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INSIGHT AND EXPERIENCE

# THE LOUISIANA LENDER LETTER

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## HAS THE CHRYSLER ASSET SALE UNDER SECTION 363 OF THE BANKRUPTCY CODE EFFECTIVELY RENDERED *BRANIFF* MOOT?

Chrysler and 24 of its subsidiaries filed for chapter 11 relief in the Southern District of New York and within days filed the necessary motions to begin a fast-tracked process to obtain court approval of the sale of substantially all of its assets under Section 363 of the Bankruptcy Code. The Bankruptcy Court's opinion, *In re Chrysler LLC*, 405 B.R. 84 (Bankr. S.D.N.Y. 2009), is worthy of note, because it is indicative of bankruptcy courts' increasingly expansive interpretation Section 363 and their authority to approve asset sales thereunder.

Section 363 of the Bankruptcy Code authorizes a debtor to use, sell or lease property of the estate outside the ordinary course of business after notice and a hearing. Debtors routinely use Section 363 to effectuate sales of assets outside the ordinary course of business and courts routinely approve such sales. However, a sale under Section 363 that, in essence, implements the terms of a plan of reorganization runs afoul of the Bankruptcy Code's provisions governing plan confirmation, if the debtor fails to follow the procedures for confirming a plan. *Sub rosa* plans are impermissible, because while in form they merely effectuate Section 363 sales, in substance they effectuate the terms of a plan, while circumventing the chapter 11 safeguards and requirements for confirming a plan. The *sub rosa* plan doctrine emanates from the Fifth Circuit's decision in *Pension Benefit Guaranty Corp. v. Braniff Airways, Inc. (In re Braniff Airways, Inc.)*, 700 F.2d 935 (5th Cir. 1983). In *Braniff Airways*, the Fifth Circuit struck down an asset sale, because it included provisions dictating the terms of a plan and provided for the release of claims against the debtor. As the Fifth Circuit stated, "[t]he debtor and the Bankruptcy Court should not be able to short circuit the requirements of Chapter 11 for confirmation of a reorganization plan by establishing the terms of the plan *sub rosa* in connection with a sale of assets."

In *Chrysler*, three Indiana state pension funds argued that Chrysler's sale constituted a *sub rosa* plan in that it prevented creditors from having any meaningful participation in the plan confirmation process and ignored the priority scheme of the Bankruptcy Code. Specifically, the pension funds argued that through the sale Chrysler was proposing to sell their collateral to "New Chrysler" (the ostensible purchaser) which would satisfy over $20 billion in unsecured creditor claims, leaving first priority lenders with only a fraction of the value of their collateral. The Bankruptcy Court rejected this argument, finding that (i) Chrysler had a "good business reason" for the sale, (ii) Chrysler was receiving fair value for the assets being sold, (iii) the proceeds from the sale would be paid to the priority lenders (even if their estimated recovery was not 100%) and (iv) Chrysler was not attempting to allocate the sale proceeds away from the priority lenders.

The *Chrysler* opinion illustrates bankruptcy courts' increasing willingness to approve transactions to avoid the *sub rosa* issues confronted by the Fifth Circuit in *Braniff Airways* and demonstrates the flexibility of bankruptcy courts to adapt to extraordinary circumstances under a compressed timeline.

## MORTGAGES HELD EXTINGUISHED

In *LLP Mortgage, Ltd. v. Food Innovisions, Inc.*, 997 So.2d 628 (La. Ct. App. 5th Cir. 2008), the Louisiana Court of Appeal for the Fifth Circuit held that mortgages securing SBA notes were extinguished when the notes prescribed. In this case, a holder of certain notes secured by two mortgages sued the maker alleging the notes were in default and sought payment of all sums due. The trial court held that the notes were prescribed pursuant to federal law. On appeal to the Fifth Circuit, the creditor argued that the mortgages remained viable and enforceable notwithstanding the prescription of the underlying promissory notes because federal law provides that a federal lien on property is not subject to state law statutes of limitations and is not subject to any prescriptive periods. The appellate court disagreed and held the mortgages were unenforceable. The Court explained that La. Civil Code article 3282 does not confer a statute of limitation or a prescriptive period which violates federal law. Rather, a mortgage is an accessory right and a creditor can only enforce the mortgages to the extent it can enforce the obligation it secured.

## BANK FAILS TO ANNUL TAX SALE FOR LACK OF SALE NOTICE

In *Tietgen v. City of Shreveport,* 2009 WL 1315833 (La. Ct. App. 2d Cir. 2009), plaintiffs purchased immovable property in Shreveport, Louisiana and granted a mortgage on the property to a national bank. The plaintiffs thereafter failed to pay the ad volorem taxes on the property. In attempting to collect the delinquent taxes, the City notified the plaintiffs of a pending tax sale of the property and sold the property at a tax sale after plaintiffs failed to pay. The bank did not receive notice of the delinquent taxes nor notice of the pending tax sale. The bank filed a declaratory action to have the tax sale annulled on this basis. The trial court held that the tax sale was null and void due to the City's failure to provide notice to the bank notwithstanding the bank's failure to request notice. The Second Circuit reversed the trial court and held that the tax sale was valid despite lack of notice to the bank. In so holding the Court noted that the plain language of La. R.S. 47:2180.1(A) requires the tax collector to provide notice of delinquent taxes to the holder of a properly recorded mortgage "if such mortgagee has notified the tax collector of such recorded mortgage" and that Section 2180.1(B)(2) prohibits the nullification of a tax sale "due to a lack of notice to the mortgagee."

## FEDERAL FIFTH CIRCUIT UPHOLDS PURCHASE-MONEY VEHICLE LENDER'S BIFURCATION OF CLAIM UNDER BANKRUPTCY CODE AMENDMENTS

Prior to the enactment of the Bankruptcy Abuse Prevention and Consumer Act of 2005 ("BAPCPA"), a debtor could confirm a chapter 13 plan in three ways: (i) the debtor and creditor agreed on a plan; (ii) the debtor retained the collateral and continued to make payments; or (iii) the debtor surrendered the collateral to the creditor, subject to the creditor's right to pursue an unsecured deficiency claim under non-bankruptcy law. *See* 11 U.S.C. § 1325(a). The ability of a creditor to pursue such an unsecured deficiency is codified in Section 506 of the Bankruptcy Code. BAPCPA seemingly altered a creditor's right to pursue such unsecured deficiency in chapter 13 cases by adding a hanging paragraph to Section 1325(a) which provides that if a creditor has a purchase money security interest securing a debt that was incurred within 910 days of the petition date and the collateral is a motor vehicle for personal use, then Section 506 shall not apply. Courts have interpreted this hanging paragraph in two disparate ways. Some courts hold that a debtor can surrender a 910 vehicle in full satisfaction of his debt regardless of whether the car was worth less than the total amount of debt. Other courts opine that a creditor can still pursue any remaining debt on a 910 vehicle under state law regardless of the elimination of Section 506.

This specific issue was recently raised in *DaimlerChrysler v. Miller*, 570 F.3d 633 (5th Cir. 2009). In *DaimlerChrysler*, the chapter 13 debtor filed a plan wherein he proposed to surrender his vehicle in full satisfaction of his debt to DaimlerChrysler (the holder of a purchase money security interest in the vehicle). The bankruptcy court confirmed the plan over DaimlerChrysler's objection, holding that the hanging paragraph described above allowed the debtor to surrender his vehicle to DaimlerChrysler in full satisfaction of the debt. The Fifth Circuit reversed, holding that Section 506 of the Bankruptcy Code is not the only source of authority to enforce a deficiency judgment. Rather, state law determines rights and obligations when the Bankruptcy Code does not supply a federal rule. Thus, while the Section 1325's hanging paragraph may deny DaimlerChrysler the use of Section 506 in pursuing its unsecured deficiency claim, Louisiana state law would permit DaimlerChrysler to pursue its deficiency claim.

## LOUISIANA COURT OF APPEALS REQUIRES CLEAR INTENTION TO ACKNOWLEDGE INTERRUPTION OF PRESCRIPTION PERIOD ON DEMAND NOTE

Where a promissory note is payable on demand, prescription runs from the date of the note and not from the date of demand. However, an obligor's acknowledgement of a debt or obligation interrupts prescription and erases the time that has accrued, with prescription commencing anew from the date of the interruption. In *Babin v. Babin*, 10 So.3d 784 (La. Ct. App. 5th Cir. 2009) the Louisiana Court of Appeals for the Fifth Circuit held that for the purposes of such acknowledgement, it was insufficient for the obligor to merely sign and date the back or bottom of the note or instrument. Rather, for the purposes of interrupting prescription, such acknowledgements must be accompanied by some language that clearly, positively and unequivocally expresses the intent to interrupt prescription.

## ABILITY TO ATTACK EXECUTORY PROCESS FORECLOSURE AFTER THE SALE IS LIMITED

Although the Louisiana Code of Civil Procedure's provisions permitting parties to attack judgments are liberally construed, they are not without limits. In *Knox v. West Baton Rouge Credit, Inc.*, 9 So.3d 1020 (La. Ct. App. 1st Cir. 2009), the plaintiff alleged that the seizure and sale of her property through executory process was unlawful, because her signature was forged on the collateral mortgage and note, rendering them absolutely null. Therefore, she claimed that the sale was relatively null pursuant to Article 2004 of the Code of Civil Procedure. Actions under Article 2004 must be brought within one year of the discovery of the fraud.

Although the plaintiff received notice of the seizure and sale of the property on November 14, 2006, she did not attempt to stop the seizure and sale and did not allege fraud or forgery until January 9, 2008, over one year after she had received notice of the seizure and sale, the sale was completed, the mortgage had been cancelled and the extra proceeds had been issued to her and the co-owner of the property. Nevertheless, she claimed that she did not discover the fraud until the one year period prior to her commencement of suit. The Louisiana Court of Appeals for the First Circuit held, however, that actual notice is not required where there is sufficient notice to excite attention, put a person on guard or prompt further investigation. Such information was tantamount to knowledge or notice of everything to which a reasonable inquiry may lead. Thus, the notice of a seizure and sale of property was sufficient to start the one-year prescriptive period running.

## FEDERAL FIFTH CIRCUIT DENIES BANKS' SUMMARY JUDGMENT ON PRESCRIPTION

The prescriptive periods (statutes of limitation) for bringing an action under Louisiana law based on contract and tort are extremely disparate. The prescriptive period for a tort action is one year from the date the injury is sustained, whereas the prescriptive period for a breach of contract action is ten years after the breach. Thus, where an action that sounds in tort and contract is commenced outside of the one year tort prescriptive period, plaintiffs are incentivized to urge that the action is one based on breach of contract, not tort.

The Fifth Circuit recently confronted this issue in *Keenan v. Donaldson, Lufkin & Jenrette, Inc.,* 2009 WL 1959418 (5th Cir. July 9, 2009). In *Keenan*, certain bank defendants allegedly promised to provide ₤165 to 190 million in financing to a company if the company's founder (the plaintiff) provided a $10 million loan to and obtained $50 million in financing for the company. The promises were made and the conditions were met in year 2000. The bank defendants failed to provide the promised financing and the company was liquidated in a receivership proceeding in the United Kingdom in 2000. When the plaintiff learned that he would only be repaid 7% of his loan through the receivership process, he filed suit in 2005 alleging causes of action for, among other things, detrimental reliance, promissory estoppel and fraud. The defendant banks moved to dismiss the action based on prescription, because the plaintiff's claims were tort (or delictual) in nature rather than contractual and thus untimely commenced.

The Fifth Circuit held that claims for detrimental reliance and promissory estoppel could sound in tort or contract, because it is the nature of the action, rather than its label, that governs which statute applies. In other words, where one relies on a promise to his detriment, an action for damages based on such reliance could ostensibly lie in tort (akin to fraud) or contract (akin to breach of a promise to perform). In the instant case, the Court determined that the plaintiff's claims derived from a breach of promise rather than a breach of duty and thus the 10-year contract period of limitations applied.

With respect to the plaintiff's fraud claims, plaintiff alleged that the defendants had no intention of performing when they made their promise to provide financing. Although admittedly the one-year prescriptive period applied to such an action, the plaintiff claimed that he only learned that defendants had no intention of performing during the course of discovery in 2006. The defendants argued that the prescriptive period began running in 2000, when they did not perform, and that knowledge of a broken promise is enough to start the period running. The Fifth Circuit disagreed, finding that a breach of promise, standing alone, is not enough for a fraud claim. Rather, the heart of a fraud claim is the present intent not to perform and it is this present intent that avoids turning every breach of contract into a fraud claim. Because the defendants failed to prove that the plaintiff knew of their present intent not to perform until within one year of his filing the amended complaint, the amended complaint was brought within the one-year prescriptive period for fraud.

## EDITORS


**Brent C. Wyatt**
Partner, New Orleans
bwyatt@lemle.com
(504) 584-9156

**Timothy S. Mehok**
Associate, New Orleans
tmehok@lemle.com
(504) 584-9472

**Wesley M. Plaisance**
Associate, New Orleans
wplaisance@lemle.com
(504) 584-9471


## ABOUT LEMLE & KELLEHER, L.L.P.

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## BANKRUPTCY & CREDITOR'S RIGHTS TEAM

### New Orleans, LA

**Thomas M. Benjamin,** tbenjamin@lemle.com, (504) 584-9424

**James C. Butler,** jbutler@lemle.com, (504) 584-9429

**James R. Conway, III,** jconway@lemle.com, (504) 584-9433

**Alan H. Goodman,** agoodman@lemle.com, (504) 584-9419

**Patrick Johnson, Jr.,** pjohnson@lemle.com, (504) 584-9417

**Timothy S. Mehok,** tmehok@lemle.com, (504) 584-9472

**Wesley M. Plaisance,** wplaisance@lemle.com, (504) 584-9471

**Brent C. Wyatt,** bwyatt@lemle.com, (504) 584-9156

### Baton Rouge, LA

**Sharon Morris,** smorris@lemle.com, (225) 408-5410

**W.L. "Coley" West,** cwest@lemle.com, (225) 408-5405

### Houston, TX

**Michael B. Donald,** mdonald@lemle.com, (713) 225-7864

**Baton Rouge**
One American Place
301 Main Street
Suite 1100
Baton Rouge, LA 70825
Phone: (225.387.5068
Fax: 225.387.4995

**Houston**
Bank of America Center
700 Louisiana St.
Suite 2060
Houston, TX 77002
Phone: 713-247-0030
Fax: 713-247-0024

**New Orleans**
Pan-American Life Center
601 Poydras Street
21st Floor
New Orleans, LA 70130
Phone: 504.586.1241
Fax: 504.584.9142

**www.lemle.com**


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