

**THE SANCTITY OF SETTLEMENTS AND THE SIGNIFICANCE OF COURT APPROVAL:
DISCERNING CLARITY FROM BANKRUPTCY RULE 9019**

REYNALDO ANAYA VALENCIA [FNa1]

Copyright © 1999 University of Oregon; REYNALDO ANAYA VALENCIA

***428** Unlike the predecessor Bankruptcy Act, [FN1] the current Bankruptcy Code [FN2] does not contain an explicit substantive provision requiring court approval of all compromise or settlement agreements in bankruptcy. Accordingly, courts interpreting the Bankruptcy Code have differed with respect to the necessity for court approval of such agreements. The Code's lack of an unambiguous directive has also resulted in proponents of compromise or settlement agreements determining that court approval is not necessary, and thus failing to seek court approval. In turn, failure to obtain court approval has led to absurd and unintended consequences not consonant with general bankruptcy principles and often not contemplated by the parties to the proposed agreements.

This Article argues that both the history of United States bankruptcy law and the spirit of the contemporary Bankruptcy Code lead to the inexorable conclusion that bankruptcy courts must play an integral role with respect to such agreements. Bankruptcy proceedings are unique in American law. Unlike ***429** traditional litigation between two or more parties, court involvement throughout the bankruptcy process has always been a hallmark of bankruptcy law. Requiring court approval of a proposed compromise or settlement in bankruptcy, therefore, is both logical and desirable, and consistent with long- standing tenets of bankruptcy.

Part I of this Article discusses the undisputed significance of compromise and settlement agreements in the bankruptcy context. Part II discusses Federal Rule of Bankruptcy Procedure 9019, which serves as the starting point for a contemporary analysis of compromises and settlements in bankruptcy. While courts are split as to the mandatory versus permissive nature of this Rule, Part II examines why precedent holding that court approval is mandatory pursuant to this Rule constitutes the more correct and well- reasoned approach. Utilizing related bodies of law, both within and outside the bankruptcy context, the remainder of this Article further illustrates the importance and necessity of requiring court approval of compromise and settlement agreements. Part III, for instance, examines the bankruptcy common- law standards for approval of compromise or settlement agreements to argue that not requiring court approval amounts to an end-run around these highly observed and extremely well-established, well-developed, and well-respected dictates within bankruptcy jurisprudence. Similarly, Part IV borrows from case-law precedent establishing that Section 363 of the Bankruptcy Code requires court approval of settlements involving causes of action belonging to the bankruptcy estate. This Part argues that the rationale of this line of cases is persuasive and informs the broader issue regarding the necessity of bankruptcy court approval for all types of compromise or settlement agreements. Part V discusses the importance of the "real party in interest" doctrine and its applicability, particularly with respect to creditors' committees, in the settlement context, thus providing further support for court approval. Part VI discusses the relevance of state rules of civil procedure which require court involvement with respect to proposed settlements, and which have been held to be applicable to settlements reached in the federal bankruptcy context. Finally, Part VII concludes that a carefully worded settlement agreement, executed between the proper parties in interest, which seeks to bind all relevant parties in the bankruptcy estate (not merely the obvious ones), followed by presentation of the ***430** proposed agreement to the bankruptcy court for its approval, is the most effective way to ensure the intended efficacy of the negotiated compromise or settlement agreement.

I

The Significance of Compromises and Settlements in Bankruptcy

Compromise and settlement agreements have long been an inherent component of the bankruptcy process. [FN3] Such negotiated outcomes save the bankruptcy estate the time and expense of protracted proceedings, perhaps even litigation, [FN4] regarding the disputed issue or issues.

The courts are uniform in their respect, desire, and appreciation of settlements in a bankruptcy case. Indeed, the United States Supreme Court has noted, "[i]n administering reorganization proceedings in an economical and practical manner it will often be wise to arrange the settlement of claims as to which there are substantial and reasonable doubts." [FN5] The leading bankruptcy *431 treatise, Collier on Bankruptcy, [FN6] similarly notes that "[c]ompromises are favored in bankruptcy," [FN7] and the Third Circuit has observed that, "[i]ndeed, it is an unusual case in which there is not some litigation that is settled between the representative of the estate and an adverse party." [FN8] The Honorable Lief M. Clark of the United States Bankruptcy Court for the Western District of Texas recently noted:

The glue that often holds the bankruptcy process together is the ability of parties to resolve disputes by settlement instead of litigation. If bankruptcy judges had to try a much larger percentage of matters than they currently do, the system would surely bog down. Thus, the sanctity of settlements can *432 hardly be overemphasized. [FN9]

II

Bankruptcy Rule 9019 and its Origins

The starting point for a discussion of compromise and settlement agreements under the Bankruptcy Code is Federal Rule of Bankruptcy Procedure 9019. [FN10] Titled "Compromise and Arbitration," Rule 9019 provides in subsection (a):

On motion by the trustee and after notice and a hearing, the court may approve a compromise or settlement. Notice shall be given to creditors, the United States trustee, the debtor, and indenture trustees as provided in Rule 2002 and to any other entity as the court may direct. [FN11]

The notice provisions of Rule 9019, as set forth above, require that notice of a compromise or settlement be given to 1) the United States trustee, 2) the debtor, and 3) indenture trustees in accordance with the provisions of Bankruptcy Rule 2002. Rule 9019 further provides that notice be given to any other entity that *433 the court may direct. [FN12] Rule 2002, in turn, requires that absent a court directive to the contrary, the requisite parties be given at least 20 days notice with respect to "the hearing on approval of a compromise or settlement of a controversy." [FN13] Rule 2002 also provides direction for a host of other issues such as the content of the notice, [FN14] the address to which the notice is to be sent, [FN15] and the sufficiency of notice to committees versus individual creditors. [FN16] Courts have held that the notice requirements of Rule 2002 may be waived for "good cause" shown. [FN17] Accordingly, Collier's concludes:

The thrust of the foregoing provisions [of Bankruptcy Rules 9019 and 2002] is that, when it comes to providing for notice of a hearing on a motion to compromise a controversy, the notice can be sent either to [] . . . In appropriate cases, no notice at all might be required. The nature of the compromise or settlement being presented and its importance to the estate, along with the need for expedition, will determine the notice which will have to be given in any particular case. [FN18]

At its core, Rule 9019(a), with its corresponding notice and hearing requirements derived from Rule 2002, provides a bankruptcy court the statutory authority to approve a proposed compromise or settlement agreement. [FN19] The problem lies in the *434 relative sparseness of the Rule's language which ultimately raises many more questions than it answers. For example, the Rule provides, "[o]n motion by the trustee and after notice and a hearing, the court may approve a compromise or settlement." [FN20] Nothing in the Rule's language explicitly requires presenting a proposed settlement to the bankruptcy court for approval. Rather, by its own terms, the Rule is triggered only by, and is applicable to, instances in which the trustee files a non-mandatory motion seeking approval of a proposed settlement or compromise. This language gives rise to uncertainty regarding the necessity of presenting any negotiated settlement agreement for court approval, and as a corollary, brings into question the validity of negotiated settlement agreements and compromises which are never presented to the court. Does failure to move the court for approval of a proposed agreement mean that Rule 9019 is not triggered and that the resulting agreement is valid? Or, to the contrary, does failure to seek court approval render the proposed agreement a legal nullity? Because of the Rule's sparse language and the varying practices among bankruptcy courts, these and a myriad of related issues, such as the Rule's underlying policy, its substantive versus procedural character, its mandatory versus permissive nature, and the standards utilized to approve such agreements, have all been addressed by the courts. In arguing that compliance with Bankruptcy Rule 9019 is mandatory, this article examines the

courts' attempts to address and resolve these complex issues, and the corresponding case-law developments.

A. The Underlying Policy of Bankruptcy Rule 9019

Many courts have noted that the purpose behind Bankruptcy Rule 9019 is to prevent secret agreements between the debtor and other parties, and to provide interested creditors with a right to object to the proposed settlement. In *Columbia Gulf Transmission *435 Co. v. Louisiana Natural Gas Pipeline, Inc.*, [FN21] the court declared, "[t]his rule prevents debtors from entering into secret agreements and safeguards the rights of creditors who otherwise might be harmed by providing them with an opportunity to object to the proposed settlement if they find it unsatisfactory." [FN22] In *In re Masters, Inc.*, [FN23] the court declared even more precisely that the "clear purpose of Rule 9019 is to prevent the making of concealed agreements which are unknown to the creditors and unevaluated by the court." [FN24]

B. Is Bankruptcy Rule 9019 Substantive or Procedural?

As mentioned above, [FN25] unlike its predecessor Rule 919 under the Bankruptcy Act, Rule 9019 neither has, nor is it based upon, a corresponding substantive section of the Bankruptcy Code. [FN26] Accordingly, some courts read Bankruptcy Rule 9019 as solely procedural, providing no substantive rights to notice and hearing. In *In re Dow Corning Corp.*, [FN27] the court held "Rule 9019, being merely a rule, can do no more than establish a procedural mechanism for exercising a statutory power." [FN28] Extending this line of reasoning to its logical conclusion, some courts have further held that since Bankruptcy Rule 9019 is procedural only, substantive rights to notice and hearing must come from a substantive section of the Bankruptcy Code. Accordingly, in *In re Telesphere *436 Communications, Inc.*, [FN29] the court declared that Bankruptcy Rule 9019(a) "provides a procedure for motions to settle, but it cannot create a substantive requirement for court approval that does not exist in the Code itself." [FN30] In *Myers v. Martin (In re Myer)*, [FN31] the Third Circuit declared, "Section 363 of the Code [FN32] is the substantive provision requiring a hearing and court approval; Bankruptcy Rule 9019 sets forth the procedure for approving an agreement to settle or compromise a controversy." [FN33]

The holdings regarding Bankruptcy Rule 9019's substantive versus procedural nature are further complicated by rulings that Bankruptcy Rule 9019 empowers bankruptcy courts to approve any compromise or settlement related to a bankruptcy case. [FN34] The implicit assumption in these rulings is that a Rule empowering a court to approve any compromise or settlement is inherently substantive.

A restrictive view of Bankruptcy Rule 9019 as applicable only when coupled with a substantive section of the Bankruptcy Code is problematic and incorrect. First, unlike the predecessor Bankruptcy Act which contained a neatly parallel set of substantive and procedural provisions, the Bankruptcy Code contains no explicit, detailed substantive section requiring court approval of all proposed compromises and settlements. Second, as discussed more fully in Part IV, it appears that Section 363 is the only substantive Code section which actually requires court approval *437 before entering into a proposed compromise or settlement of the type contemplated therein: settlement of causes of action belonging to the bankruptcy estate. Thus, reading Bankruptcy Rule 9019 in a restrictive manner essentially eviscerates the Rule's provisions in all non-Section 363 settlement situations and renders them meaningless.

One particularly absurd example arises in the area of claims litigation. Since settlement of creditors' claims against the estate would not implicate Section 363, because such claims are not causes of action belonging to the estate but causes of action against the estate, a debtor-in-possession could theoretically settle a creditor's claim for any sum the debtor-in-possession deemed appropriate without having to seek court approval. Such a result is surely not the intent of the drafters of the Bankruptcy Code, and more particularly not of Bankruptcy Rule 9019. Moreover, common principles of statutory construction require that the Rule be interpreted to avoid inequitable results such as this. [FN35] Accordingly, neither logic nor, as explained more fully below, relevant case law supports a restrictive reading of this Rule.

C. Is Bankruptcy Rule 9019 Mandatory or Permissive?

A split of authority exists as to whether Bankruptcy Rule 9019's provisions relating to bankruptcy court approval are mandatory or permissive. The great weight of authority holds that these requirements are mandatory.

1. The Need for Court Approval Prior to Bankruptcy Rule 9019

Prior to the enactment of Bankruptcy Rule 9019 in 1978, many courts, including the United States Supreme Court, had held that before a compromise or settlement agreement could be binding or enforceable in the context of a bankruptcy case, the agreement had to be approved by the bankruptcy court. [FN36] In a *438 landmark decision addressing compromises and settlements in bankruptcy, [FN37] the United States Supreme Court, in considering a case under the Bankruptcy Act, stated the following:

Compromises are 'a normal part of the process of reorganization.' In administering reorganization proceedings in an economical and practical manner it will often be wise to arrange the settlement of claims as to which there are substantial and reasonable doubts. At the same time, however, it is essential that every important determination in reorganization proceedings receive the 'informed, independent judgment' of the bankruptcy court. [FN38]

Similarly, in another Bankruptcy Act case, *Lincoln National Life Insurance Co. v. Scales*, [FN39] the United States Court of Appeals for the Fifth Circuit declared that a bankruptcy trustee's "powers depend on the law. He may not compromise or arbitrate anything except under the court's approval By no surrender of possession can he defeat the court's control over any part of the estate." [FN40] Thus, prior to the promulgation of Bankruptcy Rule 9019, definitive precedent existed regarding the importance and necessity of court approval for a proposed compromise and settlement of a contested matter in the context of a bankruptcy case.

*439 2. The Majority Rule: Precedent Holding That Compliance with Bankruptcy Rule 9019 is Mandatory

In discussing Rule 9019, the leading bankruptcy treatise, *Collier on Bankruptcy*, notes, "[i]t is an unusual case of any size in which there is not some litigation between the representative of the estate and an adverse party. Much of that litigation is settled. In such situations, the settlement must be approved by the court." [FN41] Numerous courts have similarly held that, despite Rule 9019's inconclusive language, compliance with the Rule is mandatory. In *Travelers Insurance Co. v. American Agcredit Corp. (In re Blehm Land & Cattle Co.)*, [FN42] the United States Court of Appeals for the Tenth Circuit held, "[u]nder Bankruptcy Rule 9019, a settlement or compromise agreement between the trustee and a party must be approved by the court, after notice and hearing." [FN43] Similarly, in *Valucci v. Glickman, Berkovitz, Levinson & Weiner (In re Glickman, Berkovitz, Levinson & Weiner)*, [FN44] the court held that a "bankruptcy court must review the settlement of pre-petition claims under Bankruptcy Rule 9019(a)." [FN45] Stating the proposition more broadly, the United States District Court for the Eastern District of New York, in *Saccurato v. Masters, Inc. (In re Masters, Inc.)*, [FN46] declared, "[i]n general, debtors cannot bind their estates to compromises absent bankruptcy court approval, and approval can be given only on motion and after 20 days notice to creditors [in accordance with Bankruptcy Rule 9019]." [FN47]

Noting that not all courts concur that Bankruptcy Rule 9019's requirements are mandatory, [FN48] at least one court has argued that such minority holdings should be limited to the very specific facts in those cases. In *Columbia Gulf Transmission Co. v. Louisiana Natural Gas Pipeline, Inc.*, [FN49] the court dealt with a settlement agreement which involved the debtor releasing certain actual and potential causes of action against third parties. In determining whether compliance with Bankruptcy Rule 9019 was permissive or mandatory, the court noted the existence of some authority for the proposition that even absent court approval a settlement in bankruptcy can nevertheless be binding on the parties. The court commented, however, that such precedent existed only in certain very fact-specific circumstances, such as when the agreement has been entered into in open court, or when all of the relevant parties, including all creditors, are present or aware of the contemplated settlement. More importantly, the court explicitly rejected broadening this aberrant line of authority to instances in which these factors were not present:

While some courts have endorsed dispensing with the notice requirements of Rule 9019 when all interested parties to the agreement are present during the settlement negotiations or when the settlement is placed on the record in open court, their rulings are not implicated where, as here, neither [debtor's] creditors nor the Creditor's Committee have been provided with an opportunity to review the disputed release forms Rule 9019 was conceived to prevent behind the *441 scenes dealing such as this. Accordingly, if [[debtor's] creditors have an actual or potential pecuniary interest in the claims underlying this litigation or any other claims that will be waived by the release, they are entitled to the notice provided for under Rule 9019. . . . [The debtor's] creditors must be provided with an opportunity to make their own assessment of any actual or potential claims [the debtor] may have against [possible defendants]. [FN50]

Finally, in some instances, courts, after enactment of Bankruptcy Rule 9019, although without specifically

referring to the Rule, have noted the requirement of bankruptcy court approval of a proposed compromise or settlement. Perhaps the strongest pronouncement of this sentiment is found in *Reynolds v. Commission of Internal Revenue*, [FN51] in which the United States Court of Appeals for the Sixth Circuit declared:

In bankruptcy proceedings, as distinguished from ordinary civil cases, any compromise between the debtor and his creditors must be approved by the court as fair and equitable. . . . The need for this safeguard is obvious. Any settlement between the debtor and one of his individual creditors necessarily affects the rights of other creditors by reducing the assets of the estate available to satisfy other creditors' claims. [FN52]

In *United States v. City of Miami*, [FN53] a non-bankruptcy case involving a Title VII class action, the Fifth Circuit's lengthy opinion dealt, in part, with whether court approval of the proposed settlement at issue in the case was required. In reaching its decision, the court made several important observations regarding court approval and settlement agreements in general:

In what can be termed ordinary litigation, that is, lawsuits brought by one private party against another private party that will not affect the rights of other persons, settlement of the dispute is solely in the hands of the parties. If the parties can agree to the terms, they are free to settle the litigation at any time, and the court need not and should not get involved.

* * *

In contrast, there are certain special situations in which the trial court is required by statute or rule to approve a settlement to which the parties to the litigation have agreed. The three most prevalent examples of this are proposed class action settlements, proposed shareholder derivative suit settlements, and proposed compromises of claims in bankruptcy *442 court. [FN54]

Notably, in *United States v. AWECO, Inc. (In re AWECO, Inc.)*, [FN55] the Fifth Circuit explicitly reaffirmed its pronouncement in *Miami* by declaring, "decisions as central to bankruptcy proceedings as approval of settlements cannot be visceral. They must issue from reason and rest upon factual undergirdings." [FN56]

a. Precedent Holding a Settlement Agreement is Unenforceable Absent Court Approval

With respect to the issue of enforceability of a proposed compromise or settlement agreement that has not received court approval, courts mandating compliance with Bankruptcy Rule 9019 logically hold that absent such compliance, a proposed settlement agreement is not enforceable. In *Travelers Insurance Co. v. American Agcredit Corp. (In re Blehm Land & Cattle Co.)*, [FN57] the Tenth Circuit held that "[u]nder Bankruptcy Rule 9019, a settlement or compromise agreement between the trustee and a party must be approved by the court, after notice and hearing, to be enforceable." [FN58] Similarly, in *Billingham v. Wynn & Wynn, P.C. *443 (In re Rothwell)*, [FN59] the court stated, "[a] settlement agreement is unenforceable without notice of the settlement to creditors or a court order approving it." [FN60] In *Zerodec Mega Corp. v. Terstep of Texas, Inc. (In re Zerodec Mega Corp.)*, [FN61] the court held that "since there was no notice disseminated to creditors on the parties' intended entry into the accord, nor order approving such entry, the accord is invalid and no settlement or compromise was achieved due to the requirements of Bankruptcy Rule 9019(a)." [FN62]

b. An Amplification of the Need for Court Approval: The Special Case of Notice and a Debtor's Service List

In *Saccurato v. Masters, Inc. (In re Masters, Inc.)*, [FN63] the bankruptcy court addressed the very particular issue of notice of a proposed settlement agreement to creditors who have specifically requested to be placed on the debtor's service list. The court explicitly held that in such a situation, Bankruptcy Rule 9019's notice and hearing requirements must absolutely be met, and that failure to do so rendered the proposed settlement agreement inoperative.

Where creditors have expressed sufficient interest in a bankruptcy case to have their names added to the service list, this Court finds that such creditors have a right to actual notice pursuant to Rule 9019(a) and to make objections to any proposed *444 settlement agreement prior to final approval by a bankruptcy judge. . . . Moreover, notice to the Creditors' Committee does not waive notice to the individual creditors on the service list, nor can a bankruptcy

judge eliminate the Rule 9019(a) notice requirements even if he believes that his ultimate approval of the proposed agreement is a virtual certainty. Accordingly, because various [debtor's] creditors have never been notified of the proposed . . . settlement agreement, this Court finds that the Massachusetts bankruptcy court never formally approved that agreement. [FN64]

Despite the lack of an explicit substantive code section requiring court approval of all proposed compromises or settlements, the Masters court nevertheless imposed such a requirement based on notions of creditors' rights to disclosure and rights to file objections. Because the creditors' rights sought to be protected by this decision should be protected in all bankruptcy settlement and compromise situations, the Masters' rationale is applicable and can be extended to require court approval of all such agreements.

3. The Minority Rule: Precedent Holding That Compliance with Rule 9019 is not Mandatory

A few courts have held that despite non-compliance with the notice and hearing requirements of Bankruptcy Rule 9019, a settlement agreement may be binding and enforceable. These courts, however, typically limit their holdings to enforcement with respect to the actual parties to the agreement, and only to the period of time between entry into the agreement and a court's determination whether to approve the agreement. Further, these cases usually involve parties who enter into and actually seek court approval for their proposed settlement agreement pursuant to Bankruptcy Rule 9019, or otherwise announce the settlement agreement in open court and enter its terms into the record. Thus, in these few cases, failure to move the bankruptcy court for approval and provide the concomitant notice to creditors in accordance with Bankruptcy Rule 9019 is typically not an issue. Rather, it is more common in these cases that a party to a proposed settlement agreement later seeks to rescind its acquiescence to the agreement, prior to obtaining court approval, and the court finds that such a result would be inequitable, thereby holding the agreement binding on the parties only.

*445 a. Precedent Holding Non-Court Approved Agreements Binding on Parties Only

Courts holding that non-court approved agreements are binding limit their results in two major ways. First, these courts limit the application of their holding to the actual parties to the agreement and second, the courts typically hold that the parties are bound only until such time as the court approves or fails to approve the proposed agreement. [FN65] In *In re Cotton*, [FN66] the court examined a settlement agreement entered into by the parties, followed by the attempt of one of the parties to declare the agreement unenforceable due to lack of bankruptcy court approval. The court held, "[a]n agreement by a debtor in possession to compromise litigation is binding upon all parties to the agreement, pending a court determination about whether or not to approve the agreement." [FN67] A similar situation arose in *In re Frye*, [FN68] where the court held, "[t]he [proposed settlement] agreement is therefore binding on the parties pending approval by this Court." [FN69] In *White v. C.B. Hannay Co. (In re Lyons Transportation Lines, Inc.)*, [FN70] the court declared, "[a]bsent actual or constructive fraud, a settlement agreement is binding as between the parties pending the required bankruptcy court approval." [FN71] Wording its holding even more strongly, the bankruptcy court in *In re Paolino* [FN72] stated, "[a]n agreement to settle a lawsuit, voluntarily entered into, is binding upon the parties, whether or not made in the presence of the court, and even in the absence of a writing' The agreement remains binding even if a party has a change of heart after he agreed to its terms but before the terms are reduced to writing." [FN73]

*446 b. Precedent Holding Agreements Entered into in Open Court or Entered into the Court Record are Binding on the Parties Only

With respect to agreements that are entered into in open court, a few courts have held that such agreements are also binding on the parties, even in the absence of specific court approval. In *Holder v. Gerant Industries, Inc. (In re Omni Video, Inc.)*, [FN74] the court held, "[a]n agreement announced on the record becomes binding even if a party has a change of heart after he agreed to its terms but before the terms are reduced to writing." [FN75]

4. Courts Holding That an Agreement May be Binding on Parties, but Nevertheless Unenforceable Due to Lack of Authority

In another line of cases, bankruptcy courts have taken a more complex position. Rather than limiting their holding to the proposition that compliance with Rule 9019 is mandatory, or that a proposed agreement may be

binding on the parties only, these courts proceed to consider the capacity of the parties to enter into the proposed agreement. In *Rinehart v. Stroud Ford, Inc.* (In re *Stroud Ford, Inc.*), [FN76] the bankruptcy court held that settlement agreements are binding on the parties even in the absence of compliance with Bankruptcy Rule 9019, but that if no authority existed to enter into the proposed agreement, then the agreement was not binding upon the debtor:

Court approval under Federal Rule of Bankruptcy Procedure 9019 is, thus, implied in law and does not detract from the conclusion that the agreement is binding as between the parties. Of course if the compromise agreement did not concern matters within the ordinary course of the debtor's business [pursuant to Section 363], then the debtor (or debtor-in-possession) had no authority to enter into the compromise absent 'notice and a hearing' and, therefore, the debtor cannot be bound by its terms. [FN77]

Similarly, in *Providers Benefit Life Insurance Co. v. Tidewater *447 Group, Inc.* (In re *Tidewater Group, Inc.*), [FN78] the bankruptcy court noted, "[i]t is clear to the Court that the attorney for the debtor is not competent to enter into an agreement which binds the estate without Court approval." [FN79] Interestingly, and perhaps even paradoxically, however, the bankruptcy court nevertheless went on to note that "an agreement by a debtor in possession to compromise litigation should also be binding upon all parties to the agreement pending a Court determination as to whether or not to approve the agreement." [FN80] Thus, it would appear under this line of cases that where the parties to a proposed settlement agreement lack proper authority, the agreement while perhaps held temporarily binding on the parties, will ultimately be unenforceable.

5. Settlement Agreements Incorporated Into a Plan of Reorganization

Nothing in the Bankruptcy Code prohibits a proposed compromise or settlement agreement from being incorporated into the terms of a plan of reorganization, [FN81] but incorporation of a settlement into a plan of reorganization can raise separate problems. Section 1123(b)(3)(A) of the Bankruptcy Code specifically provides that a plan may provide for the "settlement or adjustment of any claims or interests belonging to the estate." [FN82] While Section 1123(b)(3)(A)'s language is technically limited to settlement of claims "belonging to the estate," courts have also held that claims not belonging to the estate may be compromised and settled in a bankruptcy case. [FN83] In many instances, incorporation of a settlement agreement into a proposed plan of reorganization may be the best, most efficient, and most economical way to proceed. [*448 FN84] In some situations, however, this alternative may give rise to a different set of concerns. Perhaps the most perplexing issue raised by such incorporation is the validity and effectiveness of the proposed settlement agreement between the time that it is executed and the time that the plan is ultimately confirmed.

In *In re Sparks*, [FN85] the bankruptcy court was presented with a proposed settlement agreement involving the sale of assets and the incorporation of the terms of the settlement agreement into the debtor's plan of reorganization. After holding that a settlement agreement implicating Section 363's notice and hearing requirements [FN86] was not enforceable in the absence of bankruptcy court approval, the *Sparks* court next turned its attention to the wisdom of the incorporation of the settlement agreement into the debtor's plan of reorganization.

In this case, the terms of the settlement agreement not only required the sale of the Property, but those terms were to be an integral part of a plan of reorganization. The Bankruptcy Code, of course, requires court approval of a plan. 11 U.S.C. § 1129. Indeed, the Code is explicit that only a confirmed plan binds the debtor. 11 U.S.C. § 1141. Considering the many and frequently onerous requirements of § 1129, one must question *449 how the [disputing party] believed the debtor could be required to consummate this agreement before confirmation. Approval of a plan of reorganization involves all creditors of the estate. As the parties to this case know full well, when seeking confirmation of a plan of reorganization there is the possibility that . . . other unsecured creditors will object to how they are being treated by the plan, or, independent of any objection by creditors, the court may not find that all provisions of § 1129(a) have been satisfied. Certainly the [[disputing party] must have known that confirmation of a plan is not a ministerial act (especially in this case) and that to the extent their agreement was part of a plan, under § 1141 it was not enforceable until confirmed. [FN87]

Concluding that Sections 363, 1129, and Bankruptcy Rule 9019 were all applicable, the court in *Sparks* held, "[t]he creditors of this estate had to be notified of the agreement and this Court had to approve it before it became enforceable." [FN88] Accordingly, the settlement agreement at issue in *Sparks* was given no force. As demonstrated by the facts in *Sparks*, assuming that the parties to a proposed agreement desire the benefits as of the agreement's execution, incorporating the agreement into a plan of reorganization certainly does not achieve this

result, due to the lack of concomitant court approval and the lack of certainty regarding future court approval. Thus, waiting to codify interim agreements until confirmation of a plan of reorganization may short circuit the protections that mandatory court approval is meant to provide. As illustrated in Sparks, court approval of all compromises or settlements, in many instances contemporaneously with execution, is the correct course of action for settlement proponents and is consonant with general bankruptcy principles which seek to protect all creditors.

D. Mandatory Compliance with Bankruptcy Rule 9019 is Both Logical and Appropriate

Under the Bankruptcy Act, court approval was required of all compromise and settlement agreements. For some unexplainable reason, [FN89] the current Bankruptcy Code does not codify this practice, yet contains Bankruptcy Rule 9019. Therefore, since the "clear purpose of Rule 9019 is to prevent the making of concealed agreements which are unknown to the creditors and *450 unevaluated by the court," as discussed above, the notion that compliance with Bankruptcy Rule 9019 is not mandatory is incorrect, illogical, and contrary to the historical background of this Rule. Moreover, even in the rare instances in which courts have held that agreements are enforceable absent compliance with Bankruptcy Rule 9019, these courts have limited their decisions to the parties to the agreement, and required that the parties have the authority to enter into the agreement. Thus, given both the function and history of bankruptcy law, as well as the spirit of current Bankruptcy Rule 9019, proposed compromise or settlement agreements in contemporary cases should be approved by a bankruptcy court in order to be enforceable.

III

Standards for Approval of Compromises and Settlement Agreements

In addition to addressing the issue of whether compliance with Bankruptcy Rule 9019 is mandatory or permissive, courts have also produced a comprehensive and distinct body of law regarding the standards which must be considered before approving proposed compromise or settlement agreements. By considering and analyzing this extensive body of law, this section argues that to hold that compliance with rule 9019 is not mandatory is to allow an end-run around this separate, but equally important and compelling, body of law. Such a result defies logic and is not consonant with the Rule's underlying purpose of preventing secretive dealings and providing creditors the opportunity to object. Moreover, the very size and complexity of the law regarding standards for approval points to the need for an equally elaborate set of considerations which must be met before by-pass of court approval could be appropriate. Since no such by-pass standards exist in either statutes or common-law, this absence speaks volumes, arguing eloquently for the indisputability of court oversight.

A. Courts Are Not Required to Approve All Settlement or Compromise Agreements Presented

Even if a proposed compromise or settlement agreement has *451 been presented to the bankruptcy court and the requisite notice [FN90] has been provided to all of the relevant parties, there is still no guarantee that the proposed agreement will be approved by the court. The language of Bankruptcy Rule 9019 is permissive and merely provides that after notice and hearing, "the court may approve a compromise or settlement." [FN91] Nothing compels the court to do so. [FN92] Indeed, the law is well settled that "[a]pproval of a compromise and settlement is committed to the sound discretion of the [c]ourt." [FN93] Moreover, recognizing the bankruptcy *452 court's unique position with respect to whether to approve a proposed compromise or settlement, [FN94] courts have consistently held that a bankruptcy court's determination will normally not be disturbed on appeal absent a finding of abuse of discretion. [FN95] *453 Therefore, the very force and nature of the court's discretionary power in this area supports the view that court approval is mandatory. Furthermore, the lack of explicit standards for determining when a party does not have to obtain court approval also affirms this view. Stated differently, had the drafters of Rule 9019 intended exceptions to the Rule's court approval requirement, such exceptions would be provided for in the Rule.

B. Courts Are Not Required to Hold Full Evidentiary Hearings: "Lowest Point of Reasonableness Test"

Although bankruptcy courts must consider certain factors before approving a proposed compromise or settlement agreement, no decisions require that the court conduct a full evidentiary hearing. As stated in *In re Purofied Down Products Corp.*, [FN96] in considering approval of a proposed compromise or settlement, a bankruptcy court "need not conduct a 'mini-trial' to determine the merits of the underlying litigation." [FN97] Further, in *454 *DePoister v. Mary M. Holloway Foundation*, [FN98] the Seventh Circuit held that, "the bankruptcy court's failure to conduct

an evidentiary hearing, without more, is not reversible error." [FN99] Indeed, courts have consistently recognized that requiring such hearings would utterly vitiate the primary reasons for favoring settlements in the bankruptcy context--savings of time and expense. [FN100] In *Florida Trailer and Equipment Co. v. Deal*, [FN101] the Fifth Circuit reasoned, "[t]he very uncertainties of outcome in litigation as well as the avoidance of wasteful litigation and expense, lay behind the Congressional infusion of a power to compromise. . . . This could hardly be achieved if the test on hearing for approval meant establishing success or failure to a certainty." [FN102]

*455 Most courts follow the reasoning set forth in *Cosoff v. Rodman (In re W.T. Grant Co.)*, [FN103] in which the Second Circuit declared that in considering a proposed settlement, the "responsibility of the bankruptcy judge . . . is not to decide the numerous questions of law and fact raised by appellants but rather to canvass the issues and see whether the settlement 'fall[s] below the lowest point in the range of reasonableness.'" [FN104] *456 Relating the "lowest point of reasonableness" test back to the overriding principle that compromises are favored in bankruptcy, [FN105] the court in *In re Lion Capital Group*, [FN106] observed that, "it is fundamental to the settlement process that parties be encouraged to resolve their disputes themselves. The lowest level of reasonableness standard affords the flexibility that such encouragement requires." [FN107] Importantly, the fact that the lowest point of reasonableness standard was articulated in the context of a Bankruptcy Act case has not in any way diminished its precedential value following enactment of the Bankruptcy Code. [FN108]

While jurisdictions utilize various tests in determining whether a settlement "falls below the lowest point of reasonableness," [FN109] the commonality among the different tests requires that the bankruptcy court analyze various factors to assure that the proposed settlement agreement is "fair and equitable" and "in the best interest of the estate." [FN110] While the "best interest of the estate" *457 is a fairly self-explanatory concept, "fair and equitable" has been harder to define, particularly in the context of a proposed settlement. [FN111] However, the Seventh Circuit in *LaSalle National Bank v. Holland (In re American Reserve Corp.)*, [FN112] concluded, "[a]ny distinction between the 'best interests of the estate and *458 the fair and equitable' standard is of little consequence." [FN113]

Courts have held that, "[t]he trustee has the burden of persuasion that the settlement is in the best interest of the estate," [FN114] and that the trustee's determination may be given great weight. [FN115] Additionally, at least one court has held that, "[t]he reviewing court need not conduct its own investigation concerning the reasonableness of the settlement and may credit and consider the opinion of the Trustee and counsel that the settlement is fair and equitable." [FN116] Not all courts, however, agree with this approach. In *LaSalle National Bank v. Holland (In re American *459 Reserve Corp.)*, [FN117] the court stated:

abuse of discretion standard implies that the bankruptcy judge must actually exercise his discretion. He may not simply accept the trustee's word that the settlement is reasonable, nor may he merely 'rubber-stamp' the trustee's proposal. The bankruptcy judge must apprise himself of all facts necessary to evaluate the settlement and make an 'informed and independent judgment' about the settlement. [FN118]

Ultimately, as stated by the court in *Walsh*, [FN119] "[t]he reasonableness of a compromise is determined by the particular circumstances of each case." [FN120] Thus, despite the Bankruptcy Code's lack of an explicit requirement regarding court approval of all compromise and settlement agreements, the common law "lowest point of reasonableness" requirement is an explicit acknowledgment that court approval is an important and necessary part of the bankruptcy settlement and compromise process.

C. Relevance of an Adequate Record

Support for the proposition that bankruptcy court approval is an important and necessary aspect of settlements and compromises in bankruptcy can also be found in the common law requirements regarding the need for an adequate record before approving such agreements. While ample support exists for the notion that a bankruptcy court need not conduct a mini-trial on the merits, nor conduct a full evidentiary hearing to determine if a proposed compromise is fair and equitable, these well-established principles should not be interpreted as suggesting that a bankruptcy court may approve a compromise or settlement on a *460 weak or inadequate record. [FN121] Rather, the courts have consistently held that a proposed compromise or settlement may only be approved upon the existence of an adequate record. While courts have differed with respect to what constitutes an adequate record, one fact is certain: failure to present the proposed agreement to the bankruptcy court results in no record whatsoever. Accordingly, the requirement of an adequate record is further evidence of the courts' explicit acknowledgment regarding the importance and necessity for court approval of compromises and settlements in bankruptcy.

1. Courts Should Rely on an Adequate Record

In the leading Supreme Court case addressing settlements and compromises in bankruptcy, *Protective Committee for Independent Stockholders of TMT Trailer Ferry, Inc. v. Anderson*, [FN122] the Court declared that it was "clear that the present record [was] inadequate for assessing" whether to approve the proposed settlement, and determined "that a remand [was] necessary to permit further hearings to be held. Only after further investigation can it be determined whether, and on what terms, these claims should be compromised." [FN123] In arriving at its conclusions, the Court reasoned:

It is essential . . . that a reviewing court have some basis for distinguishing between well-reasoned conclusions arrived at after a comprehensive consideration of all relevant factors, and mere boilerplate approval phrased in appropriate language but unsupported by evaluation of the facts or analysis of the law.

The record before us leaves us completely uninformed as to whether the trial court ever evaluated the merits of the causes of actions held by the debtor, the prospects and problems of *461 litigating those claims, or the fairness of the terms of compromise. More than this, the record is devoid of facts which would have permitted a reasoned judgment that the claims of actions should be settled in this fashion. [FN124]

Despite this strong language, at least one court has remarked that "the Court [in *TMT Trailer Ferry*] gives us no specific direction on how much specificity or detail the bankruptcy court is required to put into its findings of fact or conclusions of law in order to comply with the Supreme Court's language." [FN125] Later cases have further grappled with this issue. In *Magill v. Springfield Marine Bank (In re Heissinger Resources Ltd.)*, [FN126] the court declined to determine whether a different record would be necessary for approval of a compromise or settlement in a liquidation case as compared to a reorganization case, but noted "the different purposes of liquidation and reorganization proceedings and the role of a settlement in each." [FN127] Relying on *TMT Trailer Ferry*, the *Heissinger Resources* court then declared that at least with respect to reorganization cases:

*462 the bankruptcy court is required to give the reviewing court some basis for distinguishing between 'well-reasoned conclusions arrived at after a comprehensive consideration of all relevant factors,' rather than 'mere boiler-plate approval phrased in appropriate language but unsupported by evaluation of the facts or analysis of the law.' [FN128]

Significantly, *In re Lion Capital Group*, [FN129] perhaps the strongest and most well-reasoned decision supporting and building on the Supreme Court's holding in *TMT Trailer Ferry*, did not limit its holding to reorganization cases. In *Lion*, the Chapter 11 trustee sought bankruptcy court approval for the settlement of a complex adversary proceeding which, while originally initiated against the trustee and thirty-seven creditors of the estate, now involved numerous other parties and multi-million dollar claims and cross-claims. Holding that the record was inadequate, particularly with respect to the trustee's potential for success on his counterclaims for preference and fraudulent conveyance against the plaintiff, the bankruptcy court ultimately denied approval of the proposed settlement. [FN130] In arriving at its decision, the court provided an eloquent and elaborate analysis and discussion regarding the necessity and significance of an adequate record before a court may approve a settlement in bankruptcy. The court's insistence on an adequate record is a strong testament to the importance and necessity of court approval in this context.

Relying on existing precedent, the *Lion* court reiterated that, "[t]he settling parties must set forth the facts in 'sufficient detail that a reviewing court could distinguish it from 'mere boilerplate *463 approval' of the trustee's suggestions.'" [FN131] The court next proceeded to consider the merits of the settlement. Throughout its lengthy consideration and analysis of the various facts and circumstances surrounding the proposed settlement, the court neither hid nor camouflaged its disdain for the inadequate record before it, nor for the parties' lackluster efforts in seeking court approval:

[W]e would note that our ability to canvass the issues and to form an opinion as to reasonableness is hampered by the lack of factual information and the presence of other issues that no one has seen fit to address. . . . On this record it is impossible to evaluate the soundness of the Trustee's judgment that the claim is of little merit.

This inability to canvass the issues pertaining to the Trustee's causes of action against [plaintiff] . . . leaves us in

the position of being unable to find that the Settlement is in the best interests of creditors notwithstanding the considered judgment of the Trustee and the [fellow defendant creditors].

. . . .
A court can not find that a settlement by a trustee fits within the lowest bounds of reasonableness where a facially significant cause of action is glossed over and key facts relevant to others are not presented even in summary fashion. . . . Approval is not permitted where the record reveals 'gaping holes in the background of information' or where the support for a key element of the settlement is to be found in 'unsubstantiated gratuitous declarations' even by a court appointed examiner.

. . . .
To the Trustee, the Settlement deserves support because it fixes the claims to the parties to the litigation, brings in a substantial sum to the Estate and enables him to begin formulation of a plan. However laudable those goals might be, they do not support . . . the relinquishment [of potential claims], without the court being able to make adequate analysis, of claims advanced by a trustee.

. . . .
Enough occurred here . . . that demands further inquiry. [FN132]

With respect to the Chapter 11 trustee's assertion that "the lowest level of reasonableness standard contemplates only a limited review[.]" [FN133] the court was similarly critical holding that:

The best interests of creditors, however, requires more than a ***464** trustee's ipse dixit or request for reliance on his judgement. Where a settlement is objected to, findings and conclusions are appropriate. No more than an ability to make a reasoned estimate [of the probability of success of the litigation] is sought here. . . . Complexity and the presence of open issues do not excuse a failure to bring forth facts and thereby effectively negate Rule 9019's requirement of a hearing where sufficient evidence is to be presented to permit appropriate analysis. [FN134]

2. Necessity for Explicit Findings and Conclusions

Despite its strong language regarding the need for an adequate record in approving a compromise or settlement agreement in bankruptcy, the Court in TMT Trailer Ferry nevertheless indicated that an adequate record need not be established solely from the judge's articulated findings and conclusions. The Court stated, "[i]f, indeed, the record contained adequate facts to support the decision of the trial court to approve the proposed compromises, a reviewing court would be properly reluctant to attack that action solely because the court failed adequately to set forth its reasons or the evidence on which they were based." [FN135]

***465** Basing its holding on the rationale set forth in TMT Trailer Ferry, the court in *In re Ira Haupt & Co.*, [FN136] characterized the referee's failure to evaluate the claims at issue pursuant to applicable law and to discuss adequately the evidence as "merely formal defects." [FN137] Additionally, the court noted:

It is true, as stated above, that the referee did not analyze the facts and the law as required but, as the court held in the TMT case, this alone is not a sufficient reason for reversal. There must be an insufficient record to support the referee's decision before reversal could be justified. [FN138]

However, in a recent case, *LaSalle National Bank v. Holland (In re American Reserve Corp.)*, [FN139] the Seventh Circuit held,

[T]he bankruptcy judge must make findings and explain his [sic] reasoning sufficiently to show that he examined the proper factors and made an informed and independent judgement. . . . The judge may make either written or oral findings; form is not important, so long as the findings show the reviewing court that the judge properly exercised his discretion. [FN140]

In *In re American Reserve Corp.*, a settlement agreement between the trustee and an administrative claimant, debtor's former chief executive officer, had been approved by the ***466** bankruptcy court over strenuous objections. [FN141] In reviewing the bankruptcy court's decision, the Seventh Circuit, consistent with established precedent, rejected the notion that the judge must conduct a mini-trial. [FN142] However, the court was extremely critical of the lack of an adequate record in the case. [FN143]

On appeal, the trustee and former CEO both urged affirmance of the bankruptcy judge's approval citing TMT Trailer Ferry as support for their position that, despite the bankruptcy judge's lack of specific findings, the record in its entirety warranted approval. The Seventh Circuit rejected this notion and this reading of TMT Trailer Ferry, holding:

Dictum in TMT Trailer Ferry supports this course [urged by the Trustee and CEO]. However, the TMT Trailer Ferry dictum does not require a reviewing court to comb the record to uphold a settlement despite inadequate findings. Requiring findings will assist both the bankruptcy courts and reviewing courts in their tasks. Requiring findings compels the bankruptcy judge to focus on the appropriate criteria, and enables him to make an independent, reasoned decision. The findings also facilitate more focused, and therefore more efficient, judicial review. Without findings, a focused and efficient review becomes difficult, if not impossible. [FN144]

*467 Not all courts have adopted the American Reserve rationale for requiring findings. For instance, in *Magill v. Springfield Marine Bank (In re Heissinger Resources Ltd.)*, [FN145] the court specifically rejected such a requirement, holding:

While specific findings of fact by a bankruptcy judge and a clear outline of his analysis in approving the settlement are helpful, we decline to impose such a high standard. Mandating that a bankruptcy judge write a full opinion on the merits of every settlement would only serve to slow the entire process and waste scarce judicial resources. [FN146]

3. Need for Adequate Record Parallels Similar Requirements for Settling Federal Class Actions and Derivative Actions

Finally, courts have also held that the need for an adequate record before approving a compromise or settlement agreement in bankruptcy is analogous to similar requirements when settling federal class actions and derivative actions. In *In re Lion Capital Group*, [FN147] the court held, "[t]his requirement of a record containing adequate information set forth in sufficient detail to enable approval of a settlement parallels the same requirement applicable to district court consideration of settlements in class and derivative actions pursuant to Rules 23 and 23.1 of the Federal Rules of Civil Procedure." [FN148]

An example of a court's consideration of a class action settlement*468 which addresses the need for an adequate record is *Plummer v. Chemical Bank*. [FN149] In *Plummer*, the Second Circuit considered an appeal from a district court's denial of a proposed settlement of a class action claim involving race discrimination under Title VII. In affirming the district court's determination that the record was inadequate to support approval of the proposed settlement, and remanding the case to the district court for further findings, the Second Circuit utilized language which is strikingly similar to that utilized by bankruptcy courts when considering approval of compromise and settlement agreements in the bankruptcy context:

Although we do not expect district judges to convert settlement hearings into trials on the merits, we do expect them to explore the facts sufficiently to make intelligent determinations concerning adequacy and fairness. There must be some 'evidentiary foundation' in support of the proposed settlement. Some Circuits have held that the district court must make findings of fact and conclusions whenever the propriety of a settlement is in dispute. If Title VII class settlements are to be treated henceforth as injunctions for purposes of appeal, it would seem that findings and conclusions should be made with respect to every controverted settlement in order to permit intelligent review. Moreover, those findings and conclusions should not be based simply on the arguments and recommendations of counsel. [FN150]

D. Relevant Factors Courts Consider for Approval

Having established that a court need not conduct a mini-trial, and that whether a court is required to render findings of fact and conclusions of law depends on the particular circuit, this section will consider the actual factors that courts use to decide whether to approve a proposed compromise or settlement agreement. Discussion of these factors is important because to hold that Bankruptcy Rule 9019's court approval provisions are not mandatory is to suggest that a compromise or settlement proponent can avoid compliance with these very well-established and well-observed requirements by simply failing to present the proposed agreement to the court. As illustrated below, such a result is surely antagonistic to the underlying rationale of Bankruptcy Rule 9019 and the spirit behind the

common-law development of these factors.

*469 1. Significance of TMT Trailer Ferry

As noted by the Fifth Circuit in *Connecticut General Life Insurance Co. v. Foster Mortgage Corp.* (In re Foster Mortgage Corp.), [FN151] "[w]hen considering a compromise settlement, courts have applied various factors to ensure that the settlement is fair, equitable, and in the interest of the estate and creditors." [FN152] However, in developing these various standards, Collier's observes that, "[t]he courts take their guidance from the United States Supreme Court case of *Protective Committee for Independent Stockholders of TMT Trailer Ferry, Inc. v. Anderson.*" [FN153]

In *TMT Trailer Ferry*, a pre-Bankruptcy Rule 9019 case, the Supreme Court provided concrete guidance to bankruptcy courts with respect to appropriate factors to consider when determining whether to approve a proposed compromise or settlement agreement:

There can be no informed and independent judgment as to whether a proposed compromise is fair and equitable until the bankruptcy judge has apprised himself of all facts necessary for an intelligent and objective opinion of the probabilities of ultimate success should the claim be litigated. Further, the judge should form an educated estimate of the complexity, expense, and likely duration of such litigation, the possible difficulties of collecting on any judgment which might be obtained, *470 and all other factors relevant to a full and fair assessment of the wisdom of the proposed compromise. Basic to this process in every instance, of course, is the need to compare the terms of the compromise with the likely rewards of litigation. [FN154]

Importantly, and as with the "lowest point of reasonableness" test discussed above, the fact that *TMT Trailer Ferry* was decided under the Bankruptcy Act does not diminish its precedential value under the Bankruptcy Code. [FN155] Furthermore, consideration of the factors set forth in *TMT Trailer Ferry* is warranted whether the compromise or settlement agreement is being proposed alone or as incorporated into a plan of reorganization. [FN156]

2. Further Development of the TMT Trailer Ferry Standard

Building on the *TMT Trailer Ferry* holding, recent court decisions continue to utilize, and in some instances, add to the requirements. In *Connecticut General Life Insurance Co. v. United *471 Companies Financial Corp.* (In re Foster Mortgage Corp.), [FN157] the Fifth Circuit summarized the contemporary approaches for approving compromise and settlement agreements as follows:

A bankruptcy court may approve a compromise settlement of a debtor's claim pursuant to Bankruptcy Rule 9019(a). However, the court should approve the settlement only when the settlement is fair and equitable and in the best interest of the estate. The judge must compare the "terms of the compromise with the likely rewards of litigation."

When considering a compromise settlement, courts have applied various factors to ensure that the settlement is fair, equitable, and in the interest of the estate and creditors. This circuit has applied a three-part test. In specific, the bankruptcy court must consider:

- (1) the probability of success in the litigation, with due consideration for the uncertainty in fact and law,
- (2) the complexity and likely duration of the litigation and any attendant expense, inconvenience and delay, and
- (3) all other factors bearing on the wisdom of the compromise. [FN158]

While noting that it had not previously elaborated on the third prong, "other factors bearing on the wisdom of the compromise," of its three-part test, the *Foster Mortgage* court declared, "we do so now." [FN159] Proceeding to clarify this prong, the Fifth Circuit held that two issues were clearly relevant to the third part of its test: 1) "the paramount interest of creditors with proper deference to their reasonable views[,]" [FN160] and 2) "the extent to which the settlement is truly the product of arms-length bargaining, and not of fraud or collusion." [FN161]

In an even more recent 1998 case, *Hicks, Muse & Co., Inc. v. Brandt* (In re Healthco Int'l, Inc.), [FN162] the

United States Court of Appeals for the First Circuit essentially collapsed the first two factors identified in the Fifth Circuit's Foster Mortgage decision into one factor and termed it the "so-called 'best interests' standard," [FN163] and then proceeded to identify and add two additional *472 factors required for consideration: 1) the creditors' views of the proposed settlement, [FN164] and 2) the relevant background of the party proposing the settlement. [FN165]

Significantly, and as illustrated by Foster Mortgage and Healthco, courts do not confine their analysis to the factors set forth in TMT Trailer Ferry. Despite the fact that TMT Trailer Ferry did not specifically identify the views of various parties in interest as a factor which may be considered, both Foster Mortgage and Healthco held that creditors' views and support, or lack thereof, for a proposed compromise or settlement agreement are important factors for a court to consider. [FN166] Courts also look to the views and positions of other parties in interest regarding the proposed settlement or compromise agreement. [FN167] All of these *473 contemporary factors and standards, however, ultimately stem from and build on the TMT Trailer Ferry ruling. [FN168] Finally, while objections from parties in interest have also been identified as a factor to consider, such objections are not controlling, [FN169] particularly *474 when they are without a factual basis. [FN170]

E. Relevance of Rules 23 and 23.1 of the Federal Rules of Civil Procedure

One of the important developments subsequent to the TMT Trailer Ferry decision is that courts have held that the inquiry as to whether to approve a compromise or settlement agreement in the context of a bankruptcy case should be the same as, [FN171] or at least parallel to, [FN172] the approval of a settlement in a class action or derivative action under Rules 23 and 23.1 of the Federal Rules of Civil Procedure. The bankruptcy courts' willingness to draw a parallel between the bankruptcy context, which does not have explicit mandatory court approval requirements for all compromises and settlements, and class action and derivative action proceedings which do, is further evidence that a restrictive reading of Bankruptcy Rule 9019 would be to reward form over substance. Such a result would be particularly troublesome since bankruptcy cases, like class actions and derivative proceedings, typically involve a multitude of parties, constituencies, and agendas, in many instances with conflicting interests. These shared similarities, therefore, speak to the necessity of court approval regarding the reasonableness of the proposed compromise or settlement agreement in bankruptcy. Accordingly, in *In re Carla* *475 *Leather*, [FN173] the bankruptcy court declared that:

As resolver of disputes to which a fiduciary is a party, the inquiry should parallel that contemplated by Rules 23 and 23.1 of the Federal Rules of Civil Procedure, pursuant to which courts are called upon to consider settlement of a class or derivative action. In those cases, a reasonableness standard applies, the courts comparing the substantive terms of the proposed settlement with the likely result of a trial. [FN174]

As mentioned above, the parallel between approving a proposed compromise or settlement agreement in bankruptcy and settling a federal class action or derivative suit pursuant to Rules 23 and 23.1 is particularly significant because, unlike Bankruptcy Rule 9019, these rules contain mandatory language regarding court approval of such settlements. Federal Rule of Civil Procedure 23, which applies to class actions, provides, in pertinent part, "[a] class action shall not be dismissed or compromised without the approval of the court, and notice of the proposed dismissal or compromise shall be given to all members of the class in such manner as the court directs." [FN175] Similarly, Federal Rule of Civil Procedure 23.1, which applies to derivative actions, provides, "[t]he action shall not be dismissed or compromised without the approval of the court, and notice of the proposed dismissal or compromise shall be given to shareholders or members in such manner as the court directs." [FN176]

Noting the parallels and similarities between class actions, derivative suits, and bankruptcy proceedings, the Fifth Circuit in *United States v. City of Miami*, [FN177] a non-bankruptcy case involving class action Title VII issues, declared that "the three most prevalent examples" of "special situations in which the trial court is required by statute or rule to approve a settlement" are "proposed class action settlements, proposed shareholder derivative suit settlements, and proposed compromises of claims in bankruptcy *476 court." [FN178] In *City of Miami*, the Fifth Circuit specifically addressed the necessity of courts, in these types of cases, reviewing the proposed compromise or settlement agreement to ensure that the agreement is reasonable, fair, and equitable to all of the relevant parties:

In these three situations, the standard for approval has been stated both positively--that the trial court must find that the settlement is fair, adequate, and reasonable, and negatively--that the trial court may only approve a settlement after determining that its terms are not unlawful, unreasonable, or inequitable.

We have been unable to discern any difference in meaning between these variants on what we perceive to be

essentially one standard; nor does the standard vary in application between the three different types of cases. In each of the three situations--bankruptcies, class actions, and shareholder derivative suits--there are special considerations not present in ordinary litigation which make this standard appropriate. [FN179]

Indeed, in *TMT Trailer Ferry*, the Supreme Court similarly recognized the uniqueness of bankruptcy proceedings by declaring, "[t]he fact that courts do not ordinarily scrutinize the merits of compromises involved in suits between individual litigants cannot affect the duty of a bankruptcy court to determine that a proposed compromise forming part of a reorganization plan is fair and equitable." [FN180]

F. The Common-Law Development of Standards for Approval Support the Necessity of Court Approval for Compromises and Settlements

The purpose of this overview and discussion regarding the common law development of standards for approval of compromises and settlements in bankruptcy is to establish that court approval is neither automatic nor perfunctory simply because a party has satisfied the relevant hearing and notice requirements *477 with respect to Bankruptcy Rule 9019. Rather, and despite the fact that courts have consistently held that a bankruptcy court need not conduct a "mini-trial on the merits," the systematic consideration and treatment which courts have nevertheless held that must be accorded to proposed settlements or compromises provides further evidence that court consideration and ultimate approval is a necessary and crucial part of the bankruptcy settlement process. To allow parties to opt-out from this entire process simply by arguing that Bankruptcy Rule 9019 is not mandatory is to reward form over substance. The development of common law factors regarding the standards for approving a proposed compromise or settlement agreement contemplate and depend on the fact that such agreements will be presented to the bankruptcy court for its consideration. Holding that Bankruptcy Rule 9019 is not mandatory completely undermines the rationale for developing these common law factors and renders these standards meaningless.

IV Section 363 of the Bankruptcy Code and Bankruptcy Rule 6004

As noted throughout this article, the Bankruptcy Code does not contain an equivalent to Section 27 of the Bankruptcy Act which required court approval of all compromises and settlements. Nevertheless, courts have reasoned that Section 363, which requires notice and hearing with respect to the "use, sale or lease" of "property of the estate" outside of the ordinary course of the debtor's business, does mandate court approval of a compromise or settlement of a cause of action belonging to the estate. Significantly, the underlying rationales behind Section 363 and Bankruptcy Rule 9019's notice and hearing requirements are identical. The reasons for requiring court approval of a settlement of a cause of action belonging to the estate pursuant to Section 363 can therefore be used to illustrate that court approval is likewise mandatory with respect to other types of settlements and compromises pursuant to Bankruptcy Rule 9019.

A. The Requirements of Section 363

Section 363 is titled "Use, Sale or Lease of Property," and provides in subsection (b) that "the trustee [or debtor-in-possession], after notice and a hearing, may use, sell, or lease, other *478 than in the ordinary course of business, property of the estate." [FN181] In short, Section 363 provides that if a debtor-in-possession is contemplating the use, sale, or lease of property of the estate, and such transaction is not in the ordinary course of the debtor's business, [FN182] the debtor-in-possession must provide creditors with "notice and a hearing" of the proposed transaction. The underlying rationale behind Section 363's notice and hearing requirements is identical to that of Rule 9019's notice and hearing requirements, [FN183] to prevent secret dealings and provide interested creditors with the opportunity to be heard. As concluded by the Third Circuit in *Myers v. Martin* (In re Martin): [FN184]

The import of Section 363 is that a trustee [or debtor-in-possession] is prohibited from acting unilaterally; this schema is intended to protect both debtors and creditors (as well as trustees) by subjecting a trustee's [or debtor-in-possession's] actions to complete disclosure and review by the creditors of the estate and by the bankruptcy court. [FN185]

Assuming Section 363 is implicated, thereby requiring notice and hearing of a proposed use, sale, or lease of estate property, Bankruptcy Rule 6004 [FN186] sets forth the procedures for conducting such a transaction. With respect to the issue of notice, Bankruptcy Rule 6004 refers to, and requires compliance with, Bankruptcy Rule 2002 subsections (a)(2), (c)(1), (i), and (k), and, if applicable, Section 363(b)(2) of the Code. [FN187] In short, the

relevant subsections of Bankruptcy Rule 2002, in turn, provide that, *479 1) unless the court shortens the time "for cause shown," 20 days notice by mail must be given to the debtor, the trustee, all creditors, and indenture trustees of "a proposed use, sale or lease of property of the estate other than in the ordinary course of business," [FN188] 2) that the content of a notice must contain "the time and place of any public sale, the terms and conditions of any private sale and the time fixed for filing objections," [FN189] 3) that the notice be sent to all duly authorized and constituted creditor and equity security holder committees in the case, [FN190] and finally, 4) that notice be sent to the United States trustee. [FN191]

B. Applicability of Section 363 When Settling Causes of Action Belonging to the Bankruptcy Estate

Assuming that a proposed compromise or settlement of a cause of action belonging to the estate is not in the ordinary course of business, courts have determined that notice and hearing is required pursuant to Section 363. Courts reach this result by interpreting sections 541 and 363 of the Code. First, a cause of action belonging to the estate is "property of the estate" as defined by section 541. Next, a proposed settlement or compromise of such "property" rights is the equivalent of a "sale" as defined by Section 363. Finally, since Section 363 requires notice and hearing with respect to the proposed "use, sale or lease" of "property of the estate" outside of the ordinary course of business, court approval is necessary with respect to a non-ordinary course settlement or compromise of a cause of action belonging to the estate.

1. Section 541 and "Property of the Estate"

Section 541 of the Bankruptcy Code is titled, "Property of the estate," and defines exactly what is and is not included as property of a debtor's bankruptcy estate. [FN192] Section 541 defines "property" broadly to include "all legal or equitable interests of *480 the debtor in property as of the commencement of the case." [FN193] Given such a broad definition, it is not surprising that causes of action held by the debtor on the petition date can be considered "property of the estate." [FN194] Moreover, courts have specifically held that rights of action belonging to the debtor as of the filing of the bankruptcy case constitute "property of the estate" pursuant to section 541. [FN195] Accordingly, because such rights constitute property of the estate, any transactions contemplating the "use, sale or lease" of such rights must be conducted in accordance with the provisions of Section 363.

2. Compromise or Settlement of a Debtor's Cause of Action is the Equivalent of a "Sale" of an Asset

Courts have specifically held that the compromise or settlement of a cause of action held by the bankruptcy estate can be likened to the sale of an asset, thus implicating the requirements of Section 363. In *In re Telesphere Communications, Inc.*, [FN196] the court stated that:

The settlement of a cause of action held by the estate is plainly the equivalent of a sale of that claim. There is no difference in the effect on the estate between the sale of a claim (by way of assignment) to a third party and a settlement of the claim with the adverse party. [FN197]

In *Valucci v. Glickman, Berkovitz, Levinson & Weiner (In re Glickman, Berkovitz, Levinson & Weiner)*, [FN198] the District Court for the Eastern District of Pennsylvania similarly declared that a proposed settlement which included the debtor's release of claims against third parties could be "likened to the post-petition *481 sale of an asset." [FN199] And, in *In re Dow Corning Corp.*, [FN200] the court concluded that "the current settlements are the same as, and not just analogous to, a sale of the Debtor's assets pursuant to § 363(b) Equating compromises/settlements of lawsuits to sales of a debtor's property is appropriate because there is so little to distinguish them." [FN201]

C. Necessity of Obtaining Court Approval for Settling a Debtor's Claim Against a Third Party

Given that a debtor's cause of action is considered an asset of the estate, courts have held that the compromise or settlement of such a claim requires bankruptcy court approval pursuant to Section 363. In *In re Telesphere Communication, Inc.*, [FN202] the court dealt with a proposed settlement of the debtor's preference and fraudulent conveyance of claims against other parties. The court concluded that the proposed settlement was subject to Section 363's notice and hearing requirements:

The settlement presented by the pending motion is subject to court review, since the trustee is seeking to liquidate

assets of the estate--certain avoidance claims--and notice and a hearing is required, under Section 363(b) of the Code, for any use or sale of estate assets out of the ordinary course. [FN203]

Other courts have agreed with the Telesphere decision. In *Myers* *482 v. *Martin* (In re *Martin*), [FN204] the Third Circuit dealt with a proposed settlement involving the release of the debtor's claims against third parties. The court noted, "[t]he instant agreement compromised an asset [the release of claims] of the debtor's estate. And clearly, this act ventured beyond the domain of transactions that the [debtors] encountered in the ordinary course of business prior to the filing of bankruptcy, thereby implicating Section 363." [FN205]

D. Failure to Obtain Court Approval of a Section 363 Sale Renders the Settlement Agreement Unenforceable

Similar to the Bankruptcy Rule 9019 context in which courts have held that settlement agreements are unenforceable absent court approval, [FN206] courts have held that failure to obtain bankruptcy court approval for a non-ordinary course Section 363 use, sale, or lease of property renders the entire, proposed transaction, including proposed settlements of a debtor's causes of action against third parties, unenforceable. In *In re Sparks*, [FN207] the court concluded that, "court approval was required under § 363 before the agreement could be carried out The settlement agreement here involved disposition of estate assets The creditors of this estate had to be notified of the agreement and this Court had to approve it before it became enforceable." [FN208] Similarly, on appeal the district court in *Sparks* [FN209] held, "in situations where the Code requires bankruptcy court approval for a particular action by the debtor, an agreement calling for that action will not become enforceable until the parties have obtained the court's approval." [FN210] Finally, in *Rinehart v. Stroud Ford, Inc.* (In re *Stroud Ford, Inc.*), [FN211] the court noted, "if the compromise agreement did not concern matters within the ordinary course of *483 the debtor's business [pursuant to Section 363], then the debtor (or debtor-in-possession) had no authority to enter into the compromise absent 'notice and a hearing' and, therefore, the debtor cannot be bound by its terms." [FN212] Thus, failure to obtain bankruptcy court approval for an agreement which proposes either to compromise or settle a cause of action held by the bankruptcy debtor renders the agreement of no force or effect. [FN213]

E. Standards for Approval of a Section 363(b)(1) Sale

As is the case with Bankruptcy Rule 9019, [FN214] merely because a proponent complies with the hearing and notice requirements of Section 363(b)(1) does not guarantee that the bankruptcy court will approve the proposed use, sale, or lease. Rather, as with non-Section 363 compromises and settlements, [FN215] a bankruptcy court considering a proposed transaction pursuant to Section 363(b)(1) is required to satisfy certain standards before it may render its approval. [FN216] One of these standards is the "good faith" *484 requirement. [FN217] Significantly, the court in *Cumberland Farms Dairy, Inc. v. National Farmer's Org. Inc.* (In re *Abbotts Dairies of Pennsylvania*), [FN218] noted that the purpose of the good faith requirement in approving a Section 363 transaction is that "it prevents a debtor-in-possession or trustee from effectively abrogating the creditor protections of Chapter 11." [FN219] Accordingly, both the underlying rationale of Section 363's notice and hearing requirements and the "good-faith" requirement for approval of use, sale, or lease transactions confirm the importance and necessity of court approval to prevent secret dealings and protect creditors. Certainly these interests need to be protected in all compromise and settlement contexts, not merely those involving causes of action belonging to the bankruptcy estate pursuant to Section 363.

F. Common-Law Development of Section 363 Provides Support for Mandatory Compliance with Bankruptcy Rule 9019

Because the purpose behind Section 363's notice and hearing requirements is to prohibit a trustee or debtor-in-possession from "acting unilaterally," and to "protect both debtors and creditors (as well as trustees) by subjecting a trustee's [or debtor-in-possession's] actions to complete disclosure and review by the creditors of the estate and by the bankruptcy court," [FN220] Section 363's underlying purpose is identical to that of Bankruptcy Rule 9019. [FN221] Furthermore, the common law interpretation of Section 363 requiring court approval of compromises or settlements involving causes of action belonging to the bankruptcy estate directly stems from this underlying purpose. Accordingly, the rationale for court approval of settlements and compromises in the Section 363 context is highly persuasive and applicable to all compromises and settlements in bankruptcy. In short, for the same reasons courts require approval of compromises and settlements *485 involving causes of action belonging to the bankruptcy estate pursuant to Section 363, to prevent secret dealings and to allow creditors to evaluate the proposed settlement or compromise, court approval is also necessary for all compromise or settlement agreements in general.

Binding the Estate and Parties to the Agreement: The Importance of the Real Party in Interest Doctrine and the Special Issues Raised by the Creditors' Committee

A compromise or settlement agreement that has been approved by the bankruptcy court is binding on the parties and the estate. [FN222] Because a creditors' committee is often a key player with respect to the settlement or compromise of various matters pertaining to the bankruptcy estate, this section discusses a number of important issues which can arise if the creditors' committee's role is not properly understood. This section argues that court approval of settlements and compromises in bankruptcy aids in preventing incorrect, unintended, and unwanted results. In instances involving an active creditors' committee which negotiates and obtains a final settlement on behalf of the debtor or debtor's estate, it may be tempting to make the committee a party to the actual settlement agreement. Absent specific court authorization, however, standing issues with respect to the committee's capacity could become problematic and render the entire agreement useless, null, void, and unenforceable as against the debtor. Because of the existence of the real "party in interest" requirement, and because a creditors' committee is not the real party in interest with respect to a debtor's cause of action, it logically follows that the committee may not settle the debtor's cause of action, and that any such settlement will not be binding on the debtor. Moreover, because the committee is a fiduciary only to its constituency and because it does not have the power to bind each constituent member, judicial approval of proposed compromises and settlements is further warranted to ensure that the proper parties to the agreement have entered into and executed *486 the agreement. This body of law is further support for the proposition that compromises and settlements must be reviewed by a bankruptcy court who is charged with considering the best interests of the estate.

A. Bankruptcy Rule 7017 and the Requirement of a "Real Party in Interest"

The issue of a creditors' committee's standing to enter into a particular agreement compromising or settling a debtor's cause of action is crucial since, as explained more fully below, absent court authority, the creditors' committee is not the true party in interest with the power to control the litigation. Accordingly, actions the creditors' committee may take on behalf of the debtor, without court authority to do so, will have no force or effect and will not be binding on the true party in interest, the debtor. Court approval of proposed compromises and settlement agreements would prevent such a result because bankruptcy courts do not intentionally approve agreements between or among the wrong parties in interest.

Subsection (a) of Rule 17 of the Federal Rules of Civil Procedure, made applicable to adversary proceedings in bankruptcy by Rule 7017(a) of the Federal Rules of Bankruptcy Procedure, is entitled "Real Party in Interest," and provides, "[e]very action shall be prosecuted in the name of the real party in interest." [FN223] As explained by the bankruptcy court in *Fisher, Hecht & Fisher v. D.H. Overmyer Telecasting Co.* (In re D.H. Overmyer Telecasting Co.), [FN224]

To be the real party in interest, the plaintiff must possess the right to maintain the action under the applicable substantive law, for only then will it be bound by any final judgment or compromise. Only if the action has been instituted by the party possessing the right to relief under the applicable law will it qualify as the real party in interest. The purpose of the real party in interest rule 'is to protect individuals from the harassment of suits by persons who do not have the power to make final and binding decisions concerning prosecution, compromise and settlement.' [FN225]

The area in which the real party in interest requirement has been most developed in the bankruptcy context is a trustee's *487 powers to institute actions on behalf of creditors. Adhering to the real party in interest requirement, and relying on the seminal Supreme Court case in this area, *Caplin v. Marine Midland Grace Trust Co.*, [FN226] courts have consistently refused to allow a trustee or debtor-in-possession to sue on behalf of creditors because such rights do not belong to the bankruptcy estate. In *Caplin*, the Supreme Court held that a trustee did not have standing to assert an action on behalf of a party or any person other than the debtor corporation. [FN227] In *In re D.H. Overmyer Telecasting Co.*, the court noted, "[n]umerous cases decided in the wake of *Caplin* hold that allegations of misconduct and damage to the debtor corporation are insufficient to give the trustee standing to sue third parties on behalf of creditors." [FN228] In *In re Washington Group, Inc.*, [FN229] the court declared, "[t]he rationale of the Court's holding in *Caplin* is unmistakable. The Trustee may only act for the direct benefit of the estate." [FN230] With respect to whether a trustee may sue on behalf of creditors, therefore, the *In re D.H.*

Overmyer Telecasting Co. court observed, "[i]t is well settled that a trustee in bankruptcy . . . lacks standing to assert the claims of creditors against third parties who are alleged to bear responsibility for a debtor's losses." [FN231]

The importance of assuring that the correct entities are parties to a proposed settlement or compromise agreement is best illustrated by *DSQ Properties Co. v. DeLorean*. [FN232] In *DSQ Properties*, the Sixth Circuit needed to decide whether a settlement agreement entered into by a trustee and debtor in a prior bankruptcy case foreclosed a subsequent suit against the former *488 debtor by one of the former debtor's creditors. The Sixth Circuit first noted that while overhauling the former Bankruptcy Act, Congress "expressly rejected an amendment that would have reversed the *Caplin* rule." [FN233] Moreover, the court observed, "[t]he Bankruptcy Code still has no provision providing for a bankruptcy trustee to sue third parties on behalf of creditors." [FN234] Accordingly, the court reasoned, "a trustee, who lacks standing to assert the claims of creditors, equally lacks standing to settle them," [FN235] and thus held that the creditors' suit against the former debtor was not foreclosed.

Applying the *DSQ* rationale to creditors' committees, who, as explained more fully below, do not have power to control a debtor's cause of action, it can similarly be concluded that "a [creditors' committee] who lacks standing to assert the claims of [a debtor], equally lacks standing to settle them." [FN236] Accordingly, requiring court approval of proposed compromise and settlement agreements would prevent such a result.

B. The Role of Creditors' Committees

In a Chapter 11 case, a creditors' committee is appointed pursuant to Section 1102 [FN237] of the Bankruptcy Code, but its powers and duties are derived from Section 1103 [FN238] of the Code. Section 1102 is titled "Creditor's and Equity Security Holders' Committees" and provides, in pertinent part, that "as soon as practicable after the order for relief under chapter 11 of this title, the United States trustee shall appoint a committee of creditors holding unsecured claims and may appoint additional committees of creditors or of equity security holders as the United States trustee deems appropriate." [FN239]

The emphasis on "shall" and "may" italicized above is significant because the legislative history to Section 1102 reveals that "[s]ubsection (a) requires the court to appoint at least one committee. That committee is to be composed of creditors holding *489 unsecured claims." [FN240] Appointment of other committees remains within the discretion of the U.S. trustee. Alternatively, on request of a party in interest pursuant to Section 1102(a)(2), the court may also appoint additional committees. [FN241] Significantly, the legislative history makes it clear that committees appointed pursuant to Section 1102 "will represent the various classes of creditors and equity security holders from which they are selected . . . [and] will also provide supervision of the debtor-in-possession and of the trustee, and will protect their constituents' interests." [FN242]

Section 1103 of the Bankruptcy Code is titled, "Powers and Duties of Committees," and sets forth the general powers and duties of a committee in a Chapter 11 case. [FN243] Section 1103(c) provides:

A committee appointed under section 1102 of this title may --

- (1) consult with the trustee or debtor in possession concerning the administration of the case;
- (2) investigate the acts, conduct, assets, liabilities, and financial condition of the debtor, the operation of the debtor's business and the desirability of the continuance of such business, and any other matter relevant to the case or the formulation of a plan;
- (3) participate in the formulation of a plan, advise those represented by such committee of such committee's determinations as to any plan formulated, and collect and file with the court acceptances or rejections of a plan;
- (4) request the appointment of a trustee or examiner under section 1104 of this title; and
- (5) perform such other services as are in the interest of those represented. [FN244]

While Section 1103(c) gives a creditors' committee the broad, discretionary power to "investigate [numerous enumerated issues] *490 and any other matter relevant to the case or to the formulation of a plan," [FN245] as well as to "perform such other services as are in the interest of [the estate]," [FN246] nothing in Section 1103(c)'s express

provisions gives a creditors' committee the right to control a cause of action belonging to the debtor. Rather, as explained more fully below, absent court authorization, control over such causes of action remains with the debtor-in-possession or the trustee.

C. Creditors' Committee and Compromise and Settlement Agreements

Causes of action which belong to the debtor as of the filing of the case become "property of the estate" pursuant to Section 541. [FN247] Importantly, control over any such rights rests with the trustee or debtor-in-possession. In *Schertz-Cibolo-University City Independent School District (In re Educators Group Health Trust)*, [FN248] the Fifth Circuit unequivocally stated, "[i]f a cause of action belongs to the estate, then the trustee [or debtor-in-possession] has exclusive standing to assert the claim." [FN249] Conversely, courts have also determined that if a cause of action does not belong to the bankruptcy estate, then neither the trustee nor the debtor-in-possession may prosecute such an action. [FN250]

***491** Understanding that rights of action belonging to the debtor's bankruptcy estate are subject to the "exclusive standing" of the trustee or debtor-in-possession to prosecute, [FN251] the next relevant inquiry becomes what role, if any, a creditors' committee may play in negotiating and executing a proposed compromise or settlement of such rights. As discussed below, a creditors' committee may not institute litigation on behalf of a debtor, and thus may neither compromise nor settle causes of action belonging to the debtor. Moreover, a creditors' committee's obligations and fiduciary duties run only to its constituents and not to the estate in general. Finally, it is clear that while a creditors' committee represents the interests of its constituents, it has neither the right nor the ability to bind its members.

1. Absent Court Authority, Creditors' Committees May Not Institute Litigation on Behalf of a Debtor

Given that case law precedent makes clear that causes of action belonging to the debtor are subject to the control of the trustee or debtor-in-possession, it is not surprising that courts have also held that, absent certain circumstances, a creditors' committee in a Chapter 11 case does not have the authority or standing to prosecute such actions. In *Louisiana World Exposition v. Federal Insurance Co.*, [FN252] the Fifth Circuit declared, "[t]he law is well-settled that in some circumstances, a creditors' committee has standing under Title 11, United States Code, section 1103(c)(5) and/or section 1109(b) to file suit on behalf of a debtor-in-possession or a trustee." [FN253] However, the Fifth Circuit ***492** outlined the very narrow set of circumstances under which a creditors' committee may obtain such rights:

While the circumstances under which a creditors' committee may sue are not explicitly spelled out in the Code, the bankruptcy courts have generally required that the claim be colorable, that the debtor-in-possession have refused unjustifiably to pursue the claim, and that the committee first receive leave to sue from the bankruptcy court. "We agree that these are relevant considerations though not necessarily a formalistic checklist." [FN254]

Ultimately, the court in *Louisiana World Exposition* held that, "[w]here the debtor-in-possession is unable or unwilling to fulfill its obligation--due, for instance, to a conflict of interest--the Committee may assert the cause of action on behalf and in the name of [the debtor] if authorized to do so by the bankruptcy court." [FN255]

***493** Stating this principle even more forcefully, the court in *In re First Capital Holdings Corp.*, [FN256] held:

A creditors' committee has a duty to take action when the debtor fails to take appropriate action for the benefit of the estate. . . . If the committee believes that the debtor has failed to fulfill its duty to prosecute actions, the committee has an obligation to bring this to the attention of the Court. This promotes the fair and orderly administration of the bankruptcy estate by providing judicial supervision over the litigation to be undertaken. [FN257]

Obviously, if a creditors' committee does not have the power to control a debtor's cause of action absent court authority, it is not the "real party in interest" as illustrated above, and may not enter into binding settlements on behalf of the debtor or the estate. Despite the temptation to make an active creditors' committee a party to a proposed settlement agreement, which the committee may have in fact negotiated for or on behalf of the debtor and the estate, it is clear that the committee is not the appropriate party to such an agreement. Requiring court approval of proposed compromise or settlements prevents such an erroneous result because a court is more likely to ensure

that non-necessary or inappropriate entities are not parties to a compromise or settlement agreement, and that instead the appropriate individuals and entities which the proposed agreement seeks to bind are made parties.

2. The Committee is a Fiduciary to its Constituency Only, Not to the Debtor or to the Estate Generally

Another reason for exercising care regarding the role of a creditors' committee in negotiating and executing a settlement agreement involving the debtor's causes of action is the committee's underlying purpose and concomitant obligations under the Bankruptcy Code. As previously mentioned, a creditors' committee appointed pursuant to Section 1102 of the Bankruptcy Code is charged with representing the interests of the unsecured creditors in accordance with the provisions of Section 1103. [FN258] In a recent case, *Advisory Committee of Major Funding Corp. v. Sommers* (In re Matter of Advisory Committee of Major Funding *494 Corp.), [FN259] the Fifth Circuit commented:

Creditor Committees have the responsibility to protect the interest of the creditors; in essence, 'the function of a creditors' committee is to act as a watchdog on behalf of the larger body of creditors which it represents'. . . . section 1103 essentially requires the committee to act in the best interest of the creditors it represents. [FN260]

Expanding this reasoning further, courts have held that a creditors' committee owes a fiduciary duty to its members. In *Shaw & Levine v. Gulf Western Industries, Inc.* (In re Bohack Corp.), [FN261] the Second Circuit noted:

Although the creditors committee represents the interests of all creditors, its main function is to advise the creditors of their rights and the proper course of action in the bankruptcy proceeding. Moreover, the committee owes a fiduciary duty to the creditors, and must guide its actions so as to safeguard as much as possible the rights of minority as well as majority creditors. [FN262]

With respect to its actions regarding potential settlements or compromises, a committee need not concern itself with, or act, to protect the best interests of the debtor or the estate in general. Indeed, courts have specifically and consistently rejected the notion that a creditors' committee owes a fiduciary duty to the debtor or the bankruptcy estate in general. In *Official Unsecured Creditors' Committee v. Stern* (In re SPM Manufacturing Corp.), [FN263] the First Circuit explicitly observed:

While a creditors' committee and its members must act in accordance with the provisions of the Bankruptcy Code and with proper regard for the bankruptcy court, the committee is a fiduciary *495 for those whom it represents, not for the debtor or the estate generally. Thus the committee's fiduciary duty, as such, runs to the parties or class it represents. It is charged with pursuing whatever lawful course best serves the interests of the class of creditors represented. [FN264]

Because the creditors' committee acts, first and foremost, with respect to the best interests of its own constituents, in the context of a proposed compromise or settlement agreement, what may be in the best interest of the committee may not necessarily be in the best interest of the debtor or the estate. [FN265] Thus, another reason for requiring court approval of proposed compromises and settlements is to assure that the agreement is truly in the best interest of the estate, and not merely the creditors' committee.

3. Creditors' Committee's Authority to Bind Individual Creditors

In addition to the issue of whether a creditors' committee has the authority to negotiate and enter into a settlement or compromise regarding potential causes of action belonging to the bankruptcy estate, there is an equally compelling issue regarding a creditors' committee's ability to bind its constituents. The case law, with respect to this issue, is scant. However, in the context of negotiating a plan of reorganization in a Chapter 11 case, at least one bankruptcy court has held that while a creditors' committee may participate in the formulation of the plan, "the committee does not have statutory authority to bind creditors to the acceptance of a plan proposal, whether that proposal is made informally, as here, or through a formal plan of reorganization." [FN266] Citing this holding, Collier's declares, "[a]lthough committees are charged with negotiating the plan on behalf of their constituencies, the committees are not authorized or empowered to bind their constituencies. They are vested with considerable power and authority under the Code, but they are not the agents of and *496 cannot bind the groups they represent." [FN267]

Similarly, in the context of a motion to approve a proposed settlement agreement, at least one bankruptcy court adopted and applied this reasoning. In *In re Quality Beverage Co.*, [FN268] the bankruptcy court declared, "[w]hile the Committee bears a strong duty to the interest of the unsecured creditors it represents, it has neither the power nor the authority to bind each individual creditor." [FN269] The court in *Quality Beverage* relied on basic principles of collateral estoppel to hold that, "[t]he doctrine of collateral estoppel cannot bind a person who was neither a party nor privy to a prior suit." [FN270]

The inability of a creditors' committee to bind its constituents is further evidence of the need for court approval of a proposed compromise or settlement agreement negotiated or entered into by the committee. This is particularly true where the parties to the proposed agreement seek to bind all general unsecured creditors represented by the committee. Specifically, the danger that parties who have entered into an agreement with the creditors' committee may not understand that the agreement is binding on the committee only, and not on its individual members, affirms the need for notice and hearing with respect to the general unsecured creditors, followed by court approval of the agreement.

D. The Real Party in Interest Doctrine and the Special Role of a Creditors' Committee Support the Need for Court Approval of Compromises and Settlements in Bankruptcy

Because of the necessity of the real party in interest, and because a creditors' committee is not the real party in interest with respect to a debtor's cause of action, it logically follows that the committee may not settle the debtor's causes of action, and that any such settlement will not be binding on the debtor or the estate. Borrowing from the court's rationale in *DSQ Properties* with respect to trustees, it is clear that a creditors' committee "who lacks standing to assert the claims of [the debtor], equally lacks standing to settle them." Moreover, because the committee is a fiduciary only to its constituency and does not have the *497 power to bind each constituent member, judicial approval is further warranted to ensure that the proper parties to the agreement have entered and executed the agreement, and that the agreement is binding on the intended parties and the estate. Therefore, mandatory court approval of compromise or settlement agreements is supported by this body of law.

VI

Applicability of State Rules of Civil Procedure

In addition to the Bankruptcy Code sections and Bankruptcy Rules discussed above, a particular state's rules of civil procedure may be applicable to settlements and compromises in bankruptcy. In Texas, for instance, Rule 11 of the Texas Rules of Civil Procedure states: "No agreement between attorneys or parties touching any suit pending will be enforced unless it be in writing, signed and filed with the papers as part of the record, or unless it be made in open court and entered of record." [FN271]

At least three separate reported decisions within the Fifth Circuit, including one from the Court of Appeals itself, hold that this rule is applicable to settlements reached in a bankruptcy proceeding. In *Houston, OTR v. Holder* (*In re Omni Video*), [FN272] the Fifth Circuit was presented with the question of whether the settlement of an adversary proceeding, which was entered into by the parties and announced in open court, was binding absent bankruptcy court approval. The court held:

As we have held in federal diversity suits, a settlement is a contract and is best resolved by reference to state contracts law. Thus, since the alleged agreement was negotiated and to be performed in Texas, the settlement agreement entered by the parties will be interpreted under Texas law. . . . Assuming a settlement meets the requirements of Rule 11 and is an enforceable contract, it can be enforced by summary *498 judgment. [FN273]

By focusing on Rule 11's "any suit pending" language, some may interpret the holding in the *Omni* case as applicable only in instances involving adversary proceedings that have actually been initiated, as distinguished from instances in which there is merely a threat of an adversary proceeding, followed by an attempted settlement. In a very recent case, however, the United States Bankruptcy Court for the Western District of Texas, in *In re Mortgage Analysis Portfolio Strategies, Inc.*, [FN274] held that Rule 11 of the Texas Rules of Civil Procedure must be complied with in order for a settlement of a bankruptcy dispute to be enforceable. Notably, the disputes in *Mortgage Analysis* were not in the context of an ongoing adversary proceeding. Rather, these disputes merely involved several contested matters arising out of the general bankruptcy case. Nonetheless, citing the Fifth Circuit's

holding in *Omni*, the bankruptcy court held:

In *Omni*, as here, the Fifth Circuit found that since the agreement was negotiated and to be performed in Texas, Rule 11 of the Texas Rules of Civil Procedure applies. . . . Thus, while this Court has the inherent power to enforce settlement agreements between parties, this Court must first find that the settlement meets the requirements of Rule 11 before it can even reach the issue of the enforceability of the contract. [FN275]

Thus, this line of cases suggests that in addition to Bankruptcy Rule 9019, compliance with relevant state rules of civil procedure regarding requirements for proposed compromise or settlement agreements must also be satisfied before the settlement will be enforceable in bankruptcy. Mandatory court approval facilitates this result.

VII

Conclusions and Suggestions for Reform

As illustrated throughout this article, and concluded by the Honorable Lief M. Clark, "the sanctity of settlements can hardly be overemphasized." [FN276] Moreover, by understanding the sanctity *499 of settlements, the concomitant necessity of court approval cannot be questioned. Despite the Bankruptcy Code's lack of an equivalent to Section 27 of the Bankruptcy Act, there exists a wealth of support, both inside and outside of bankruptcy, for this conclusion.

Alternatively, if this reality is too burdensome and unworkable for modern-day bankruptcy cases, the enactment of a substantive Bankruptcy Code section patterned after current Section 363 might merit consideration. Rather than requiring court approval for all compromise and settlements such as former Section 27, a new, substantive Code section could require approval only when the agreement is "outside the ordinary course" of the debtor's business. Thus, the policies underlying Bankruptcy Rule 9019, preventing secretive dealings and allowing creditors the opportunity to object, would still be observed, while simultaneously promoting the equally compelling goals of encouraging savings of time and expense through the use of compromises and settlements. In the absence of such a Code provision, however, and despite its ambiguity, compliance with this Rule 9019 must be considered mandatory.

[FN1]. Professor of Law; Director, Center for Latina/Latino Legal Studies, St. Mary's University School of Law. Adjunct Professor of Law, Texas Tech University School of Law. A.B., A.M. 1987, Stanford University; J.D. 1990, Harvard Law School. Professor Valencia is currently a 1999-2000 White House Fellow assigned to the White House Office of the Chief of Staff.

My interest in the subject of this Article originated from my retention as an expert witness in a state-court litigation which raised many of the same issues discussed herein. This litigation was ultimately settled, and I have neither solicited nor received any compensation for writing or publishing this work, or for taking the specific positions advocated herein.

I would like to thank my St. Mary's colleagues Marsha Huie, John Teeter and Kathy Tullos for their willingness to assist with this work and their helpful comments on prior drafts. I would particularly like to acknowledge my colleague Emily Hartigan, without whose invaluable assistance, reassurance, and gentle encouragement, this piece would not have come to conclusion. I thank Barbara J. Oyer, my former colleague in the Dallas law office of Jones, Day Reavis & Pogue, who sparked my initial interest in bankruptcy and who was continually available for consultation throughout my writing of this article. Finally, I thank my secretary Alma Canales, whose able assistance, as always, was essential. Any errors, of course, remain my own.

[FN1]. Bankruptcy Act of 1889, ch. 541, 30 Stat. 544, amended by Chandler Act of 1938, ch. 575, 52 Stat. 840, 11 U.S.C. §§ 1-703, repealed by the Bankruptcy Code, see *infra* note 2 (hereinafter the "Bankruptcy Act").

[FN2]. Bankruptcy Reform Act of 1978, 52 Stat. 2549, 11 U.S.C. §§ 101- 1330 (1978) as amended (hereinafter, the "Bankruptcy Code" or "Code").

[FN3]. This reality has been acknowledged by the United States Supreme Court. See *Protective Comm. for Indep. Stockholders of TMT Trailer Ferry v. Anderson*, 390 U.S. 414, 424 (1968) ("Compromises are a normal part of the process of reorganization.") (citing *Case v. Los Angeles Lumber Prods. Co.*, 308 U.S. 106, 130 (1939)).

[FN4]. Importantly, while compromise and settlement issues in bankruptcy most often arise and are considered in the context of actual litigation, the Fifth Circuit has clearly stated, "[t]he right and power of the Trustee to settle subject to court approval extends to controversies and not merely those involved in pending suits." *Florida Trailer and Equip. Co. v. Deal*, 284 F.2d 567, 569 (5th Cir. 1960). *Accord In re Del Grosso*, 106 B.R. 165, 167 (Bankr. N.D. Ill. 1989) ("The Trustee's power to compromise extends to all controversies affecting the estate and not merely those involved in pending suits.") (citing *Florida Trailer*, 284 F.2d 567) (emphasis provided). Thus, the principles discussed throughout this article are applicable not only to compromise or settlements of disputes in actual litigation, but to all controversies which may arise in a bankruptcy case.

[FN5]. *Id.* See also *Martin v. Kane (In re A & C Properties)*, 784 F.2d 1377, 1380-81 (9th Cir. 1986) ("The purpose of a compromise agreement is to allow the trustee and the creditors to avoid the expenses and burdens associated with litigating sharply contested and dubious claims.") (citation omitted); *United States v. Alaska Nat'l Bank (In re Walsh Constr.)*, 669 F.2d 1325, 1328 (9th Cir. 1982) ("A compromise agreement allows the trustee and the creditor to avoid the expenses and burdens associated with litigating 'sharply contested and dubious' claims.") (citation omitted); *Florida Trailer*, 284 F.2d at 571 ("[T]he very uncertainties of outcome in litigation, as well as the avoidance of wasteful litigation and expense, lay behind the Congressional infusion of a power to compromise."); *In re Drexel Burnham Lambert Group, Inc.*, 138 B.R. 723, 758 (Bankr. S.D.N.Y. 1992) ("Compromises are favored by the Courts because they allow the estate to avoid the expenses and burdens associated with litigating contested claims.") (citations omitted); *In re Del Grosso*, 106 B.R. at 167 ("The purpose of a compromise is to allow the Trustee and the creditors to avoid the expenses and burdens associated with litigating contested claims.") (citing *Walsh*, 669 F.2d 1325); *Chopin Assocs. v. Smith (In re Holywell Corp.)*, 93 B.R. 291, 295 (Bankr. S.D. Fla. 1988) (quoting *Florida Trailer*, 284 F.2d 567); cf. *In re Prudence Co., Inc.*, 98 F.2d 559, 560 (2d Cir. 1938) ("The very purpose of a compromise is to avoid the determination of sharply contested and dubious issues...."); *Magill v. Springfield Marine Bank (In re Heissinger Resources Ltd.)*, 67 B.R. 378, 382 (C.D. Ill. 1986) ("Settlement is intended to conserve [judicial] resources, and is therefore encouraged.").

[FN6]. *Collier on Bankruptcy* (15th ed. 1993) [hereinafter, *Collier's*].

[FN7]. *Id.* at P 9019.03[1]. See also *Hicks, Muse & Co., Inc. v. Brandt (In re Healthco Int'l, Inc.)*, 136 F.3d 45, 50 n.5 (1st Cir. 1998) (quoting *Collier's*); *Kowal v. Malkemus (In re Thompson)*, 965 F.2d 1136, 1145 (1st Cir. 1992) (noting bankruptcy's "traditional policies favoring compromise and expeditious administration in bankruptcy cases") (citations omitted); *Martin v. Kane (In re A & C Properties)*, 784 F.2d at 1381 ("[T]he law favors compromise and not litigation for its own sake.") (citation omitted); *Port O'Call Inv. Co. v. Blair (In re Blair)*, 538 F.2d 849, 851 (9th Cir. 1976) ("[T]he law favors compromise and not litigation for its own sake."); *Florida Trailer*, 284 F.2d at 571 ("Congressional infusion of a power to compromise ... is a recognition of the policy of the law generally to encourage settlements."); *Thomas v. Fallon (In re Chicago Rapid Transit Co.)*, 196 F.2d 484, 490 (7th Cir. 1952) ("We fully realize the desirability of settling claims without resort to litigation in bankruptcy matters ... where any reasonable basis for compromise settlements appears they should be encouraged."); *In re Del Grosso*, 106 B.R. 165, 167 (Bankr. N.D. Ill. 1989); *Chopin Assoc. v. Smith*, 93 B.R. at 295 (quoting *Florida Trailer*, 284 F.2d 567 (5th Cir. 1960)); *In re Central Ice Cream Co.*, 59 B.R. 476, 488 (Bankr. N.D. Ill. 1985) (noting that the court "has given due consideration to the principle that the law favors compromise") (citing *Blair*, 538 F.2d 849 (9th Cir. 1976)); cf. *McGraw v. Yelverton (In re Bell & Beckwith)*, 87 B.R. 476, 480 (N.D. Ohio 1988) (noting that the "practice of negotiation and compromise [are] highly valued in our judicial system") (citation omitted); *Magill v. Springfield Marine Bank (In re Heissinger Resources Ltd.)*, 67 B.R. at 383 (when considering a proposed compromise or settlement, "the bankruptcy court is to consider that the law favors compromise"); *Fogg v. Sherman Homes, Inc. (In re Sherman Homes, Inc.)*, 28 B.R. 176, 177 (Bankr. D. Me. 1983) (in considering compromise, "court must consider the principle that 'the law favors compromise' ") (citing *Blair*, 538 F.2d 849 (9th Cir. 1976)).

[FN8]. *Myers v. Martin (In re Martin)*, 91 F.3d 389, 393 (3d Cir. 1996) (citing *Collier's*, supra note 6, at P 9019.03).

[FN9]. Leif M. Clark, Symposium Survey: Bankruptcy, 28 *Tex. Tech L. Rev.* 299, 324 (1997) (emphasis added).

[FN10]. Fed. R. Bankr. Pro. 9019(a).

[FN11]. *Id.* Bankruptcy Rule 9019's predecessor was former Bankruptcy Rule 919 of the Federal Bankruptcy Act.

This predecessor rule provided that "on application by the trustee or receiver and after hearing on notice to the creditors as provided in Rule 203(a) and to such persons as the court may designate, the court may approve a compromise or settlement." Fed. R. Bankr. Proc., 11 U.S.C. 919(a) (1982) (repealed).

The Advisory Committee Note to former Bankruptcy Rule 919 revealed that the rule's provisions dealing with compromises and settlements were based on Section 27 of the Bankruptcy Act, 11 U.S.C. § 50 (1976) (repealed 1978), which provided, in pertinent part, that "the receiver or trustee may, with approval of the court, compromise any controversy arising in the administration of the estate upon such terms as he may deem for the best interest of the estate." Collier's, supra note 6 at P 9019.RH[1] (citing Advisory Committee Note to former Bankruptcy Rule 919).

The Advisory Committee Note to Bankruptcy Rule 9019 states that subdivisions (a) and (c) of the rule "are essentially the same as the provisions of former Bankruptcy Rule 919." Fed. R. Bankr. Proc. 9019 advisory committee note. Accord, *Magill v. Springfield Marine Bank (In re Heissinger Resources Ltd.)*, 67 B.R. at 382 (noting that Bankruptcy Rule 9019 "is the same as former Rule 919(a), which had been interpreted to give the bankruptcy court broad authority to approve compromises") (citation omitted); *Estate of Patel v. Patel (In re Patel)*, 43 B.R. 500, 504 (N.D. Ill. 1984) (noting that "former Rule 919 [is] exactly the same as Rule 9019"); *In re Del Grosso*, 106 B.R. 165, 167 (N.D. Ill. 1989); *In re Carla Leather, Inc.*, 44 B.R. 457, 466 n.5 (Bankr. S.D.N.Y. 1984) (noting that "Rule 9019(a) [is] substantially the same as Rule 919(a), its predecessor under the Bankruptcy Act.").

[FN12]. Fed. R. Bankr. Pro. 9019(a).

[FN13]. Id. at 2002(a)(3).

[FN14]. Id. at 2002(c).

[FN15]. Id. at 2002(g).

[FN16]. Id. at 2002(i).

[FN17]. See, e.g., *Kowal v. Malkemus (In re Thompson)*, 965 F.2d 1136, 1140-41 n.5 (1st Cir. 1992) ("[T]he general notice requirement under Bankruptcy Rule 2002(a)(3) is not absolute, but can be dispensed with 'for cause shown.' ") (citation omitted); *Estate of Patel v. Patel (In re Patel)*, 43 B.R. 500, 503-04 (N.D. Ill. 1984) ("Under rule 2002(a)(3), the bankruptcy court must give 20-day notices to debtor, Trustee, and creditors of a hearing to approve a compromise or settlement of a controversy. However, a bankruptcy judge may waive such notice for good cause shown.").

[FN18]. Collier's, supra note 6 at P 9019.01 (emphasis added).

[FN19]. See *In re Purofied Down Prods. Corp.*, 150 B.R. 519, 522 (S.D.N.Y. 1993) ("Rule 9019(a) of the Rules of Bankruptcy Procedure gives the court the authority to approve any compromise or settlement related to a reorganization or liquidation.") (citation omitted); *Magill v. Springfield Marine Bank (In re Heissinger Resources Ltd.)*, 67 B.R. 378, 382 (C.D. Ill. 1986) ("Bankruptcy Rule 9019 empowers the court to approve a compromise or settlement."); *Estate of Patel v. Patel (In re Patel)*, 43 B.R. at 504; *In re Drexel Burnham Lambert Group, Inc.*, 134 B.R. 493, 496 (S.D.N.Y. 1991) ("The Bankruptcy Court derives its authority to approve settlements from F. R. Bkrctcy. P. Rule 9019(a)."); *In re Public Serv. Co. of New Hampshire*, 114 B.R. 820, 826 (Bankr. N.H. 1990) ("Bankruptcy Rule 9019 establishes the discretionary power of a bankruptcy court to approve or disapprove compromises or settlements."); *In re Del Grosso*, 106 B.R. 165, 167 (Bankr. N.D. Ill. 1989) ("Bankruptcy Rule 9019(a) empowers the Court to approve a proposed compromise or settlement.... The Rule has been construed to give the Court broad authority to approve compromises.") (citation omitted); *In re Lion Capital Group*, 49 B.R. 163, 175 (Bankr. S.D.N.Y. 1985) ("Rule 9019(a) of the Rules of Bankruptcy Procedure gives the court the power to approve a compromise or settlement."). In this respect, Rule 9019 is identical to its predecessor. Cf. *Fogg v. Sherman Homes, Inc. (In re Sherman)*, 28 B.R. 176, 177 (Bankr. D. Me. 1983) ("Rule 919(a) gives the court broad authority to approve compromises.") (citation omitted).

[FN20]. Fed. R. Bankr. Pro. 9019(a) (emphasis added).

[FN21]. 1994 WL 693361 (E.D. La. 1994).

[FN22]. *Id.* at *3.

[FN23]. 141 B.R. 13 (Bankr. E.D.N.Y.), *aff'd*, 149 B.R. 289 (1992).

[FN24]. *Id.* at 16. See also *Saccurato v. Masters, Inc. (In re Masters, Inc.)*, 149 B.R. 289, 292 (E.D.N.Y. 1992) ("The purpose of the procedural rules governing notice to creditors is to allow those parties with a pecuniary interest in the settlement to have an opportunity to be heard and to object if they find it unsatisfactory."); *In re United Shipping Co.*, 1989 WL 12723, at *6 (Bankr. D. Minn. 1989) ("The focus of Rule 9019 is to protect other creditors against bad deals made between one creditor and the debtor.").

[FN25]. See *supra* note 11 (discussion of former Bankruptcy Rule 919 and Section 27 of the Bankruptcy Act).

[FN26]. In *Hicks, Muse & Co. v. Brandt (In re Healthco Int'l., Inc.)*, 136 F.3d 45 (1st Cir. 1998), the First Circuit noted, "[f]ormer Bankruptcy Rule 919, predecessor to Bankruptcy Rule 9019, was the procedural counterpart to Bankruptcy Act § 27, whose substantive provisions have not been carried forward in the Bankruptcy Code. Moreover, the legislative history relating to the repeal of Bankruptcy Act § 27 affords no insight to the intent behind this discontinuity." *Id.* at 50 n.4 (citations omitted) (emphasis added).

[FN27]. 198 B.R. 214 (Bankr. E.D. Mich. 1996).

[FN28]. *Id.* at 246.

[FN29]. 179 B.R. 544 (N.D. Ill. 1994).

[FN30]. *Id.* at 552. Accord *Hicks, Muse & Co. v. Brandt*, 136 F.3d at 50 (noting that "no substantive Code provision directly governs settlement approvals by the bankruptcy court").

[FN31]. 91 F.3d 389 (3d Cir. 1996).

[FN32]. See discussion of Section 363 and its requirements, *infra* Part IV.

[FN33]. *Id.* at 395, n.2. See also *In re Sparks*, 190 B.R. 842, 845 (Bankr. N.D. Ill. 1996), *aff'd*, 1997 WL 156488 (N.D. Ill. 1997) (holding that Section 363 is "the substantive provision[] of the Bankruptcy Code requiring a hearing and court approval; Rule 9019 merely sets forth the procedure for approving an agreement to settle or compromise a controversy"). Cf. *Valucci v. Glickman, Berkovitz, Levinson & Weiner (In re Glickman, Berkovitz, Levinson & Weiner)*, 204 B.R. 450, 455 (E.D. Pa. 1997) ("The courts have distinguished between the post-petition sale of assets, which are governed by 11 U.S.C. § 363(b), and the settlement of pre-petition claims, which are governed by Rule 9019(a) of the Federal Rules of Bankruptcy Procedure.").

[FN34]. *In re Purofied Down Prods. Corp.*, 150 B.R. 519, 522 (S.D.N.Y. 1993) ("Rule 9019(a) of the Rules of Bankruptcy Procedure gives the court the authority to approve any compromise or settlement related to a reorganization or liquidation.") (citing Fed. R. Bankr. Pro. 9019(a)) (emphasis added); cf. *infra* Part II.C.2. (discussing cases which hold that Bankruptcy Rule 9019 requires court approval of all compromises and settlements).

[FN35]. See, e.g., *Petitioning Creditors of Melon Produce, Inc. v. Braunstein*, 112 F.3d 1232, 1237 (1st Cir. 1997) (engaging in statutory construction in the context of the Bankruptcy Code, the court declared, "[w] herever possible, statutes should be construed in a common sense manner, avoiding absurd or counterintuitive results.") (citation omitted).

[FN36]. To be sure, much of this case-law development most likely depended on Bankruptcy Act Section 27's mandatory language, which, as previously discussed, provided, "[t]he receiver or trustee may, with approval of the court, compromise any controversy arising in the administration of the estate upon such terms as he may deem for the best interest of the estate." 11 U.S.C. § 50 (1976) (repealed 1978) (emphasis added). As previously discussed, *supra* note 26, Bankruptcy Rule 9019 does not have a corresponding section of the Bankruptcy Code similar to Section 27 of the Bankruptcy Act. Significantly, however, the language of these pre-Rule 9019 cases does not so much focus on the mandatory language of Section 27, but rather on the underlying principle that a bankruptcy court should have a role in administering the important aspects of the bankruptcy debtor's estate.

[FN37]. 390 U.S. 414 (1968).

[FN38]. *Id.* at 424 (emphasis added) (citation omitted). This aspect of the Supreme Court's language has been consistently affirmed in cases following the enactment of the Bankruptcy Code. See, e.g., *United States v. AWECO, Inc. (In re AWECO, Inc.)*, 725 F.2d 293, 297 (5th Cir. 1984) ("Initially, we note that important determinations in reorganization proceedings must receive the informed, independent judgment of the Bankruptcy Court.") (quoting *TMT Trailer Ferry*, 390 U.S. 414 (1968)); *In re Texaco*, 84 B.R. 893, 901 (Bankr. S.D.N.Y. 1988) ("The important determinations in reorganization proceedings must receive the 'informed, independent judgment of the Bankruptcy court.' ") (quoting *TMT Trailer Ferry*, 390 U.S. 414 (1968)).

While the Court's holding in *TMT Trailer Ferry* appears applicable only in reorganization proceedings, courts have also applied the logic of this decision to liquidation proceedings. See *infra* Part III.C.1-2.

[FN39]. 62 F.2d 582 (5th Cir. 1933).

[FN40]. *Id.* at 585 (citing Section 27 of the Bankruptcy Act) (emphasis added).

[FN41]. See *Collier's*, *supra* note 6, at P 9019.01. In addition to this influential treatise, bankruptcy practitioner manuals, albeit without much justification or analysis, concur with respect to the necessity of court approval. The highly regarded *Norton Bankruptcy Law and Practice* explicitly states, "[i]n bankruptcy cases, Bankruptcy Court approval of all compromises and settlements should be obtained. The procedure set forth in Bankruptcy Rule 9019 must be followed in settlements of adversary proceedings and contested matters." *Norton Bankruptcy Law and Practice* § 145:1 (2d ed. 1993) (citations omitted) (emphasis added). Similarly, the *Bankruptcy Litigation Manual* concludes, "[a]bsent compliance with the procedural requirements for notice, hearing and court approval, the compromise or settlement is unenforceable." *Bankruptcy Litigation Manual* § 15[II][B][1] (Michael L. Cook ed., Prentice Hall Law & Business 1994). Moreover, the practical advice provided on this point in the *Bankruptcy Litigation Manual* is clear and unequivocal. Under a section titled "Practice Pointers," the manual instructs:

The settling parties should provide that (a) the settlement agreement is subject to court approval, (b) the trustee must apply for such approval, and (c) the trustee must apply for approval within a definite time period.

....

The settlement agreement should provide that, if approval is denied, neither party nor any third party may rely on the settlement agreement or any conduct in furtherance of the settlement.

Id. at § 15[III][D][1] and [2] (emphasis added).

[FN42]. 859 F.2d 137 (10th Cir. 1988).

[FN43]. *Id.* at 141 (emphasis added).

[FN44]. 204 B.R. 450 (E.D. Pa. 1997).

[FN45]. *Id.* at 455 (emphasis added).

[FN46]. 149 B.R. 289 (E.D.N.Y. 1992).

[FN47]. *Id.* at 291. See also *In re Leslie Fay Co.*, 168 B.R. 294, 305 (Bankr. S.D.N.Y. 1994) ("Compromises may not be made in bankruptcy absent notice and a hearing and a court order.") (citing Fed. R. Bankr. Pro. 9019(a)); *In re Pugh*, 167 B.R. 251, 253-54 (Bankr. M.D. Fla. 1994) (holding that Bankruptcy Rule 9019 "in subclause (a) requires a Court approval of any compromise by the estate") (emphasis added); *In re Trout*, 108 B.R. 235, 238 (Bankr. N.D. 1989) (holding that Rule 9019(a) and 2002(a)(3) "provide for the compromise or settlement of a controversy only upon notice, hearing and court approval") (emphasis added); accord *In re Del Grosso*, 106 B.R. 165, 168 (Bankr. N.D. Ill. 1989) (noting "requirement of Court approval" in context of compromise or settlement agreement).

[FN48]. See *infra* Part II.C.3 (discussing cases holding Bankruptcy Rule 9019's requirements are not mandatory).

[FN49]. 1994 WL 693361 (E.D. La. 1994).

[FN50]. *Id.* at *2-3.

[FN51]. 861 F.2d 469 (6th Cir. 1988).

[FN52]. *Id.* at 473 (emphasis added).

[FN53]. 614 F.2d 1322 (5th Cir. 1980), modified, 664 F.2d 435 (5th Cir. 1981).

[FN54]. *Id.* at 1330 (citing, in part, *TMT Trailer Ferry*, 390 U.S. 414 (1968)) (emphasis added). In a footnote, the Fifth Circuit also noted that due to recent legislation at the time, consent decrees in antitrust suits initiated by the United States could also be added to this list of "special situations" requiring court approval. *Id.* at n.16. Accord *Alumax Mill Prods. v. Congress Fin. Corp.*, 912 F.2d 996, 1002 (8th Cir. 1990) ("[s]pecial situations' which require court approval include proposed class action settlements, proposed shareholder derivative suit settlements, proposed compromises of claims in bankruptcy court, and consent decrees in antitrust suits brought by the United States.") (citing *City of Miami*, 614 F.2d 1322 (5th Cir. 1980)); *Gardiner v. A.H. Robbins Co.*, 747 F.2d 1180, 1189 (8th Cir. 1984) (citing *City of Miami*, 614 F.2d 1322); *Cowley v. Texas Snubbing Control, Inc.*, 812 F. Supp. 1437, 1449 (S.D. Miss. 1992) (citing *City of Miami*, 614 F.2d 1322); *United States v. Louisiana*, 527 F. Supp. 509, 512 (E.D. La. 1981) (noting existence of "special situations in which court approval of a proposed settlement is required because important public interests are implicated"). See also discussion regarding Federal Rules of Civil Procedure 23 and 23.1, *infra* Part III.E.

Importantly, both the Reynolds and Miami courts' distinction between ordinary litigation and a bankruptcy proceeding is paralleled by the Supreme Court's implicit recognition of this distinction in *TMT Trailer Ferry, Inc.*: "The fact that courts do not ordinarily scrutinize the merits of compromises involved in suits between individual litigants cannot affect the duty of a bankruptcy court to determine that a proposed compromise forming part of a reorganization plan is fair and equitable." *Id.* at 424.

[FN55]. 725 F.2d 293 (5th Cir. 1984).

[FN56]. *Id.* at 300.

[FN57]. 859 F.2d 137 (10th Cir. 1988).

[FN58]. *Id.* at 141 (emphasis added).

[FN59]. 159 B.R. 374 (Bankr. D. Mass. 1993).

[FN60]. *Id.* at 379.

[FN61]. 47 B.R. 304 (Bankr. E.D. Pa. 1985), *aff'd* in part, *rev'd* on other grounds, 60 B.R. 884 (1985).

[FN62]. *Id.* at 309. See also *In re Lloyd, Carr and Co.*, 617 F.2d 882, 885 (1st Cir. 1980) (holding that compromise was unenforceable under precursor to Bankruptcy Rule 9019, "[a]mong other reasons for nonenforceability is the fact that the notice requirements of the Bankruptcy Rules were not met" and "[p]articularly where principal creditors had been given no opportunity to consider or respond to it, ... [the settlement agreement] whatever it may have been, was not a valid compromise ..."); *Columbia Gulf Trans. Co. v. Louisiana Natural Gas Pipeline*, 1994 WL 693361, at *2 (E.D. La. 1994) ("Under Rule 9019 of the Bankruptcy Code, a debtor ... cannot generally bind its estate to a settlement agreement absent specific authorization from the bankruptcy court."); *In re Pugh*, 167 B.R. 251, 253-54 (Bankr. M.D. Fla. 1994) ("[I]t is clear that it could not have become a binding contract unless the Trustee complied with F.R.B.P. 9019 which in subclause (a) requires a Court approval of any compromise by the estate submitted by a Motion filed by the Trustee and after hearing on notice to creditors.") (emphasis added); *Bramham v. Nevada First Thrift (In re Bramham)*, 38 B.R. 459, 465 (Bankr. Nev. 1984) (holding that "[a]bsent compliance with these requirements of notice, hearing, and court approval, a purported settlement or compromise is unenforceable," pursuant to predecessor to Bankruptcy Rule 9019).

[FN63]. 149 B.R. 289 (Bankr. E.D.N.Y. 1992).

[FN64]. *Id.* at 293.

[FN65]. At least one court declined to determine the issue altogether. In *Myers v. Martin (In re Martin)*, 91 F.3d

389 (3d Cir. 1996), the court noted, "[w]e emphasize that in reaching this conclusion we do not decide the broader issue of whether, absent intervention of a bankruptcy court, parties are bound by the terms of a settlement pending final approval of the bankruptcy court." *Id.* at 395.

[FN66]. 127 B.R. 287 (Bankr. M.D. Ga. 1991), *aff'd*, 136 B.R. 888 (M.D. Ga. 1992), *rev'd* on other grounds, 992 F.2d 311 (1993).

[FN67]. *Id.* at 290 (emphasis added).

[FN68]. 216 B.R. 166 (Bankr. E.D. Va. 1997).

[FN69]. *Id.* at 174.

[FN70]. 163 B.R. 474 (Bankr. W.D. Pa. 1994).

[FN71]. *Id.* at 476 (emphasis added).

[FN72]. 78 B.R. 85 (Bankr. E.D. Pa. 1987).

[FN73]. *Id.* at 89; *cf.* *In re United Shipping Co.*, 1989 WL 12723, at * 5 (Bankr. D. Minn. 1989) ("The absence of court approval does not mean that the parties did not agree to the settlement. It only means that the court has not yet approved it.").

[FN74]. 165 B.R. 22 (Bankr. N.D. Tex. 1994).

[FN75]. *Id.* at 26; see also *In re Christie*, 173 B.R. 890, 891 (Bankr. E.D. Tex. 1994) (oral announcement made in open court and entered on record is binding on all parties to settlement, even if party has change of heart before terms are reduced to writing).

[FN76]. 205 B.R. 722 (Bankr. M.D. Pa. 1996).

[FN77]. *Id.* at 726.

[FN78]. 8 B.R. 930 (Bankr. N.D. Ga. 1981).

[FN79]. *Id.* at 932.

[FN80]. *Id.* at 933.

[FN81]. See *United States v. AWECO, Inc. (In re AWECO, Inc.)*, 725 F.2d 293, 297 (5th Cir. 1984) ("Compromises may be effected separately during reorganization proceedings or in the body of the reorganization plan itself.") (citing *Collier's*, *supra* note 6); *In re Drexel Burnham Lambert Group, Inc.*, 134 B.R. 493, 496 (Bankr. S.D.N.Y. 1991) (same); *In re Texaco*, 84 B.R. 893, 901 (Bankr. S.D.N.Y. 1988) (same).

[FN82]. 11 U.S.C. § 1123(b)(3)(A) (1994).

[FN83]. *In re Texaco*, 84 B.R. at 901 (noting that the proposed settlement which was incorporated into a plan of reorganization did "not belong to the debtor or to the estate," but that "a compromise between parties in the context of a bankruptcy reorganization may be accomplished with the court's approval").

[FN84]. For instance, in *In re Texaco*, 84 B.R. 893 (Bankr. S.D.N.Y. 1988), *Texaco, Inc.*, and its two wholly owned financial subsidiaries, filed for bankruptcy protection following state court litigation in Texas which resulted in a jury verdict in excess of \$11 billion in favor of the plaintiff, *Penzoil Company*, and against *Texaco, Inc.*, the defendant. Following the jury verdict, and with some modifications, both the Texas district court and the Texas Court of Appeals upheld the award, and the Texas Supreme Court refused *Texaco's* application for review. *Id.* at 894. Viewing itself as having no other alternative, *Texaco* and its two subsidiaries filed for Chapter 11 protection. During the course of the bankruptcy case, all of the various issues relating to what came to be known as the "Penzoil Judgment" were settled between *Texaco* and *Penzoil* and the terms incorporated into a plan of

reorganization. Thus, the plan of reorganization was essentially a settlement of the massive state court judgment against the debtors in which Pennzoil agreed to settle its claim for less than the full amount of the jury verdict, and all of the relevant parties agreed to mutual releases. As noted by the court,

[T]he basic feature of the Plan is the settlement of the Pennzoil judgement in excess of \$11.259 billion for a payment of \$3 billion dollars. Additionally, the officers, directors and representatives of Pennzoil are to be released and indemnified by Texaco for any and all claims arising out of this settlement, and they in turn, will issue reciprocal releases to Texaco's officers, directors and representatives.

Id. at 899-900 (emphasis added). Finding that the proposed plan and settlement agreement met the relevant standards for approval, the court confirmed the plan of reorganization. Id. at 911.

[FN85]. 190 B.R. 842 (Bankr. N.D. Ill. 1996), *aff'd*, 1997 WL 156488 (N.D. Ill. 1997).

[FN86]. See *infra* Part IV (discussing Section 363's notice and hearing requirements).

[FN87]. *In re Sparks*, 190 B.R. at 844 (emphasis added).

[FN88]. Id. at 845.

[FN89]. See *supra* note 26.

[FN90]. See *supra* Part II (discussing notice and hearing requirements pursuant to Bankruptcy Rules 9019 and 2002).

[FN91]. Fed. R. Bankr. Pro. 9019(a) (emphasis added); accord, *Connecticut Gen. Life Ins. Co. v. United Companies Fin. Corp.* (*In re Foster Mortgage Corp.*), 68 F.3d 914, 917 (5th Cir. 1995) ("A bankruptcy court may approve a compromise settlement of a debtor's claim pursuant to Bankruptcy Rule 9019(a).") (citation omitted) (emphasis added).

[FN92]. See *In re Prudence Co.*, 98 F.2d 559, 559 (2d Cir. 1938) ("[A] pproval of a compromise of a claim against a bankrupt's estate is [] discretionary"); *In re Public Service Co. of New Hampshire*, 114 B.R. 820, 826 (Bankr. N.H. 1990) ("Bankruptcy Rule 9019 establishes the discretionary power of a bankruptcy court to approve or disapprove compromises or settlements.") (emphasis added); *In re Lion Capital Group*, 49 B.R. 163, 176 (Bankr. S.D.N.Y. 1985) ("[T]he bankruptcy courts have discretion in determining whether to approve a proposed compromise or settlement ... discretion permits [a bankruptcy court] ... to approve a settlement ... [a] pproval is not required.") (citation omitted).

[FN93]. *In re Drexel Burnham Lambert Group, Inc.*, 134 B.R. 493, 494 (Bankr. S.D.N.Y. 1991); see also *Woodson v. Fireman's Fund Ins. Co.* (*In re Woodson*), 839 F.2d 610, 620 (9th Cir. 1988) ("The bankruptcy court has great latitude in approving compromise agreements.") (citation omitted); *United States v. AWECO, Inc.* (*In re AWECO, Inc.*), 725 F.2d 293, 297 (5th Cir. 1984) ("The decision of whether to approve a particular compromise lies within the discretion of the trial judge....") (citations omitted); *Thomas v. Fallon* (*In re Chicago Rapid Transit Co.*), 196 F.2d 484, 490 (7th Cir. 1952) ("[The] [[B]ankruptcy court has broad discretion to approve" compromises and settlements.); *In re Purofied Down Prods. Corp.*, 150 B.R. 519, 524 (Bankr. S.D.N.Y. 1993) (recognizing "broad discretion afforded bankruptcy court judges with respect to the review of proposed settlements"); *McGraw v. Yelverton* (*In re Bell & Beckwith*), 87 B.R. 476, 478 (N.D. Ohio 1988) ("The decision of whether to approve a trustee's proposed settlement lies within the sound discretion of the bankruptcy court....") (citation omitted); *In re Del Grosso*, 106 B.R. 165, 167 (Bankr. N.D. Ill. 1989) ("The decision to approve an application to compromise is a matter within the discretion of the Court.") (citations omitted); *Chopin Assocs. v. Smith* (*In re Holywell Corp.*), 93 B.R. 291, 294 (Bankr. S.D. Fla. 1988) ("The approval of the proposed [] settlement agreement is a matter within this Court's sound discretion."); *In re Texaco*, 84 B.R. 893, 901 (Bankr. S.D.N.Y. 1988) ("The decision of whether to approve a particular compromise lies within the discretion of the Bankruptcy judge...."); *Knowles v. Putterbaugh* (*In re Hallet*), 33 B.R. 564, 565 (Bankr. D. Me. 1983) ("Whether to approve an application to compromise is a matter within the discretion of the Court.") (citations omitted); *Providers Benefit Life Ins. Co. v. Tidewater Group, Inc.* (*In re Tidewater Group, Inc.*), 13 B.R. 764, 765 (Bankr. N.D. Ga. 1981) ("The determination of whether to approve an application to compromise is a matter within the sound discretion of the bankruptcy judge.") (citations omitted); *Fogg v. Sherman Homes, Inc.* (*In re Sherman Homes, Inc.*), 28 B.R. 176, 177 (Bankr. D. Me. 1983) (citation omitted); *Collier's*, *supra* note 6 at P 9019.02 ("The decision of the bankruptcy judge as to the approval or disapproval of a compromise agreement rests in the judge's sound discretion.") (citations omitted).

[FN94]. See *Sandoz v. Bennett (In re Emerald Oil Co.)*, 807 F.2d 1234, 1239 (5th Cir. 1987) ("[The] [B]ankruptcy court is ordinarily in the best position, as the trial court and as the ongoing supervisory court for the bankruptcy proceeding, to determine whether" a proposed compromise or settlement meets the standards for approval.); *United States v. Alaska Nat'l. Bank (In re Walsh Constr., Inc.)*, 669 F.2d 1325, 1328 (9th Cir. 1982) ("[T]he bankruptcy judge is uniquely situated to consider the equities and reasonableness of a particular compromise."); *In re Purofied Downs Prods. Corp.*, 150 B.R. at 522 (quoting *Sandoz*, 807 F.2d 1234 (5th Cir. 1987)).

[FN95]. See *Connecticut Gen. Life Ins. Co. v. United Co. Fin. Corp. (In re Foster Mortgage Corp.)*, 68 F.3d 914, 917 (5th Cir. 1995) (appellate court "should review the Bankruptcy Court's approval of the compromise settlement for abuse of discretion") (citation omitted); *Fishell v. Soltow (In re Fishell)*, 47 F.3d 1168, 1995 WL 66622, at *2 (6th Cir. 1995) ("We review a bankruptcy court's approval of a compromise under the abuse of discretion standard."); *LaSalle Nat'l Bank v. Holland (In re American Reserve Corp.)*, 841 F.2d 159, 162 (7th Cir. 1987) ("[W]e will not reverse that determination [to approve a compromise] unless the bankruptcy judge abused his discretion.") (citations omitted); *Sandoz v. Bennett (In re Emerald)*, 807 F.2d at 1239 (bankruptcy court's decision regarding approval of a compromise or settlement "should not be disturbed except for an abuse of discretion."); *Martin v. Kane (In re A & C Properties)*, 784 F.2d 1377, 1380 (9th Cir. 1985) ("[T]he bankruptcy court's order approving the trustee's application to compromise the controversy is reviewed for an abuse of discretion."); *Anaconda-Ericsson, Inc. v. Hessen (In re Teltronics Servs. Inc.)*, 762 F.2d 185, 189 (2d Cir. 1985) (noting that under the Bankruptcy Act "the approval of a settlement in a bankruptcy proceeding [was] committed to the sound discretion of the bankruptcy court"); *United States v. AWECO, Inc. (In re AWECO, Inc.)*, 725 F.2d at 297 ("[A]n appellate court will reverse [approval of a settlement or compromise] only when that discretion has been abused.") (citations omitted); *United States v. Alaska Nat'l. Bank (In re Walsh Constr. Inc.)*, 669 F.2d at 1328 ("[A]pproval or denial of a compromise will not be disturbed on appeal absent a clear abuse of discretion."); *In re Prudence Co.*, 98 F.2d at 559 ("[A]pproval of a compromise of a claim against a bankrupt's estate is a discretionary order which can be reversed only for an abuse of discretion."); *Magill v. Springfield Marine Bank (In re Heissinger Resources Ltd.)*, 67 B.R. 378, 382 (C.D. Ill. 1986) ("Absent a clear abuse of discretion, approval of a compromise of the settlement will not be disturbed.") (citing *Walsh*, 669 F.2d 1325 (9th Cir. 1982)); *Estate of Patel v. Patel (In re Patel)*, 43 B.R. 500, 505 (N.D. Ill. 1984) (bankruptcy judge's decision "will not be disturbed on appeal absent a clear abuse of discretion") (citing *Walsh*, 669 F.2d 1325); *In re Purofied Down Prods. Corp.*, 150 B.R. at 522 ("A Bankruptcy Court's decision to approve a settlement should not be overturned unless its decision is manifestly erroneous and 'a clear abuse of discretion.' "); *In re Del Grosso*, 106 B.R. at 167 ("The decision will not be disturbed on appeal absent a clear showing of abuse of discretion.") (citations omitted); see also *Collier's*, supra note 6 at P 9019.02 ("Such a decision is reviewable ... but will normally not be set aside except where there is an abuse of discretion.") (citing *Teltronics*, 762 F.2d 185 (2d Cir. 1985)).

[FN96]. 150 B.R. 519 (Bankr. S.D.N.Y. 1993).

[FN97]. *Id.* at 522; see also *LaSalle Nat'l Bank v. Holland (In re American Reserve Corp.)*, 841 F.2d at 163 ("A bankruptcy judge need not hold a mini-trial or write an extensive opinion every time he approves or disapproves a settlement."); *Port O'Call Inv. Co. v. Blair (In re Blair)*, 538 F.2d 849, 851 (9th Cir. 1976) (rejecting notion that in a liquidation case "there must be a mini-trial on the merits of the claims sought to be compromised"); *Official Comm. of Unsecured Creditors of Int'l Distribution Ctrs. Inc. v. Talcott, Inc. (In re International Distribution Ctrs, Inc.)*, 103 B.R. 420, 423 (S.D.N.Y. 1989) ("A trial or 'mini-trial' on the merits is not required for court approval of a settlement.") (citation omitted); *Magill v. Springfield Marine Bank (In re Heissinger Resources Ltd.)*, 67 B.R. at 383 ("We reject the notion that a 'mini-trial' on the merits of the claim sought to be compromised is required.") (citing *Blair*, 538 F.2d 849 (9th Cir. 1976)); *In re Drexel Burnham Lambert Group, Inc.*, 138 B.R. at 759 ("Approval of a settlement does not require a 'mini trial' on the merits.") (citations omitted); *In re Drexel Burnham Lambert Group, Inc.*, 134 B.R. 493, 496 (Bankr. S.D.N.Y. 1991) ("[A] trial or 'mini-trial' on the merits is not required for Court approval of a settlement."); cf. *Florida Trailer and Equip. Co. v. Deal*, 284 F.2d 567, 571 (5th Cir. 1960) (policy that law favors compromise "could hardly be achieved if the test on hearing for approval meant establishing success or failure to a certainty"); *McGraw v. Yelverton (In re Bell & Beckwith)*, 87 B.R. at 479 ("In considering a proposed settlement, the bankruptcy court is not resolving issues. The court is merely identifying and clarifying issues so that it can make an informed decision on the reasonableness of the settlement.") (citation omitted); *In re Public Serv. Co.*, 114 B.R. 820, 826 (Bankr. N.H. 1990) ("[I]t is not necessary for the bankruptcy court to decide questions of law or fact raised by objectors."); *Chopin Assocs. v. Smith (In re Holywell Corp.)*, 93 B.R. 291, 295 (Bankr. S.D. Fla. 1988) ("In making its evaluation, this Court need not rest its decision whether to approve a settlement upon a resolution of ultimate factual and legal issues which underlie the disputes that are

proposed to be compromised.") (citing *Florida Trailer*, 284 F.2d 567 (5th Cir. 1960)).

[FN98]. 36 F.3d 582 (7th Cir. 1994).

[FN99]. *Id.* at 586; cf. *Port O'Call Inv. Co. v. Blair (In re Blair)*, 538 F.2d at 851-52 (Bankruptcy Act case rejecting notion that mini-trial on the merits is required and holding that "[t]he decision as to whether there should be a mini-trial in a liquidation bankruptcy as to the merits of the compromised claims and defenses is best left to the sound discretion of the bankruptcy judge upon an application and showing of necessity by the interested parties or by creditors of the bankrupt.>").

[FN100]. See *United States v. Alaska Nat'l. Bank (In re Walsh Constr. Inc.)*, 669 F.2d 1325, 1328 (9th Cir. 1982) ("A compromise agreement allows the trustee and the creditor to avoid the expenses and burdens associated with litigating 'sharply contested and dubious' claims. [Accordingly,] [t]he bankruptcy court need not conduct an exhaustive investigation into the validity of the asserted claim."); cf. *Fishell v. Soltow (In re Fishell)*, 47 F.3d 1995 WL 66622, at *4 (6th Cir. 1995) (noting that requiring a full evidentiary hearing "would be virtually indistinguishable from a trial, which is the very thing the compromise was designed to avoid"); *In re Ira Haupt & Co.*, 304 F. Supp. 917, 935 (S.D.N.Y. 1969) (rejecting notion that approval of a settlement requires a trial and concluding, "[i]f settlement has any purpose at all, it is to avoid a trial on the merits because of the uncertainty of the outcome").

[FN101]. 284 F.2d 567 (5th Cir. 1960).

[FN102]. *Id.* at 571. See also *Purofied Down Prods.*, 150 B.R. at 522- 23 ("The lenient standards concerning approval of settlements and a limited scope of review reflect the considered judgment that little would be saved by the settlement process if bankruptcy courts could approve settlements only after an exhaustive investigation and determination of the underlying claims."); accord *In re Carla Leather, Inc.*, 44 B.R. 457, 470 (Bankr. S.D.N.Y. 1984) (citing *Florida Trailer*, 284 F.2d 567 (5th Cir. 1960)); cf. *Magill v. Springfield Marine Bank (In re Heissinger Resources Ltd.)*, 67 B.R. at 382 ("Mandating that a bankruptcy judge write a full opinion on the merits of every settlement would only serve to slow the entire process and waste scarce judicial resources."); but see *LaSalle Nat'l Bank v. Holland (In re American Reserve Corp.)*, 841 F.2d at 162-63 ("[T]he bankruptcy judge must make findings and explain his reasoning sufficiently to show that he examined the proper factors and made an informed and independent judgment.... The judge may make either written or oral findings; form is not important, so long as the findings show the reviewing court that the judge properly exercised his discretion.").

[FN103]. 699 F.2d 599 (2d Cir. 1983).

[FN104]. *Id.* at 608 (citing *Newman v. Stein*, 464 F.2d 689, 693 (2d Cir.), cert. denied sub nom., *Benson v. Newman*, 409 U.S. 1039 (1972)). See also *Anaconda-Ericsson, Inc. v. Hessen (In re Teltronics Servs. Inc.)*, 762 F.2d 185, 189 (2d Cir. 1985) (courts need only "canvass the issues [to] see whether the settlement 'fall[s] below the lowest point in the range of reasonableness.'") (quoting *W.T. Grant*, 699 F.2d at 608); *In re Purofied Down Prods. Corp.*, 150 B.R. at 522 ("[T]he court's responsibility is to 'canvass the issues and see whether the settlement fall[s] below the lowest point in the range of reasonableness.'") (quoting *W.T. Grant*, 699 F.2d at 608); *Official Comm. of Unsecured Creditors v. Talcott, Inc. (In re Int'l Distribution Ctrs., Inc.)*, 103 B.R. 420, 423 (S.D.N.Y. 1989) ("[S]ettlement should be approved unless it falls below the lowest point in the range of reasonableness.") (citing *W.T. Grant*, 699 F.2d at 608); *McGraw v. Yelverton (In re Bell & Beckwith)*, 87 B.R. 476, 478-79 (N.D. Ohio 1988) ("While the court should not substitute its judgment for that of the trustee, it must 'canvass the issues and see whether the settlement fall[s] below the lowest point in the range of reasonableness.'") (quoting *W.T. Grant*, 699 F.2d at 608); *In re Drexel Burnham Lambert Group, Inc.*, 138 B.R. 723, 758 (Bankr. S.D.N.Y. 1992) ("The inquiry under the Bankruptcy Code ... need only determine whether the settlement falls below the lowest point of the range of reasonableness.") (citations omitted); *Chopin Assocs. v. Smith (In re Holywell Corp.)*, 93 B.R. 291, 294 (Bankr. S.D. Fla. 1988) ("[T]he Court must consider all of the relevant facts and evaluate whether the compromise suggested falls below the 'lowest point in the range of reasonableness.'") (citations omitted); accord *Magill v. Springfield Marine Bank (In re Heissinger Resources Ltd.)*, 67 B.R. at 383 (citing *W.T. Grant*, 699 F.2d at 608); *In re Lion Capital Group*, 49 B.R. 163, 175 (Bankr. S.D.N.Y. 1985) (citing *W.T. Grant*, 699 F.2d at 608); *In re Carla Leather, Inc.*, 44 B.R. at 465-66 (quoting *W.T. Grant*, 699 F.2d at 608).

The court's responsibility to canvass the issues and inform itself about the reasonableness of a proposed compromise is paralleled by a similar duty on the part of the trustee. See *In re Carla Leather, Inc.*, 44 B.R. at 472 ("There can be no question that a trustee's judgment in proposing a settlement is to be informed. Yet it is not

suggested that a trustee, in informing himself, is to explore every possible fact without regard to the cost to the estate of doing so or to the potential benefit to be achieved.") (citations omitted); accord *Florida Trailer and Equip. Co. v. Deal*, 284 F.2d 567, 573 (5th Cir. 1960) (trustee must establish that "it is prudent to eliminate the risks of litigation to achieve specific certainty though admittedly it might be considerably less (or more) than were the case fought to the bitter end"); *Thomas v. Fallon* (In re *Chicago Rapid Transit Co.*), 196 F.2d 484, 491 (7th Cir. 1952) ("[T]he trustee in recommending compromises should take into account, as he has here, the uncertainty and cost of litigation as well as the existence of unsettled questions of liability.") (citation omitted); In re *Central Ice Cream Co.*, 59 B.R. 476, 487 (Bankr. N.D. Ill. 1985) ("The Trustee, in recommending the proposed settlement, is not required to establish the outcome of the litigation to a legal certainty. Rather, the Trustee must establish to the reasonable satisfaction of the Court that, all things considered, it is prudent to eliminate the risks and delays of litigation to ... the bitter end, even where the certain amount obtained by settlement is less than the possible ultimate recovery.") (citing, in part, *Florida Trailer*, 284 F.2d 567); cf. In re *Lion Capital Group*, 49 B.R. at 188 ("The availability of legal or factual argument to his adversary may justify a Trustee exercising his judgment within the bounds of reason in recognizing that argument in settling a case.") (citing *Carla Leather*, 44 B.R. 457 (S.D.N.Y. 1984))).

[FN105]. See *supra* Part I.

[FN106]. 49 B.R. 163 (Bankr. S.D.N.Y. 1985).

[FN107]. *Id.* at 190.

[FN108]. As set forth in *supra* note 104, it is quite evident that courts have consistently applied the lowest point of the reasonableness test following enactment of the Code. In most instances, this is done without mention of the fact that *W.T. Grant* was decided under the Bankruptcy Act. In *In re Carla Leather, Inc.*, 44 B.R. 457 (Bankr. S.D.N.Y. 1984), however, the court addressed this issue directly. "With the bankruptcy court's surrender, upon the enactment of the Code, of its administrative role under the Bankruptcy Act, even more reason exists for focusing determination on whether the settlement falls within the bounds of reasonableness.... [This standard] applies to cases under the Code." *Id.* at 466 (citations omitted) (emphasis added). See also *In re Drexel Burnham Lambert Group, Inc.*, 138 B.R. at 758 ("The inquiry under the Bankruptcy Code (as well as under the Bankruptcy Act) need only determine whether the settlement falls below the lowest point of the range of reasonableness.") (emphasis added) (citing *W.T. Grant*, 699 F.2d at 608).

[FN109]. *In re Drexel Burnham Lambert Group, Inc.*, 134 B.R. at 497 ("Courts look to several factors which shed light on whether the compromise remains above the lowest point in the range of reasonableness.").

[FN110]. *Connecticut Gen. Life Ins. Co. v. Foster Mortgage Corp.* (In re *Foster Mortgage Corp.*), 68 F.3d 914, 917 (5th Cir. 1995) ("[T]he court should approve the settlement only when the settlement is fair and equitable and in the best interest of the estate.") (citations omitted); *Depoister v. Mary M. Holloway Found.*, 36 F.3d 582, 586 (7th Cir. 1994) ("[T]he bankruptcy court is to determine whether the proposed compromise is fair and equitable and in the best interest of the bankruptcy estate.") (citations omitted); *Reynolds v. Commissioner*, 861 F.2d 469, 473 (6th Cir. 1988) ("In considering a proposed compromise, a bankruptcy court is charged with an affirmative obligation ... to make an independent judgment as to whether the compromise is fair and equitable."); *Woodson v. Fireman's Fund Ins. Co.* (In re *Woodson*), 839 F.2d 610, 620 (9th Cir. 1988) ("The court may approve a compromise only if it is 'fair and equitable.' ") (citations omitted); *LaSalle Nat'l Bank v. Holland* (In re *American Reserve Corp.*), 841 F.2d 159, 161 (7th Cir. 1987) ("A bankruptcy judge may approve a settlement in a liquidation proceeding if the settlement is in the estate's best interests.") (citations omitted); *Martin v. Kane* (In re *A & C Properties*), 784 F.2d 1377, 1380, 1381-82 (9th Cir. 1986) ("It is clear that there must be more than a mere good faith negotiation of a settlement by the trustee in order for the bankruptcy court to affirm a compromise agreement. The court must also find that the compromise is fair and equitable.... [I]t must also weigh certain factors to determine whether the compromise is in the best interest of the bankrupt estate.") (citations omitted); *United States v. AWECO, Inc.* (In re *AWECO, Inc.*), 725 F.2d 293, 297 (5th Cir. 1984) ("A court may approve such a compromise or settlement only when it is 'fair and equitable.' ") (citing *TMT Trailer*, 390 U.S. 414, 424 (1968)); In re *Purofied Down Prods. Corp.*, 150 B.R. 519, 523 (S.D.N.Y. 1993) (bankruptcy court must determine "whether a settlement is fair and equitable and 'in the best interest of the estate' ") (citations omitted); *McGraw v. Yelverton* (In re *Bell & Beckwith*), 87 B.R. 476, 478 (N.D. Ohio 1988) ("In deciding whether to approve a proposed settlement, the bankruptcy court must determine whether the settlement is in the best interest of the estate.") (citation omitted); *Magill v. Springfield Marine Bank* (In re *Heissinger Resources Ltd.*), 67 B.R. 378, 383 n.6 (Bankr. C.D. Ill. 1986)

("Courts have used a 'fair and equitable' standard in reviewing compromises in reorganization cases.... [T]he bankruptcy judge also should consider the best interest of the estate."); *In re Drexel Burnham Lambert Group, Inc.*, 134 B.R. 493, 494 (Bankr. S.D.N.Y. 1991) ("If a settlement agreement is fair and equitable and in a debtor's best interest, and those of its creditors', it will be approved."); *In re Del Grosso*, 106 B.R. 165, 167 (Bankr. N.D. Ill. 1989) ("Generally, the Court will approve a settlement if it is in the best interest of the estate.") (citations omitted); *Knowles v. Putterbaugh* (*In re Hallet*), 33 B.R. 564 (Bankr. D. Me. 1983) ("The Court should approve a compromise ... only if it is in the best interests of the estate.") (citation omitted); accord *Collier's*, supra note 6, P 9019.02 ("[I]n other words, therefore, a compromise will be approved when it is both 'fair and equitable' and in the best interests of the estate.") (citations omitted).

[FN111]. Nevertheless, the United States Court of Appeals for the Fifth Circuit in *United States v. AWECO, Inc.* (*In re AWECO, Inc.*), 725 F.2d at 298, did provide some guidance with respect to the "fair and equitable" standard, explaining that, "[t]he words 'fair and equitable' are terms of art-- they mean that 'senior interests are entitled to full priority over junior ones.'" ' Accord *LaSalle Nat'l Bank v. Holland* (*In re American Reserve Corp.*), 841 F.2d at 162 (same, and concluding, "[i]n a settlement context, 'fair and equitable means that the settlement reasonably accords with the competing interests' relative priorities") (citing *AWECO*, 725 F.2d 293)).

[FN112]. 841 F.2d 159 (7th Cir. 1987).

[FN113]. *Id.* at 162 (citation omitted); accord *In re Del Grosso*, 106 B.R. at 168 n.1 (citing *In re American Reserve*, 841 F.2d 159 (7th Cir. 1987)).

[FN114]. *McGraw v. Yelverton* (*In re Bell & Beckwith*) 87 B.R. at 478 (citing *In re Hermitage Inn, Inc.*, 66 B.R. 71, 72 (Bankr. D. Colo. 1986)); see also *Woodson v. Fireman's Fund Ins. Co.* (*In re Woodson*), 839 F.2d at 621 ("[T]rustee has burden of persuading court that settlement is fair and equitable.") (citation omitted); *Martin v. Kane* (*In re A & C Properties*), 784 F.2d at 1381 ("The trustee, as the party proposing the compromise, has the burden of persuading the bankruptcy court that the compromise is fair and equitable and should be approved.") (citation omitted); *In re Del Grosso*, 106 B.R. at 167 ("The Trustee, as proponent of the proposed settlement, has the burden of showing that the settlement terms are in the best interest of the estate."). Cf. *In re Ira Haupt & Co.*, 304 F. Supp. 917, 935 (S.D.N.Y. 1969) (noting that "the trustee had to support his application [for approval of the proposed settlement] by 'proof of facts' and not by mere allegations").

Rather than limiting their holding to the trustee, some courts have held that the party proposing the settlement has the burden of persuasion. See *In re Hermitage Inn, Inc.*, 66 B.R. 71, 72 (Bankr. D. Colo. 1986) ("The burden of persuading the court that a settlement should be approved rests with the party proposing the settlement."); *Knowles v. Putterbaugh* (*In re Hallet*), 33 B.R. at 565-66 ("The parties proposing the compromise have the burden of persuading the court that the compromise should be approved.") (citations omitted).

The court in *In re Del Grosso*, 106 B.R. 165 (Bankr. N.D. Ill. 1989), set forth a unique set of requirements which the trustee, or any proponent, of a settlement must meet:

Proponents of settlement, and normally the Trustee in the first instance, must show the proposal is reasonable and that: 1) the settlement was not collusive, but was arrived at after arms-length negotiations; 2) that the proponents have counsel experienced in similar cases; 3) that there has been sufficient discovery of the underlying claims of parties to enable counsel to act intelligently; and 4) that the number of objectants or their relative interest is small. *Id.* at 168 (citation omitted).

[FN115]. See *Official Comm. of Unsecured Creditors v. Talcott, Inc.* (*In re Int'l Distribution Ctrs., Inc.*), 103 B.R. 420, 423 (S.D.N.Y. 1989) ("A court may give weight to the Trustee's informed judgment that a compromise is fair and equitable[.]"); cf. *In re Del Grosso*, 106 B.R. at 168 ("The Trustee's disapproval is a factor pointing to the impropriety of a compromise.).

[FN116]. *In re Purofied Down Prods. Corp.*, 150 B.R. 519, 522 (S.D.N.Y. 1993).

[FN117]. 841 F.2d 159 (7th Cir. 1987).

[FN118]. *Id.* at 162 (quoting *TMT Trailer Ferry*, 390 U.S. 414 (1968)). Accord *Depoister v. Mary M. Holloway Found.*, 36 F.3d 582, 587 (7th Cir. 1994) (abuse of discretion "standard implies that the bankruptcy judge must actually exercise his discretion and not simply 'rubber stamp' the trustee's proposal") (citing *In re American Reserve*, 841 F.2d at 162); *In re Lion Capital Group*, 49 B.R. 163, 189 (Bankr. S.D.N.Y. 1985) ("The best interests of creditors, however, requires more than a trustee's ipse dixit or request for reliance on his judgment. Where a

settlement is objected to, findings and conclusions are appropriate.") In re Carla Leather, Inc., 44 B.R. 457, 465 (Bankr. S.D.N.Y. 1984) ("This standard of inquiry does not portend substitution of the court's judgement for that of the trustee.").

[FN119]. United States v. Alaska Nat'l Bank (In re Walsh Constr.), 669 F.2d 1325 (9th Cir. 1982).

[FN120]. Id. at 1328. See also Martin v. Kane (In re A & C Properties), 784 F.2d 1377, 1381 (9th Cir. 1986) ("[W]e must determine whether the settlement entered into by the trustee was reasonable, given the particular circumstances of the case.") (citation omitted).

[FN121]. See In re Lion Capital Group, 49 B.R. at 175-76 ("Such canvassing of the issues hardly means ... that the Bankruptcy Court is not to conduct a thorough and informed analysis.") (citation omitted); Cf. Martin v. Kane (In re A & C Properties), 784 F.2d 1377, 1383 (9th Cir. 1985) ("An approval of a compromise, absent a sufficient factual foundation which establishes that it is fair and equitable, inherently constitutes an abuse of discretion.") (citing AWECO, 725 F.2d 293, 298 (5th Cir. 1984)); United States v. AWECO, Inc. (In re AWECO, Inc.), 725 F.2d at 298 ("If a court approves a settlement as part of a reorganization plan absent reasonable assurance that the settlement accords with the fair and equitable standard, that court has abused its discretion.... An approval of a compromise, absent a sufficient factual foundation, inherently constitutes an abuse of discretion.").

[FN122]. 390 U.S. 414 (1968).

[FN123]. Id. at 441.

[FN124]. Id. at 434, 440-41; accord United States v. AWECO, Inc. (In re AWECO, Inc.), 725 F.2d at 300 ("[D]ecisions as central to bankruptcy proceedings as approval of settlements cannot be visceral. They must issue from reason and rest upon factual undergirdings.").

[FN125]. Martin v. Kane (In re A & C Properties), 784 F.2d at 1382.

[FN126]. 67 B.R. 378 (C.D. Ill. 1986).

[FN127]. Id. at 381. In noting this distinction, the Heissinger court quoted from the United States Court of Appeals for the Ninth Circuit's decision in Blair which confronted this very issue. Id. In Blair, the Ninth Circuit declared that:

This [liquidation proceeding] is not the same as a [reorganization] proceeding and there are sound reasons for drawing the distinction. A corporate reorganization is a continuing business affair requiring close supervision and affecting many interested parties. The success or failure of a reorganization may hinge upon the very compromise at issue. A liquidation bankruptcy is a terminal affair. The bankrupt's financial affairs are beyond repair. Liquidation is to be accomplished as rapidly as possible consistent with obtaining the best possible realization upon the available assets and without undue waste by needless or fruitless litigation.

In re Blair, 538 F.2d 849, 852 (9th Cir. 1976) (footnote omitted) (citing TMT Trailer Ferry, 390 U.S. 414 (1968)); accord In re Central Ice Cream Co., 59 B.R. 476, 487 (Bankr. N.D. Ill. 1985) ("[T]he 'best interest of the estate' takes on a different meaning depending on whether the goal in Bankruptcy is reorganization or liquidation.") (citing Blair, 538 F.2d 849 (9th Cir. 1976)).

While Blair and Central Ice Cream are Bankruptcy Act cases which discussed the distinctions between these two types of cases under the Bankruptcy Act, the analysis is nevertheless applicable to contemporary cases because the Bankruptcy Code, as evidenced by the discussion in Heissinger Resources, has retained the basic distinctions between a liquidation (Chapter 7) and a reorganization (Chapter 11). See generally 11 U.S.C. §§ 701-66, 1101-74 (1994).

[FN128]. Heissinger, 67 B.R. at 381-82 (quoting, in part, TMT Trailer Ferry, 390 U.S. at 434); accord LaSalle Nat'l Bank v. Holland (In re American Reserve Corp.), 841 F.2d 159, 161 (7th Cir. 1987); cf. Martin v. Kane (In re A & C Properties), 784 F.2d 1377, 1383 (9th Cir. 1985) ("An approval of a compromise, absent a sufficient factual foundation which establishes that it is fair and equitable, inherently constitutes an abuse of discretion.") (citing In re AWECO, 725 F.2d 293 (5th Cir. 1984)); United States v. AWECO, Inc. (In re AWECO, Inc.), 725 F.2d at 299 ("The duty of [the] bankruptcy judge to reach an 'intelligent, objective and educated evaluation' of settlements cannot be carried out absent a sufficient factual background.... An approval of a compromise, absent a sufficient factual foundation, inherently constitutes an abuse of discretion.") (citation omitted); In re Texaco, 84 B.R. 893,

901, 902 (Bankr. S.D.N.Y. 1988) ("The duty of a bankruptcy judge to reach an 'intelligent, objective and educated evaluation' of settlements cannot be carried out absent factual background.... Decisions as central to bankruptcy proceedings as approval of settlements cannot be visceral. They must issue from reason and rest upon factual undergirdings.") (citing, in part, *AWECO*, 725 F.2d at 300).

[FN129]. 49 B.R. 163 (Bankr. S.D.N.Y. 1985).

[FN130]. *Id.* at 190.

[FN131]. *Id.* at 176 (quoting *In re Boston & Providence R.R. Corp.*, 673 F.2d 11, 12 (1st Cir. 1932)).

[FN132]. *Id.* at 183-90 (citations omitted).

[FN133]. *Id.*

[FN134]. *Id.* at 190 (citations omitted). For other examples of courts granting or denying approval based on adequate or inadequate records, compare *Depoister v. Mary M. Holloway Found.*, 36 F.3d 582, 586 (7th Cir. 1994) (holding that the bankruptcy judge did not abuse his discretion in approving the proposed settlement because, despite lack of evidentiary hearing, "there was an adequate factual basis upon which the bankruptcy judge could conclude that the settlement was in the best interests of the estate"); *McGraw v. Yelverton (In re Bell & Beckwith)*, 87 B.R. 476, 481 (N.D. Ohio 1988) ("The Trustee presented sufficient evidence for the bankruptcy court to find that the settlement did not fall below the lowest level of reasonableness.") with *LaSalle Nat'l Bank v. Holland (In re American Reserve Corp.)*, 841 F.2d 159, 161 (7th Cir. 1987) ("Because the bankruptcy judge's findings are not adequate to allow us to review the settlement, we reverse and remand for further findings."); *United States v. AWECO, Inc. (In re AWECO, Inc.)*, 725 F.2d 293, 299 ("An examination of the record in the case before us reveals gaping holes in the background of information regarding the ... settlement.... [T]he information before the bankruptcy court was inadequate."); *Knowles v. Putterbaugh (In re Hallet)*, 33 B.R. 564, 566 (Bankr. D. Me. 1983) ("[T]he trustee has failed to sustain his burden of persuading the Court that the compromise is in the best interest of the estate. He has presented no evidence in support of the proposed compromise.").

[FN135]. *TMT Trailer Ferry*, 390 U.S. at 437; accord *Fishell v. Soltow (In re Fishell)*, 47 F.3d 1168 (6th Cir. 1995) (citing *TMT Trailer Ferry*, 390 U.S. 414 (1968)); *Drexel Burnham Lambert, Inc. v. Flight Transp. Corp. (In re Flight Transp. Corp. Sec. Litig.)*, 730 F.2d 1128, 1136 (8th Cir. 1984) (quoting *TMT Trailer Ferry*, 390 U.S. at 437); *Magill v. Springfield Marine Bank (In re Heissinger Resources Ltd.)*, 67 B.R. 378, 381 (C.D. Ill. 1986) (citing *Flight Transp.*, 730 F.2d at 1136); cf. *Martin v. Kane (In re A & C Properties)*, 784 F.2d 1377, 1381 (9th Cir. 1985) ("Appellate review is made more difficult by the lower court's failure to write an opinion explaining why it deemed the compromise to be fair, reasonable and adequate. However, where the record supports approval of the compromise, the bankruptcy court should be affirmed.") (citing *Flight Transport*, 730 F.2d at 1136.).

[FN136]. 304 F. Supp. 917 (S.D.N.Y. 1969).

[FN137]. *Id.* at 923.

[FN138]. *Id.* at 934. Finding that the record taken as a whole supported the referee's decision, the District Court affirmed approval of the settlement. *Id.* at 922, 933, 934, 947. See also *Fishell v. Soltow (In re Fishell)*, 47 F.3d 1168 (6th Cir. 1995) (stating that "it is preferable that these matters be addressed in the Bankruptcy Court's opinion," but holding that approval may still be granted if the record before the court is adequate) (citing *TMT Trailer Ferry*, 390 U.S. 414 (1968)); *Martin v. Kane (In re A & C Properties)*, 784 F.2d at 1383 ("An approval of a compromise, absent a sufficient factual foundation which establishes that it is fair and equitable, inherently constitutes an abuse of discretion. However, the record in the case before this court is replete with factors which support the bankruptcy court's approval of the compromise.... Appellate review is made more difficult by the lower court's failure to write an opinion explaining why it deemed the compromise to be fair, reasonable and adequate. However, where the record supports approval of the compromise, the bankruptcy court should be affirmed.") (citing *Flight Transport*, 730 F.2d at 1136); *Estate of Patel v. Patel (In re Patel)*, 43 B.R. 500, 505 (N.D. Ill. 1984) ("The record of the bankruptcy court proceeding reveals exhaustive discussion of the advantages and disadvantages of the settlement and therefore provides ample support for this Court's finding that the bankruptcy court did not abuse its discretion in approving the settlement.")

[FN139]. 841 F.2d 159 (7th Cir. 1987).

[FN140]. *Id.* at 162-63.

[FN141]. *Id.* at 161.

[FN142]. *Id.* at 163. See also *supra* Part III.B.

[FN143]. Using the facts before it as an example, the court in *In re American Reserve Corp.* elaborated further on its reasons for requiring findings in the context of approval of a compromise or settlement.

This case shows the danger of inadequate findings. The bankruptcy judge found that the settlement was in the estate's and creditors' best interests. But the judge did not discuss his reasons for this finding, nor did he discuss the legal issues relevant to the claim. The bankruptcy judge did mention that litigation expenses would exceed the settlement amount. However, it appears that the bankruptcy judge merely took the trustee's word on litigation costs. The record does not contain evidence of what the expected litigation costs were. Nor does the judge explain, based on the evidence that was in the record or on his analysis of the legal issues involved in the claim, why he accepted the trustee's testimony that litigation costs would exceed the settlement. Furthermore, the record is replete with statements by the bankruptcy judge that the trustee considered factors such as expense and litigation risks, but does not contain any indication that the judge independently evaluated those or other relevant factors. Although the judge mentioned a number of times during the settlement approval hearing that he could not just accept the trustee's judgement, he apparently (as far as we can tell from the record before us) did just that. Requiring the bankruptcy judge to adequately explain his reasoning and show that he evaluated the proper factors will help avoid these problems in the future.

Id. at 163.

[FN144]. *Id.* at 162-63. See also *In re Lloyd, Carr and Co.*, 617 F.2d 882, 890-91 n.9 (1st Cir. 1980) (commenting on whether proposed settlement agreement was a benefit to the estate, the court held, "we think this was an issue requiring in-depth analysis and findings by the district court premised upon a full record and considered responses by the creditors. The receiver's oral conclusions were not enough.") (citing *TMT Trailer Ferry*, 390 U.S. 414 (1968)).

[FN145]. 67 B.R. 378 (C.D. Ill. 1986).

[FN146]. *Id.* at 382. See also *Fishell v. Soltow (In re Fishell)*, 47 F.3d 1168 (6th Cir. 1995) (stating that "it is preferable that these matters be addressed in the Bankruptcy Court's opinion," but holding that approval may still be granted if the record before the court is adequate) (citing *TMT Trailer Ferry*, 390 U.S. 414 (1968)).

[FN147]. 49 B.R. 163 (Bankr. S.D.N.Y. 1985).

[FN148]. *Id.* at 176 (citation omitted). See also *In re Del Grosso*, 106 B.R. 165, 167 (Bankr. N.D. Ill. 1989) ("The requirement that adequate information be set forth in sufficient detail to enable approval of a settlement parallels the same requirement applicable to consideration of settlements in class action or derivative actions pursuant to Rules 23 and 23.1 of the Federal Rules of Civil Procedure.") (citing *Lion*, 49 B.R. 163, 176 (Bankr. S.D.N.Y. 1985)); *Magill v. Springfield Marine Bank (In re Hessinger Resources Ltd.)*, 67 B.R. 378, 382 (C.D. Ill. 1986) (same and concluding, "Its purpose, of course, is to insure that the lower court did indeed give fair consideration to each party's claim.").

[FN149]. 668 F.2d 654 (2d Cir. 1982).

[FN150]. *Id.* at 659 (citations omitted).

[FN151]. 68 F.3d 914 (5th Cir. 1995).

[FN152]. *Id.* at 917. Accord *Collier's*, *supra* note 6 at P 9019.02 ("[t] here are numerous opinions which set out the standards to be applied by courts in determining whether it should approve a proffered settlement or compromise of a controversy").

[FN153]. *Collier's*, *supra* note 6 at P 9019.02 (citing *TMT Trailer Ferry*, 390 U.S. 414 (1968)). Accord *In re*

Purofied Down Prods. Corp., 150 B.R. 519, 522 (S.D.N.Y. 1993) (noting that in TMT Trailer Ferry "the Supreme Court described the procedures to be followed in determining whether a settlement agreement should be approved"); Official Comm. of Unsecured Creditors v. Talcott, Inc. (In re International Distribution Ctrs., Inc.), 103 B.R. 420, 422 (S.D.N.Y. 1989) ("The Supreme Court set forth the procedure a court should follow in determining whether or not it should approve a compromise agreement in [TMT Trailer Ferry]."); In re Drexel Burnham Lambert Group, Inc., 134 B.R. 493, 496 (Bankr. S.D.N.Y. 1991) ("The Supreme Court set forth the standard a Bankruptcy Court should follow in determining whether or not it should approve a compromise agreement in [TMT Trailer Ferry]."); In re Carla Leather, Inc., 44 B.R. 457, 465 (Bankr. S.D.N.Y. 1984) ("The Supreme Court has spoken clearly of the court's role in passing upon proposed settlements ...") (citing TMT Trailer Ferry, 390 U.S. 414 (1968)); see also Port O'Call Inv. Co., v. Blair (In re Blair), 538 F.2d 849, 851-52 (9th Cir. 1976); In re Drexel Burnham Lambert Group, Inc., 138 B.R. at 758; In re Central Ice Cream Company, 59 B.R. 476, 487 (Bankr. N.D. Ill. 1985) (citing Blair, 538 F.2d 849 (9th Cir. 1976)).

[FN154]. 390 U.S. at 424-25. Prior to the Supreme Court's pronouncement in TMT Trailer Ferry, many courts had utilized the Eighth Circuit's landmark holding in Drexel v. Loomis, 35 F.2d 800 (8th Cir. 1929) for guidance in this area. Ironically, despite the similarity in language and concepts between these two decisions, TMT Trailer Ferry neither mentions nor cites to Drexel. In Drexel, the Eighth Circuit set forth the following four factors for use in approving a settlement in bankruptcy:

- (a) [t]he probability of success in the litigation;
 - (b) the difficulties, if any, to be encountered in the matter of collection;
 - (c) the complexity of litigation involved, and the expense, inconvenience and delay necessarily attending it;
 - (d) the paramount interest of the creditors and a proper deference to their reasonable views in the premises.
- Id. at 806.

[FN155]. See In re Public Serv. Co. of New Hampshire, 114 B.R. 820, 826 (Bankr. D.N.H. 1990) ("the policy underlying the application of this [TMT Trailer Ferry] standard is so strong that it has been held to apply equally to pre-confirmation compromises presented during the course of reorganization proceedings under the Bankruptcy Code"); In re Hermitage Inn, Inc., 66 B.R. 71, 72 (Bankr. Colo. 1986) ("The standards to be used by the Court in considering a compromise and settlement are the same as those used under the Bankruptcy Act....") (citations omitted).

[FN156]. See, e.g., In re Public Serv. Co., 114 B.R. at 826 ("When a substantial compromise is embodied in a reorganization [plan] [sic] which effectively 'short-circuits' the formal provisions required for plan confirmation under Chapter 11 of the Bankruptcy Code, the courts have not hesitated to apply the general requirements for evaluating compromises in reorganization proceedings as first announced in [TMT Trailer Ferry].") (citations omitted); In re Texaco, 84 B.R. 893, 901 (Bankr. S.D.N.Y. 1988) ("With regard to approval of compromises that form part of a plan of reorganization, a definite rule limits the exercise of discretion. This rule provides a court may approve such a compromise only when it is 'fair and equitable.' ") (citing TMT Trailer Ferry, 390 U.S. 414 (1968)).

[FN157]. 68 F.3d 914 (5th Cir. 1995).

[FN158]. Id. at 917 (citations omitted). In a footnote, the Foster Mortgage court acknowledged that its "three-part test was derived from the four-part test first announced in Drexel v. Loomis, 35 F.2d 800, 806 (8th Cir. 1929)." Id. at 917 n.3. For a discussion of Drexel, see supra note 154.

[FN159]. 68 F.3d at 917.

[FN160]. Id.

[FN161]. Id. at 918.

[FN162]. 136 F.3d 45, 47 (1st Cir. 1998).

[FN163]. Id. at 50.

[FN164]. Id.

[FN165]. Id. Specifically, the court in Healthco stated that "among other factors," a bankruptcy court may consider

(1) the probability of success were the claim to be litigated-given the expense, inconvenience and delay entailed in its litigation-measured against the more definitive, concrete and immediate benefits attending the proposed settlement (so-called 'best interests' standard);
(2) a reasonable accommodation of the creditors' views regarding the proposed settlement; and
(3) the experience and competence of the fiduciary proposing the settlement.
Id. (citations omitted).

[FN166]. See also *Knowles v. Putterbaugh (In re Hallet)*, 33 B.R. 564, 566 (Bankr. D. Me. 1983) ("emphasis is placed on the paramount interests of creditors and proper deference will be given to [their] reasonable views") (citations omitted).

[FN167]. See, e.g., *Martin v. Kane (In re A & C Properties)*, 784 F.2d 1377, 1384 (9th Cir. 1985) ("The bankruptcy judge may give weight to the opinions of the trustee, the parties, and their attorneys.") (citing *Blair*, 538 F.2d 849 (9th Cir. 1976)); *Port O'Call Inv. Co. v. Blair (In re Blair)*, 538 F.2d 849, 851 (9th Cir. 1976) ("The bankruptcy judge and the district court may, in a case such as this, give weight to the opinions of the trustee, the parties, and their attorneys."); *In re Purofied Down Prods. Corp.*, 150 B.R. 519, 522 (S.D.N.Y. 1993) (court "may credit and consider the opinion of the Trustee and counsel that the settlement is fair and equitable") (citations omitted); *Official Comm. of Unsecured Creditors v. Talcott, Inc. (In re International Distribution Ctrs., Inc.)*, 103 B.R. 420, 422-23 (S.D.N.Y. 1989) ("A court may give weight to the Trustee's informed judgment that a compromise is fair and equitable, and consider the competency and experience of counsel who support the compromise.") (citations omitted); *Magill v. Springfield Marine Bank (In re Heissinger Resources Ltd.)*, 67 B.R. 378, 383 (C.D. Ill. 1986) ("The bankruptcy judge and the district court also may give weight to the opinions of the trustee, the parties and their attorneys.") (citing *In re Blair*, 538 F.2d 849 (9th Cir. 1976)); *In re Drexel Burnham Lambert Group, Inc.*, 138 B.R. 723, 758 (Bankr. S.D.N.Y. 1992) ("A Court may properly give weight to the debtor's informed judgment that a settlement is fair and reasonable and consider the competency of the counsel who favor the compromise.") (citations omitted); *In re Drexel Burnham Lambert Group, Inc.*, 134 B.R. 493, 496 (Bankr. S.D.N.Y. 1991) ("The Court can give weight to the Trustee's informed judgment that a compromise is fair and equitable. The Court can also give weight to the competency and experience of counsel who support the settlement.") (citations omitted); cf. *In re Del Grosso*, 106 B.R. 165, 168 (Bankr. N.D. Ill. 1989) ("The Trustee's disapproval is a factor pointing to the impropriety of a compromise."). But cf. *Martin v. Kane (In re A & C Properties)*, 784 F.2d at 1384 ("[T]he court may exclude evidence which is relevant where such evidence creates undue delay, waste of time or needless presentation of cumulative evidence.") (citing *Fed. R. Evid.* 403).

[FN168]. For a general overview of the various standards utilized by different circuit courts see generally *Meyers v. Martin (In re Martin)*, 91 F.3d 389 (3d Cir. 1996); *Jeffrey v. Desmond*, 70 F.3d 183 (1st Cir. 1995); *Fishell v. Soltow (In re Fishell)*, 47 F.3d 1168 (6th Cir. 1995); *In re Woodson*, 839 F.2d 610, 620 (9th Cir. 1988) (citing *TMT Trailer Ferry*, 390 U.S. 414 (1968) and *In re A & C Properties*, 784 F.2d 1377 (9th Cir. 1985)); *LaSalle Nat'l Bank v. Holland (In re American Reserve Corp.)*, 841 F.2d 159 (7th Cir. 1987); *Martin v. Kane (In re A & C Properties)*, 784 F.2d 1377 (9th Cir. 1986); *Drexel Burnham Lambert, Inc. v. Flight Transp. Corp. (In re Flight Transp. Corp. Sec. Litig.)*, 730 F.2d 1128, 1135 (8th Cir. 1984).

In most instances, the courts have not drawn a distinction between liquidation and reorganization cases when articulating the relevant standard for approval. However, at least one court did limit its holding to liquidation proceedings. In *In re Central Ice Cream Co.*, 59 B.R. 476 (Bankr. N.D. Ill. 1985), the court declared,

[T]he "best interest of the estate" takes on a different meaning depending on whether the goal in Bankruptcy is reorganization or liquidation.... In approving a settlement in a liquidation proceeding, the Court must determine what course of action is in the best interests of the Estate, with major consideration to the interests of the creditors. A proposed settlement in a liquidation proceeding should be approved if it provides for "the best possible realization upon the available asset ... without undue waste or needless or fruitless litigation."
Id. at 487 (citations omitted).

[FN169]. See *LaSalle Nat'l Bank v. Holland (In re American Reserve Corp.)*, 841 F.2d at 161-62 ("The bankruptcy judge should also consider the creditors' objections to the settlement; however, the creditors' views are not controlling.") (citation omitted); *Martin v. Kane (In re A & C Properties)*, 784 F.2d at 1382 ("[W]hile creditors' objections to a compromise must be afforded due deference, such objections are not controlling.") (citations omitted); *In re Lloyd, Carr and Co.*, 617 F.2d 882, 891 (1st Cir. 1980) ("The views of creditors are, of course, not controlling ... No case has come to our attention, however, where a compromise has been imposed without the support of a single creditor and over the active opposition of the major creditors.") (citation omitted); *Magill v. Springfield Marine Bank (In re Heissinger Resources Ltd.)*, 67 B.R. at 383 ("[I]t is important to note that a

creditor's objection is not controlling and will not prevent approval.") (citing *Sherman Homes*, 28 B.R. 176 (Bankr. D. Me. 1983)); *In re Drexel Burnham Lambert Group, Inc.*, 138 B.R. at 758 ("While a Court may consider the objections of parties in interest who oppose a proposed settlement, such objections certainly are not controlling.") (citations omitted); *Knowles v. Putterbaugh (In re Hallet)*, 33 B.R. 564, 566 (Bankr. D. Me. 1983) ("[a] creditors' objections are not controlling") (citing *Sherman Homes*, 28 B.R. 176); *Fogg v. Sherman Homes, Inc. (In re Sherman Homes, Inc.)*, 28 B.R. 176, 178 (Bankr. D. Me. 1983) ("a creditor's objection is not controlling and will not prevent approval") (citation omitted); cf. *Drexel Burnham Lambert, Inc. v. Flight Transp. Corp. (In re Flight Transp. Corp.)*, 730 F.2d 1128, 1138 (8th Cir. 1984) ("A court of bankruptcy has, to be sure, the right to approve settlements, and may do so, in a proper case, over the objection of some parties, so long as a settlement is found to be in the best interests of the estate as a whole."); *In re Del Grosso*, 106 B.R. at 168 ("The Court may approve a settlement over objections of some parties, as long as the settlement is in the best interests of the estate as a whole.") (citing *Flight Transp. Corp.*, 730 F.2d 1128 (8th cir. 1984)).

[FN170]. See *In re Carla Leather, Inc.*, 44 B.R. 457, 472 (Bankr. S.D.N.Y. 1984) ("To allow objectors to disrupt settlements by merely objecting, 'without demonstrating any factual basis for their objections, and force the parties to expend large amounts of time, money and effort to answer their rhetorical questions ... [would] thwart the settlement process.' ") (quoting *City of Detroit v. Grinnell Corp.*, 495 F.2d 448, 464 (2d Cir. 1974)).

[FN171]. *Drexel Burnham Lambert, Inc. v. Flight Transp. Corp. (In re Flight Transp. Corp.)*, 730 F.2d 1128, 1135 (8th Cir. 1984) (noting that TMT Trailer Ferry involved "approval of settlement in bankruptcy cases, and the same standards apply to the approval of a class-action settlement under Rule 23(e)") (citation omitted).

[FN172]. *In re Carla Leather*, 44 B.R. at 466; cf. *LaSalle Nat'l Bank v. Holland (In re American Reserve Corp.)*, 841 F.2d 159, 161 (7th Cir. 1987) (noting similarity of factors which courts consider when approving a proposed compromise in bankruptcy and a class action) (citation omitted).

[FN173]. 44 B.R. at 466.

[FN174]. *Id.* (citations omitted). For an example of a court applying the TMT Trailer Ferry standard in the context of a Rule 23 proposed settlement of a class action involving alleged securities fraud, see *McDonald v. Chicago Milwaukee Corp.*, 565 F.2d 416 (7th Cir. 1977).

As discussed *supra* in Part III.C.3., courts have also held that the requirement for an adequate record in the context of approving a proposed compromise or settlement agreement is also similar to that necessary under Rules 23 and 23.1.

[FN175]. Fed. R. Civ. P. 23(e) (emphasis added).

[FN176]. Fed. R. Civ. P. 23.1 (emphasis added).

[FN177]. 614 F.2d 1322 (5th Cir. 1980), modified, 664 F.2d 435 (5th Cir. 1981). See also *supra* note 54 and accompanying text (discussing *Miami* and citing similar holdings).

[FN178]. *Id.* at 1330 (emphasis added). See also *supra* note 54 and cases cited therein and accompanying text (discussing *Miami* and citing similar holdings). In a footnote, the Fifth Circuit also noted that due to recent legislation, consent decrees in antitrust suits initiated by the United States could be added to this list of "special situations" requiring court approval. *Id.* at n.16.

[FN179]. *Id.* at 1330 (emphasis added). Accord, *United States v. Louisiana*, 527 F. Supp. 509, 512 (E.D. La. 1981) (noting existence of "special situations in which court approval of a proposed settlement is required because important public interests are implicated.") (citing *City of Miami*, 614 F.2d 1322 (5th Cir. 1980)).

[FN180]. *TMT Trailer Ferry*, 390 U.S. at 424.

[FN181]. 11 U.S.C. § 363(b) (1994) (emphasis added).

[FN182]. A threshold determination that must be made with respect to Section 363's applicability is whether the proposed transaction is within the ordinary course of the debtor's business. If the proposed transaction is within the ordinary course of the debtor's business, then by its own terms, the section's notice and hearing requirements are not

triggered and the proposed transaction does not need to be approved by the court. If, however, the proposed transaction falls outside of the debtor's ordinary course of business, Section 363 requires that notice and hearing must be given in accordance with Bankruptcy Rule 6004. 11 U.S.C. § 363. The term "ordinary course" is a term of art not defined by the Bankruptcy Code, but developed by case law. See generally *In re Roth Am., Inc.*, 975 F.2d 949, 952 (3d Cir. 1992) ("Neither the Bankruptcy Code nor its legislative history provides a framework for analyzing whether particular transactions are in the ordinary course of a debtor's business for the purpose of section 363.").

[FN183]. See *supra* Part I.A.1. (discussing underlying rationale for Bankruptcy Rule 9019(a)).

[FN184]. 91 F.3d 389 (3d Cir. 1996).

[FN185]. *Id.* at 395.

[FN186]. Fed. R. Bankr. Pro. 6004(a).

[FN187]. *Id.* Bankruptcy Rule 6004(a), states "[n]otice of a proposed use, sale, or lease of property, other than cash collateral, not in the ordinary course of business shall be given pursuant to Rule 2002(a)(2), (c)(1), (i), and (k) and, if applicable, in accordance with § 363(b)(2) of the Code." *Id.*

[FN188]. Fed. R. Bankr. Pro. 2002(a)(2).

[FN189]. Fed. R. Bankr. Pro. 2002(c)(1). Subsection (c)(1) further states that a notice relating to the sale of real estate "is sufficient if it generally describes the property." *Id.*

[FN190]. Fed. R. Bankr. Pro. 2002(i).

[FN191]. Fed. R. Bankr. Pro. 2002(k).

[FN192]. 11 U.S.C. § 541(a)(1) (1994).

[FN193]. *Id.* See generally Susan C. Gieser, *Property of the Estate: Section 541(a)(1)*, 4 *Bankr. Devs. J.* 123 (1987).

[FN194]. See *Schertz-Cibolo-University City Indep. Sch. Dist. v. Wright (In re Educators Group Health Trust)*, 25 F.3d 1281, 1283-84 (5th Cir. 1994) ("The term 'all legal or equitable interests' has been defined broadly to include causes of action.").

[FN195]. See *Louisiana World Exposition v. Federal Ins. Co.*, 858 F.2d 233, 245 (5th Cir. 1988) ("Section 541(a)(1)'s reference to 'all legal or equitable interests of the debtor in property' includes causes of action belonging to the debtor at the time the case is commenced."); *Swift v. Seidler (In re Swift)*, 198 B.R. 927, 930 (Bankr. W.D. Tex. 1996), *aff'd*, 129 F.3d 792 (5th Cir. 1997) ("It is undisputed that a cause of action belonging to a debtor as of the petition's filing becomes property of the estate."); see also *Collier's*, *supra* note 6, § 363.02 ("[A] chose in action is property of the estate.").

[FN196]. 179 B.R. 544 (Bankr. N.D. Ill. 1994).

[FN197]. *Id.* at 522, n.7.

[FN198]. 204 B.R. 450 (Bankr. E.D. Pa. 1997).

[FN199]. *Id.* at 455.

[FN200]. 198 B.R. 214 (Bankr. E.D. Mich. 1996).

[FN201]. *Id.* at 222, n.7, 245; cf. *In re Wieboldt Stores, Inc.*, 92 B.R. 309, 312 (N.D. Ill. 1988) (holding that settlement agreement which contemplated debtor's transferring certain real estate property interests in return for a release of indebtedness "constituted a sale of assets under Section 363"). But see *Hicks, Muse & Co. v. Brandt (In*

re Healthco, Inc.) 136 F.3d 45, 49 (1st Cir. 1998) (distinguishing between a settlement which "[b]y its very nature ... resolves adversarial claims prior to their definitive determination by the court" with a "sale" which "effects a 'transfer of the title ... [to] property for consideration" ' and, accordingly, refusing to hold that a settlement of a Chapter 7 trustee's fraudulent conveyance action was the equivalent of a "sale" or "lease" as those terms are used in Section 363(m)) (emphasis in original); In re Neshaminy Office Bldg. Assocs., 62 B.R. 798, 805 (E.D. Pa. 1986) ("I do not believe it is proper to equate the settlement of this controversy over conflicting claims to [property] with the sale of that property. As the Bankruptcy Court held, the settlement of a controversy over conflicting claims to property simply does not constitute a sale of that property."); In re Fidelity Am. Fin. Corp., 43 B.R. 74, 77 (Bankr. E.D. Penn. 1984) ("[W]e do not equate the settlement of a controversy over conflicting claims to property with the sale of that property.").

[FN202]. 179 B.R. 544 (N.D. Ill. 1994).

[FN203]. Id. at 552.

[FN204]. 91 F.2d 389 (3d Cir. 1996).

[FN205]. Id. at 395. See also Collier's, supra note 6, § 363.02 ("It has been held that because choses in action are property of the estate, settlement of an action is equivalent to a sale of property under Section 363. Thus, notice and a hearing is required prior to settling a chose in action out of the ordinary course of business.") (footnote omitted).

[FN206]. See supra Part II.C.2.a.

[FN207]. 190 B.R. 842 (Bankr. N.D. Ill. 1996), aff'd, No. 96C 1373, 1997 WL 156488 (N.D. Ill. Apr. 1, 1997).

[FN208]. Id. at 844-45.

[FN209]. Lecompte v. Sparks, No. 96C 1373, 1997 WL 156488 (N.D. Ill. Apr. 1, 1997).

[FN210]. Id. at *6 (footnote omitted).

[FN211]. 205 B.R. 722 (Bankr. M.D. Pa. 1996).

[FN212]. Id. at 725 (emphasis provided); see also In re Roth Am., Inc., 975 F.2d 949, 954 (3d Cir. 1992) (holding that proposed settlement agreement "was not a transaction in the ordinary course of business" within the meaning of Section 363(c) and that "notice and a hearing in the bankruptcy court on that agreement was required for it to be enforceable") (footnote omitted); In re Leslie Fay Co., 168 B.R. 294, 301-03 (Bankr. S.D.N.Y. 1994) ("[I]f the debtor were to agree to do something extraordinary ... then ... pursuant to Section 363(b)(1) the agreement is not enforceable absent notice and a hearing.... [A] post-petition modification to a collective bargaining agreement, if out of the ordinary course of business, is not enforceable absent compliance with Section 363(b)").

[FN213]. Because a settlement agreement is in essence no more than a contract, cases dealing with contracts in the context of Section 363 are also instructive on this point. With respect to proposed contracts which are subject to Section 363's notice and hearing requirements, courts have held that there can be no contract where the parties to such a contract fail to obtain bankruptcy court approval. See G-K Dev. Co. v. Broadmoor Place Invs. (In re Broadmoor Place Invs.), 994 F.2d 744, 745 n.1 (10th Cir. 1993), ("The said agreement [involving a sale of the debtor's real estate] necessarily required [the debtor] to seek the approval of the Bankruptcy Court for the sale ... there can be no contract in this situation without Bankruptcy Court approval."); In re Landscape Properties, Inc., 100 B.R. 445, 447 (Bankr. E.D. Ark. 1988) (holding that in the context of a proposed Section 363 sale of real property, "there simply is no contract without bankruptcy court approval").

[FN214]. See supra Part III.A. (noting that approval pursuant to Bankruptcy Rule 9019 is discretionary, therefore not mandatory).

[FN215]. See generally supra Part III (discussing standards for approving compromises and settlements in bankruptcy).

[FN216]. See, e.g., *Committee of Equity Sec. Holders v. Lionel Corp. (In re Lionel Corp.)*, 722 F.2d 1063, 1070 (2d Cir. 1983) ("[T]here must be some articulated business justification, other than appeasement of major creditors, for using, selling or leasing property out of the ordinary course of business before the bankruptcy judge may order such disposition under Section 363(b).").

[FN217]. See *Cumberland Farms Dairy, Inc. v. National Farmers' Org., Inc. (In re Abbotts Dairies of Pa.)*, 788 F.2d 143, 149-50 (3d Cir. 1986) ("[W]e hold that when a bankruptcy court authorizes a sale of assets pursuant to Section 363(b)(1), it is required to make a finding with respect to the 'good faith' of the purchaser.").

[FN218]. *Id.*

[FN219]. *Id.* at 150 n.5. As noted by the court in *In re Abbotts Dairies*, "[U]nfortunately, neither the Bankruptcy Code nor the Bankruptcy Rules attempts to define 'good faith.'" *Id.* at 147.

[FN220]. *Myers v. Martin (In re Martin)*, 91 F.3d 389, 395 (3d Cir. 1996).

[FN221]. See *supra* Part II.

[FN222]. See *Columbia Gulf Transmission Co. v. Louisiana Natural Gas Pipeline*, No. CIV.A. 93-239, 1994 WL 693361, at *3 (E.D. La. 1994) ("a debtor ... cannot generally bind its estate to a settlement agreement absent specific authorization from the bankruptcy court.").

[FN223]. Fed. R. Civ. P. 17(a).

[FN224]. 56 B.R. 657 (Bankr. N.D. Ohio 1986).

[FN225]. *Id.* at 662-663 (citations and footnotes omitted).

[FN226]. 406 U.S. 416 (1972).

[FN227]. *Id.* at 434.

[FN228]. *In re D.H. Overmeyer Telecasting Co.*, 56 B.R. at 660.

[FN229]. 476 F. Supp. 246 (M.D.N.C. 1979), *aff'd* without opinion, 636 F.2d 1213 (4th Cir. 1980).

[FN230]. *Id.* at 252.

[FN231]. *In re D.H. Overmyer Telecasting Co.*, 56 B.R. 657, 659 (footnote omitted); see also *Rochelle v. Marine Midland Grace Trust*, 535 F.2d 523 (9th Cir. 1976) (trustee lacked standing to assert claim on behalf of alleged defrauded debenture holders); *Clarke v. Chase Nat'l Bank*, 137 F.2d 797 (2d Cir. 1943); *King v. Sharp*, 63 F.R.D. 60, 63 (N.D. Tex. 1974) ("If the bankrupt estate has no cause of action in its own right, then the trustee has no authority to institute suits as a class representative or otherwise for the benefit of third parties."); *Warheit v. Osten*, 57 F.R.D. 629 (E.D. Mich. 1973); cf. *In re Washington Group, Inc.* 476 F. Supp. 246, 251 (M.D.N.C. 1979), *aff'd* without opinion, 636 F.2d 1213 (4th Cir. 1980) (trustee lacks "broad license either to sue on behalf of or provide financial assistance to third parties with claims against the estate").

[FN232]. 891 F.2d 128 (6th Cir. 1989).

[FN233]. *Id.* at 131 (noting that Congress rejected "§ 544(c) of H.R. 8200 which would have over-ruled Caplin") (citing 124 Cong. Rec. H11,097 (Sept. 28, 1978)).

[FN234]. *Id.*

[FN235]. *Id.* See also *William v. California First Bank*, 859 F.2d 664 (9th Cir. 1988) (holding that a trustee cannot represent the interests of the creditors even where the creditors have assigned their interest to the trustee).

[FN236]. *Id.*

[FN237]. 11 U.S.C. § 1102 (1999).

[FN238]. 11 U.S.C. § 1103 (1999).

[FN239]. 11 U.S.C. § 1102(a) (emphasis added).

[FN240]. H.R. Rep. No. 95-595, at 401 (1977).

[FN241]. 11 U.S.C. § 1102(a)(2).

[FN242]. H.R. Rep. No. 95-595, at 401 (1977).

[FN243]. *Id.* The Section's legislative history provides: "This section defines the powers and duties of a committee elected or appointed under Section 1102." S. Rep. No. 95-989, at 114 (1977).

[FN244]. 11 U.S.C. § 1103. See generally, Blain & O'Gawa, *Creditors Committees Under Chapter 11 of the United States Bankruptcy Code: Creation, Powers and Duties*, 73 Marq. L. Rev. 581 (1992); *Operation of Creditors' Committees in Reorganization Cases Under Chapter 11 of the Bankruptcy Code: A Survey of Theory and Practice*, 1982 Am. Surv. Bankr. L. 339 (1982); DeNatale, *The Creditors Committee Under the Bankruptcy Code: A Primer*, 55 Am. Bankr. L.J. 43 (1981).

[FN245]. H.R. Rep. No. 95-595, at 402 (1977).

[FN246]. 11 U.S.C. § 1103(a)(5).

[FN247]. See *infra* Part IV.B.1. (discussing Section 541 and definition of "property of the estate").

[FN248]. 25 F.3d 1281 (5th Cir. 1994).

[FN249]. *Id.* at 1284. See also *Larson v. Groos Bank*, 204 B.R. 500, 502 (Bankr. W.D. Tex. 1996) ("When a cause of action is property of the estate, the bankruptcy trustee [or debtor-in-possession] has 'exclusive standing' to assert the claim.").

The principle that, subject to court orders to the contrary, causes of action are subject to the control of the trustee only, as discussed *supra* Part V.A., is paralleled by similar case law holding that, absent court approval: 1) creditors and other non-parties may not intervene in an action commenced by the trustee or debtor-in-possession, 2) non-parties to a settlement do not have standing to appeal settlements entered into by the trustee or debtor-in-possession which have been approved by the court, and 3) only the trustee or debtor-in-possession may object to proofs of claim. See generally, *Kowal v. Malkemus (In re Thompson)*, 965 F.2d 1136 (1st Cir. 1992), and discussion of supporting case-law therein. Cf. *Jones v. Harrell*, 858 F.2d 667 (11th Cir. 1988) (holding that the debtor was without authority to settle and release a personal injury claim postpetition because the bankruptcy trustee had succeeded to the debtor's cause of action at the time of the bankruptcy filing; control over the disputed claim was thus in the trustee, not the debtor).

[FN250]. *Fischer, Hecht & Fisher v. D.H. Overmeyer Telecasting Co. (In re D.H. Overmeyer Telecasting Co., Inc.)*, 56 B.R. 657, 661 (Bankr. N.D. Ohio 1986) ("It is long settled that a trustee in bankruptcy, like a receiver in equity, occupies no better position than the entity he represents, and can only assert claims which the corporation could have asserted."). See also *supra* Part V.A. (discussing trustee's lack of authority to sue on behalf of creditors).

[FN251]. See *supra* Part V.C.

[FN252]. 858 F.2d 233 (5th Cir. 1988).

[FN253]. *Id.* at 247. Similarly, in *Unsecured Creditors Comm. v. Noyes (In re STN Enters.)*, 779 F.2d 901 (2d Cir. 1985), the Second Circuit held:

Most bankruptcy courts that have considered the question have found an implied, but qualified, right for creditors' committees to initiate adversary proceedings in the name of the debtor in possession under 11 U.S.C. §§ 1103(c)(5) and 1109(b).... We agree with these bankruptcy courts that 11 U.S.C. §§ 1103(c)(5) and 1109(b) imply a qualified

right for creditors' committees to initiate suit with the approval of the bankruptcy court. Id. at 904. See also *Chalk Line Mfg., Inc. v. Frontenac Venture V Ltd.* (In re *Chalk Line Mfg.*), 184 B.R. 828, 832- 33 (Bankr. N.D. Ala. 1995) ("A creditor's committee may, in an appropriate case, institute an adversary proceeding against third parties on behalf of the bankruptcy estate or the debtor-in-possession.") (citations omitted); *In re First Capital Holdings Corp.*, 146 B.R. 7, 10, 11 (Bankr. C.D. Ca. 1992) ("In appropriate circumstances a committee of unsecured creditors may be authorized to bring [] an action instead of a debtor in a chapter 11 case.... The Bankruptcy Code contains no explicit authority for a creditors' committee to initiate adversary proceedings. Case law establishes an implied right under § 1103(c)(5) for a committee to bring such an action in appropriate circumstances.") (citations omitted).

[FN254]. Id. (citations omitted) (emphasis added). Analogizing to the corporate law context in which demand before instituting a shareholder derivative action is excused when such a demand would be futile, the court in *In re First Capital Holdings Corp.*, 146 B.R. 7 (Bankr. C.D. Ca. 1992), held that, "a creditor's committee may be excused from making demand upon a debtor to pursue a cause of action on behalf of the estate where such a demand is futile." Id. at 13. However, excuse of the demand requirement does not negate the need to obtain court approval before instigating litigation. In *First Capital*, for instance, the court, finding that the demand would have been futile, excused the committee's non-compliance with the requirement, and then proceeded to authorize the committee, pursuant to its request, "to prosecute this action on behalf of the debtor." Id.

[FN255]. *Louisiana World Exposition*, 858 F.2d at 252 (emphasis added). See also *In re Chalk Line Manuf., Inc.*, 184 B.R. 828 (Bankr. N.D. Ala. 1995); see generally, Snider, "The Chapter 11 Creditor Committee Right to Institute Suit," 2 J. Bankr. L. & Prac. 779 (1992).

Similarly, with respect to an individual creditor pursuing rights of action which belong to the bankruptcy estate, courts have held that "extraordinary circumstances must be present before the court will allow them standing to bring these types of suits." *Spring Serv. Texas, Inc. v. McConnell* (In re *McConnell*), 122 B.R. 41, 44 (Bankr. S.D. Tex. 1989). In *In re McConnell*, the court set forth the very specific circumstances, albeit strikingly similar to those required before a committee may pursue a debtor's right of action, under which an individual creditor may have standing to pursue a right of action belonging to the bankruptcy estate.

The conditions necessary for the right to pursue a right of action include the following: "(1) that the claim be colorable; (2) that the intervention must be brought on behalf of the estate; and (3) that the trustee or debtor-in-possession has unjustifiably refused to bring the suit or abused its discretion in not suing." Id.

[FN256]. *First Capital*, 146 B.R. at 7.

[FN257]. Id.

[FN258]. See *supra* note 245 and accompanying text.

[FN259]. 109 F.3d 219 (5th Cir. 1997).

[FN260]. Id. at 224 (citing, in part, Andrews, "The Chapter 11 Creditors' Committee: Statutory Watchdog?," 2 *Bankr. Dev. J.* 247 (1985)) (other citations omitted).

[FN261]. 607 F.2d 258 (2d Cir. 1979).

[FN262]. Id. at 262 (citations omitted); see also *Official Comm. v. American Sav. & Loan Ass'n* (In re *General Homes Corp.*), 181 B.R. 870, 882 (Bankr. S.D. Tex. 1994) ("The fiduciary duty that exists between the members of the Unsecured Creditors' Committee and the other unsecured creditors includes the duty to act in good faith and to insure to the greatest extent possible its actions are based on 'accurate and correct' information. The Committee's counsel, as well, has of course a fiduciary relation to all unsecured creditors, not just Committee members.").

Importantly, the court in *SPM Mfg.*, 984 F.2d 1305, 1317 (1st Cir. 1993), noted that, "[i]f the unsecured creditors' committee fails to be properly representative of the unsecured creditors, any party in interest can move to have the committee reconstituted." (citations omitted).

[FN263]. 984 F.2d 1305 (1st Cir. 1993).

[FN264]. Id. at 1315 (emphasis added).

[FN265]. As noted by the court in *SPM Mfg. Corp.*:

The duty of the unsecured creditors' committee to pursue the best interests of the unsecured creditors requires different outcomes in different situations, and may entail entering contracts regarding reorganization plans, recommending rejection of a debtor's plan of reorganization, or filing motions to convert a Chapter 11 case to Chapter 7.

Id. at 1318.

[FN266]. *Creditors' Comm. v. Kitty Fan Koo (In re Donlevy's, Inc.)*, 111 B.R. 1, 2 (Bankr. D. Mass. 1990).

[FN267]. *Collier's*, *supra* note 6 at P 1103.5[1][d][I] (emphasis added).

[FN268]. 181 B.R. 887 (Bankr. S.D. Tex. 1995).

[FN269]. *Id.* at 894 (emphasis added).

[FN270]. *Id.*

[FN271]. Tex. R. Civ. P. 11. See also Ariz. Rev. Stat. Rule 801(d) ("No agreement or consent between parties or attorneys in any matter is binding if disputed, unless it is in writing, or made orally in open court, and entered in the minutes."); Ala. R. Ct. Rule 47 ("No private agreement or consent between the parties or their attorneys, relating to the proceedings in any cause, shall be alleged or suggested by either against the other, unless the same be in writing, and signed by the party to be bound thereby; provided, however, agreements made in open court or at pretrial conferences are binding, whether such agreements are oral or written.").

[FN272]. 60 F.3d 230 (5th Cir. 1995).

[FN273]. *Id.* at 232. See also *Holder v. Gerant Indus., Inc. (In re Omni Video, Inc.)*, 165 B.R. 22, 25 (Bankr. N.D. Tex. 1994) ("This matter [[involving a settlement agreement] is governed by Rule 11 of the Texas Rules of Civil Procedure Federal courts sitting in Texas are obligated to follow that rule.") (citations omitted).

[FN274]. 221 B.R. 386, 388 (Bankr. W.D. Tex. 1998).

[FN275]. *Id.* at 388, 389.

[FN276]. See *supra* note 9.