Beverage* involved a settlement agreement in a class action case that expressly provided that undistributed funds would be disbursed by the court based on “the doctrine of *cy pres* and courts’ broad equitable powers.” *Id.* at 479. The *Superior Beverage* case is

<sup>12</sup> The court explained that in 1930 Joseph Force Crater, a then newly appointed New York Supreme Court Justice, “stepped into a New York City taxicab and vanished from the face of the Earth... In all New York history, no one has ever gone more impressively missing.” After nine years of waiting for his return, a declaration of death was issued. Judge Crater never returned to claim his New York Supreme Court seat and extensive searching efforts proved unavailing. *Id.* at 357 n. 1 (citing Maeder, Jay, “Missing Persons: Joseph Crater,” 1930, *N.Y. Daily News*, May 5, 1998, at 45).

<sup>13</sup> See, e.g., *In re Infant Formula Multidistrict Litigation*, 2005 WL 2211312 (N.D. Fla. 2005) (citing Associated Press, “Washington Moves to Help Katrina’s Victims” (Aug. 20, 2005), available at [www.cnn.com/2005/WEATHER/08/30/Katrina.washington.ap](http://www.cnn.com/2005/WEATHER/08/30/Katrina.washington.ap); Department of Homeland Security, “Hurricane Katrina: What Government Is Doing” (Sept. 6, 2005), available at [www.dhs.gov/interweb/assetlibrary/katrina.htm](http://www.dhs.gov/interweb/assetlibrary/katrina.htm) (both Web pages have expired)). After court costs and other payments, the court donated \$700,000 of the funds to the American Red Cross that would be geared toward “combating harms similar to those that injured the class members.” *Id.* at \*3. In the wake of Hurricane Katrina, infant formula was one of the chief priorities of rescue officials. *Id.*; see also *In re Simon II Litigation*, 211 F.R.D. 86 (E.D.N.Y. 2002), *overturned on other grounds* (in tobacco class action, court-ordered funds not distributed to class members would be “allocated by the court on a *cy pres* basis to treatment and research organizations working in the field of each disease on advice of experts in the fields”).

instructive in respect of the *cy pres* doctrine generally and offers an example of a court’s thoughtful analysis of competing grant applications submitted by various charitable and not-for-profit organizations for \$2 million of undistributed funds. See *id.* at 480.<sup>14</sup>

Other courts have also allowed unclaimed or undistributed funds to be donated to unrelated charities. See *id.* at 479 (citing, e.g., *In re Ocean Shipping Antitrust Litigation*, MDL No. 395 (S.D.N.Y. 1991) (\$800,000 donated to the National Association for Public Interest Law)).<sup>15</sup> One court has approved the creation of a scholarship fund. *Georgia-Pacific Corp.*, *supra* n. 11. Several of the contributions authorized by the *Superior Beverage* court served as “seed money” to fund endowments in support of ongoing, long-range projects. *Superior Beverage*, 827 F.Supp. at 479.

One recent published bankruptcy court opinion relied on the *cy pres* doctrine to donate funds in a liquidating chapter 11 case to charitable organizations after all distributions provided for under the plan had been made. See *Xpedior*, \_\_\_ B.R. \_\_\_, 2006 WL 3017330. *Xpedior* presents unusual facts. Under the plan, equity in the debtor was extinguished and approximately \$842,000 remained after all claims were paid in full plus interest. The type of funds subject of the *Xpedior* case are not squarely within the definition of undistributed funds set forth in note 2, *supra*. But the *Xpedior* case is nonetheless instructive as an example of the recognition of the *cy pres* doctrine by a bankruptcy court.

The *Xpedior* plan provided that any remaining amount under \$15,000 could be distributed to the Make-A-Wish Foundation of Northern Illinois. But the plan did not contemplate or provide for the distribution of funds in excess of \$15,000. The U.S. Trustee supported the plan trustee’s proposal to distribute the money to charity so long as the donations benefited children in some fashion and were not made to a charity whose primary objective was to promote religious activity. *Id.* at \*8.

<sup>14</sup> The court (1) advertised in the *Wall Street Journal*, (2) accepted applications for the unclaimed funds and (3) held an all-day hearing to give representatives of each applicant an opportunity to advocate for a donation. *Id.*

The *Xpedior* court fashioned a creative way to fill the cracks in §347 of the Code and avoid application of Chapter 129 entirely. The *Xpedior* court determined that the liquidating trust formed under the plan was an “entity,” as such term is defined in §101(15), and that the liquidating trust was the entity that acquired the assets of the debtor for purposes of §347(b). *Id.* at \*21. Thus, the liquidating trust was the entity entitled to the remaining funds and the *cy pres* doctrine was invoked not to “sidestep” the provisions of Chapter 129, but rather for its original doctrinal purpose: to guide a court in disposing of funds in the absence of contractual or statutory guidance.

Throughout the country, there are so very many worthwhile *pro bono* initiatives and charitable organizations relevant to bankruptcy matters that are desperately in need of funding. Whether providing funding for continuing legal education programs, law school clinics that help to provide *pro bono* services to clients in need of bankruptcy counsel or the exciting work of the Hon. **John C. Ninfo II**, Chief Judge for the U.S. Bankruptcy Court of the Western District of New York, and his Credit Abuse Resistance Education (C.A.R.E.) program which is dedicated to the education of high school students on the responsible use of credit and credit cards,<sup>16</sup> undistributed funds can do so much more than languish in court registries. Please consider including provisions in your liquidating plans to allow undistributed funds to be put to good use.

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<sup>15</sup> See also *State of Illinois v. J.S. Petersen Coal & Oil Co.*, No. 71 C 2548 (N.D. Ill. March 15, 1976) (distribution of one-half of the unclaimed residue to the Chicago Bar Foundation and one-half to the Chicago Lawyers Committee for Civil Rights); *Pray v. Lockheed Aircraft Corp.*, 644 F.Supp. 1289 (D. D.C. 1986) (*cy pres* allowed award to charitable organization as part of a settlement fund that it had discretion to distribute. However, the charitable donation was eventually severed from the settlement due to ongoing negotiations by the parties.); *In re Corrugated Container Antitrust Litigation*, MDL No. 310, 53 Antitrust & Trade Regulation Reports 711 (S.D. Tex. Oct. 6, 1987) (more than \$1 million was divided among six law schools, the National Association of Attorneys General and two packaging industry foundations).

<sup>16</sup> Information about the C.A.R.E. program is available at [www.careprogram.us](http://www.careprogram.us).

