POST-CONFIRMATION LITIGATION AND LIQUIDATION TRUSTS: CONSIDERATION OF CERTAIN REQUIRED PLAN PROVISIONS AND TAX IMPLICATIONS

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Post-confirmation liquidation and litigation trusts[2] are popular tools for resolving certain claims and interests in a Chapter 11 estate and enabling a debtor to emerge from bankruptcy sooner than would be possible without the use of such a trust. As discussed in this outline, the use of such a trust requires a well-drafted reorganization plan and corresponding trust agreement that properly identify the claims and interests being retained and deposited into the trust. An understanding of the potential tax implications involved in administering a growing litigation trust also is essential in analyzing its ultimate utility and impact on beneficiaries. The jurisdictional issues that arise in connection with post-confirmation litigation and liquidation trusts are beyond the scope of this outline and are addressed elsewhere in the materials.[3]

Trust Claims and Interests

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[2] The terms liquidation and litigation trusts sometimes are used interchangeably in this outline. A liquidation trust typically is established to liquidate assets, especially tangible assets, currently held by the debtor. Outside of the bankruptcy context, distribution to creditors from a liquidation trust would be made on a first-come, first-served basis. The *res* of a litigation trust, on the other hand, typically consists of claims of the debtor or its estate against third parties, the value of which is contingent upon the success of the prosecution of such claims, and also may include cash to fund the prosecution of such claims. In the bankruptcy context, similarly situated creditors receive equal treatment under a plan and receive a *pro rata* distribution from the trust assets. For more information on the difference between liquidation and litigation trusts, see the "Tax Implications" and subsequent sections of this outline.

[3] *See* "The Scope of Post-Confirmation Bankruptcy Court Jurisdiction" by David R. Hurst, Laurie A. Krepto and Simon E. Fraser, included within the ABI's materials.

Unless the reorganization plan provides otherwise, upon confirmation, all property of the estate vests in the reorganized debtor. 11 U.S.C. § 1141(b). Claims and interests may be retained and enforced under the plan "by the debtor, by the trustee or by a *representative of the estate* appointed for such purpose. . . ." 11 U.S.C. § 1123(b)(3)(B) (emphasis added). Section 1123(b)(3)(B) raises two issues that are integral to the creation of post-confirmation liquidation and litigation trusts and must be addressed in the plan of reorganization. To establish standing to prosecute claims and interests post-confirmation, a plan must describe the claims and interests being retained and identify the party who will act as the estate's representative in pursuing them. The courts differ on the degree of specificity needed in identifying the claims and interests being retained. Additionally, the plan must provide that the retained claims and interests will be prosecuted by a representative of the estate. Failure to identify claims and interests and provide for the appointment of a representative of the estate to pursue such claims and interests can open the door to legal challenges and limit the efficacy of the trust.

The paramount utility of a trust is that it supports the Bankruptcy Code's intent to hasten a debtor's reorganization. *In re Acequia, Inc.*, 34 F.3d 800 (9th Cir. 1994) ("[The] aim [of section 1123(b)(3)(B)] was to make possible the formulation and consummation of a plan before completion of the investigation and prosecution of causes of action such as those for previous insider misconduct and mismanagement of the debtor. Thus, the statute was in furtherance of the purpose of preserving all assets of the estate while facilitating confirmation of a plan")(quoting *Duvoisin v. East Tenn. Equity, Ltd.* (*In re Southern Indus. Banking Corp.*), 59 B.R. 638 (Bankr. E.D. Tenn. 1986). The analysis of meritorious claims belonging to the debtor and the bankruptcy estate and the disposition of those claims can take years to resolve. Creating a trust into which retained claims or interests have been deposited enables the bankruptcy case to be closed sooner, thus conserving costs, among other benefits. *See, e.g.*, 28 U.S.C. § 1930(a)(6) (quarterly fees payable to the United States Trustee cease when the case is converted or dismissed). Only those claims properly belonging to the debtor's estate may be retained and enforced by a litigation or liquidation trust. 7 *Collier on Bankruptcy* ¶ 1123.02[3][a] (Alan N. Resnick & Henry J. Sommer eds. 15th ed. rev.) ("Section 1123(b)(3) provides statutory authority for the settlement, pursuant to the plan, of any action filed or which could have been filed in respect of a claim that constitutes 'property of the estate' or 'property of the debtor.'"). Thus, the confirmed plan can retain only those claims that could have been asserted by a trustee or debtor prior to confirmation.

<u>Reservation of Claims and Interests</u>

The retention of claims in a plan of reorganization satisfies the notice requirements to creditors of the debtor's intent to enforce such causes of action. Accordingly, the plan of reorganization and the associated trust agreement must identify the claims and interests that are being retained after confirmation of a plan. *Harstad v. First Am. Bank*, 39 F.3d. 898 (8th Cir. 1994) ("[C]reditors are entitled to know if the debtors intend to pursue the preferences in post-confirmation actions . . . and to have the mechanics of preference-sharing spelled out in the plan").

Some courts have held that a specific reservation of claims is required under the Bankruptcy Code, while others have permitted a more general reservation to pursue claims. For example, in *D&K Props. Crystal Lake v. Mut. Life Ins. Co. of N.Y.*, 112 F.3d 257 (7th Cir. 1997), the court determined that a blanket reservation of claims would not suffice. In that case, D&K Properties Crystal Lake ("D&K") sued Mutual Life Insurance Company of New York ("MLIC") for breach of contract after MLIC increased the rate of interest and accelerated a loan made to

D&K. Soon thereafter, D&K filed for Chapter 11 protection. During the course of the Chapter 11 case, MLIC proposed a competing, liquidating plan to D&K's plan, which provided that " . . . the Disbursing Agent, on behalf of the Debtor and the Estate, shall enforce all causes of action existing in favor of the Debtor and Debtor in Possession." The Bankruptcy Court for the Northern District of Illinois confirmed MLIC's plan over the objections of D&K. After the plan was confirmed, D&K filed another complaint for breach of contact against MLIC in state court, which was removed to the federal district court. MLIC moved to dismiss the complaint on the ground that D&K's claim was barred by the doctrine of *res judicata*. The district court found in favor of MLIC and dismissed the complaint. D&K appealed, claiming that the confirmed plan expressly reserved its claim against MLIC under a clause that reserved "all causes of action existing in favor of the Debtor." Affirming the decision of the district court, the United States Court of Appeals for the Seventh Circuit, rejected the blanket reservation of claims in MLIC's plan as sufficient:

> The identification must not only be express, but also the claim must be specific. A blanket reservation that seeks to reserve all causes of action reserves nothing. To hold otherwise would eviscerate the finality of a bankruptcy plan containing such a reservation, a result at odds with the very purpose of a confirmed bankruptcy plan.

See also 7 *Collier on Bankruptcy* ¶ 1123.02[3][b] (Alan N. Resnick & Henry J. Sommer eds. 15th ed. rev.) (citing *Browning v. Levy*, 283 F.3d 761 (6th Cir. 2002) (because the reservation neither named the proposed defendant nor the factual basis for the reserved claim, blanket reservation was of little value)).

A less restrictive view was taken in *In re I. Appel Corp.*, 300 B.R. 564 (S.D.N.Y. 2003). In that case, the debtor, I. Appel Corp. ("IAC"), had confirmed a plan of reorganization in November, 1999. Earlier that year, the debtor's sole shareholder, as assignee of the debtor, brought claims against a former officer of the debtor alleging conversion and misappropriation. Before the Chapter 11 case was closed, the debtor initiated an arbitration proceeding against the former 50% shareholder of the debtor for amounts allegedly due under a stock purchase agreement. Several years later, the sole shareholder, as assignee of the debtor, commenced another action against the former 50% shareholder and the former officer (father and son) for misappropriation of assets of the debtor. IAC's bankruptcy schedules had included claims against certain other parties, but did not include as assets any of the claims against the former shareholder and officer. The defendants moved to dismiss the claims against them on the ground that the claims had not been scheduled by the debtor. Meanwhile, as respondent in the arbitration, the former shareholder was successful in having the arbitration stricken on that basis, arguing that the debtor lacked standing because the claim was not included in its schedule of assets filed in the bankruptcy case. IAC then moved to reopen its Chapter 11 case in order to amend its schedules to specifically include those claims, and the court granted the motion to reopen the case. On appeal from that ruling, the district court acknowledged that "confirmation of a plan of reorganization prevents the subsequent assertion of any claim not preserved in the plan as required by § 1123(b)(3)." *Id.*, 300 B.R. at 567. The debtor argued, however, that its plan preserved the right to assert the claims and "retain[ed] all rights to any claims or causes of action which I. Appel and/or its creditors held as of the Petition Date or which arose or could arise during the Bankruptcy Case, whether pursuant to the recovery provisions of Sections 542 through 554 of the Bankruptcy Code or under applicable federal or state law, except under Section 547 of the Bankruptcy Code." *Id.* Moreover, the debtor's disclosure statement discussed that special counsel had been investigating acts and omissions of the former shareholder, and the results of that investigation might give rise to claims against the former shareholder and his son. *Id.* at 567-68. The defendants countered that the general reservation of claims in the plan was insufficient to preclude the *res judicata* effect of the confirmation order.

The district court disagreed with the cases relied upon by the defendants taking the more restrictive approach, concluding:

> It is neither reasonable nor practical to expect a debtor to identify in its plan of reorganization or disclosure schedules every outstanding claim it intends to pursue with the degree of specificity that the Katzes [defendants] would require. As other courts reaching this conclusion have noted, mandating a specific description of every claim the debtor intends to pursue could entail months or years of investigation and a corresponding delay in the confirmation of the plan of reorganization.

300 B.R. at 569. *See also* 7 *Collier on Bankruptcy* ¶ 1123.02[3][b] (Alan N. Resnick & Henry J. Sommer eds. 15th ed. rev.) (citing *Cohen v. Tic Fin. Sys.* (*In re Ampace Corp.*), 279 B.R. 145 (Bankr. D. Del. 2002) ("a general reservation in a plan of reorganization indicating the type or category of claims to be preserved should be sufficiently specific to provide creditors with notice that their claims may be challenged post-confirmation")).

To maintain standing to prosecute claims post-confirmation and avoid the preclusive effect of *res judicata* resulting from a confirmation order, the claims retention provision in a plan must balance the specificity required under applicable case law while maintaining some flexibility to bring meritorious claims that may not have been fully investigated pre-confirmation.

<u>Representative of the Estate</u>

The party acting as the representative of the estate must generally meet two requirements to have standing to enforce causes of action. A "party other than the debtor or trustee that seeks to enforce claim must show (1) that is has been appointed; and (2) that it is the representative of the estate." *Bankruptcy Service*, L. Ed. § 44:224. The representative of the estate must be approved by the court and "may not be accomplished by unilateral declaration of the debtor in possession." *In re Sweetwater*, 884 F.2d 1323 (10th Cir. 1989). The requirement that a party has been appointed is easily met if the confirmed plan provides for the appointment of a representative to enforce retained claims. Id. The additional requirement that the party enforcing the claim be a representative of the estate requires greater analysis by the court.

In order to qualify as a "representative of the estate," the court must find that the claims pursued and any successful recovery by the representative is intended to benefit the estate and, generally, unsecured creditors of the estate.[4] Similarly, the courts have found that the "representative of the estate" pursuing avoidance actions must uphold the fundamental principle that all similarly situated creditors be treated equally. *Sweetwater*, 884 F.2d at 1328. In *In re Mako, Inc.*, 985 F.2d 1052 (10th Cir. 1993), under the confirmed plan proposed by a third party, Retail Marketing Company ("RMC"), the debtor's assets were sold to RMC, which also assumed the debtor's priority and secured debt. The confirmed plan established a liquidating trust into which the assets of the debtor would be transferred to RMC. The confirmed plan also identified a litigation trustee to pursue certain claims for the benefit of unsecured creditors. A separate provision of the confirmed plan purported to appoint RMC as the representative of the estate with the following powers:

> [C]onfirmation of the plan will result in the assumption by RMC of all the debtor's rights in pending litigation constituting contested matters or adversary proceedings in this case, and all pending appeals to which debtor or the liquidating trustee is or was a party

[4] While few estates have sufficient assets to satisfy creditor claims in full, and thus following the priority scheme set forth in the Bankruptcy Code, *see* 11 U.S.C. § 1129(a) and (b), most litigation or liquidation trusts are established to benefit general unsecured creditors, such trusts may be established to benefit other constituents of a Chapter 11 estate, such as holders of administrative expense claims, *see In re Mako, Inc.*, 985 F.2d 1052, 1056 10th Cir. 1993) (citing *Sweetwater*, 884 F.2d at 1327), and equity security holders. *See NCP Litigation Trust v. KPMG LLP*, 187 N.J. 353 (2006).

> on the effective date. . .together with the right to prosecute or defend any other such litigation which the debtor or liquidating trustee may have brought on or before the effective date. Without limiting the generality of the foregoing, RMC shall be entitled to prosecute all objections to claims which may exist on the effective date, or any others to which RMC may object in accordance with the plan, and may appear as the real party in interest in any pending or later instituted contested matter or adversary proceeding filed herein.

In re Mako, 985 F.2d at 1054-1055.

The confirmed plan obligated RMC to pay all administrative claims of the estate, but the amount necessary to satisfy those claims exceeded RMC's expectations by approximately $1 million. To recoup that excess payout, RMC commenced certain avoidance actions. Various defendants filed motions for summary judgment on the ground that RMC was not a "representative of the estate" within the meaning of Section 1123(b)(3) of the Bankruptcy Code. The Tenth Circuit affirmed the district court's determination that RMC did not have authority to pursue the avoidance actions. The appellate court held that "there must be clear evidence of the reservation of the avoidance powers," *id*. at 1055, and absent such clear evidence there is a "presumption against reservation of avoidance powers." *Id*. at 1056. It found that the language in the plan purporting to give RMC that authority was not clear but instead vague. It was also inconsistent with the rights of a Litigation Trustee identified in the plan who would act for the benefit of unsecured creditors, while RMD was acting for its own benefit. The Tenth Circuit found that RMC, in pursuing the avoidance actions, was under no obligation to distribute any proceeds recovered to unsecured creditors and failing that requirement, did not qualify as a representative of the estate.

Railworks Corporation ("RC") and its affiliates filed voluntary bankruptcy petitions for relief under Chapter 11. RC's Second Amended Joint Plan of Reorganization, which created a litigation trust to pursue certain avoidance actions post-confirmation, was confirmed by the court. The litigation trustee commenced actions against various defendants to recover fraudulent transfers. In response, certain defendants filed motions to dismiss the complaints arguing that (i) the litigation trustee did not have standing to bring fraudulent conveyance claims; (ii) the court could not authorize the litigation trustee to assert these claims under its equitable authority; and (iii) prosecution of the claims was not allowed under Section 1123(b)(3) of the Bankruptcy Code. The court denied the defendants' motions to dismiss and determined that the plan retained the avoidance claims; the litigation trustee was appointed in accordance with the litigation trust created pursuant to the plan; the litigation trustee was a representative of the estate and was prosecuting the claims for the benefit of unsecured creditors; and that the claims belonged to the estate under Section 1123(b)(3)(A). *In re Railworks Corp.*, 325 B.R. 709 (Bankr. D. Md. 2005). In determining that the avoidance actions "belonged" to the estate, the court reasoned that while avoidance claims do not fall within the definition of property of the bankruptcy estate under Section 541(a) of the Bankruptcy Code, they are rights given to the trustee or debtor in possession. Moreover, the property recovered through these actions becomes property of the estate. 11 U.S.C. §§ 541(a)(3) and (a)(7). Section 1123(b)(3)(A) provides that a plan may "provide for the settlement or adjustment of any claim or interest belonging to the debtor or to the estate," which is a less specific term than "property of the estate." The court ruled that a claim may belong to the estate under Section 1123(b)(3)(A), even if it is not property of the estate.

The Maryland bankruptcy court also addressed the defendant's claim that only a bankruptcy trustee can pursue avoidance actions, as the Supreme Court had held in *Hartford Underwriters Ins. Co. v. Union Planters Bank, N.A.*, 530 U.S. 1 (2000). In *Hartford* the

Supreme Court found that Congress "says in a statute what it means and means what it says," and this premise applies when the Bankruptcy Code indicates that a specific person is the only one authorized to seek direct relief. The Maryland bankruptcy court found that the litigation trustee possessed the same standing as the trustee has during the existence of the estate under Section 1123(b)(3)(B). *See Railworks*, 325 B.R. at 719 ("clarification of the types of claims that can be preserved, i.e. those belonging to the estate or those that belong to the debtor, is a reflection and acknowledgement of all claims that a trustee may bring as they exist during the bankruptcy case"). Ultimately, the bankruptcy court found that the litigation trustee was seeking a direct right to relief based on specific authority granted under Section 1123 of the Bankruptcy Code.

Tax Implications

Aside from properly designing the provisions of the plan of reorganization related to the retention of claims and appointment of a representative of the estate, the creation of post-confirmation trusts requires an understanding of pertinent federal and state income tax law. While any analysis of tax liability and obligations must be specific to a particular trust agreement, following are certain general tax issues that should be considered in the creation of any post-confirmation litigation or liquidation trust. This overview looks specifically at a liquidation trust, even though much of the reasoning may be applied to litigation trusts as well.

Characterization as a Liquidating Trust

Treas. Reg. §301.7702-4(d) states in relevant part as follows:

> An organization will be considered a liquidating trust if it is organized for the primary purpose of liquidating and distributing the assets transferred to it, and if its activities are all reasonably necessary to, and consistent with, the accomplishment of that purpose. A liquidating trust is treated as a trust for purposes of the Internal Revenue Code because it is formed with the objective of

> liquidating particular assets and not as an organization having as its purpose the carrying on of a profit-making business which normally would be conducted through business organizations classified as corporations or partnerships. However, if the liquidation is unreasonably prolonged or if the liquidation purpose becomes so obscured by business activities that the declared purpose of liquidation can be said to be lost or abandoned, the status of the organization will no longer be that of a liquidating trust.

A liquidating trust is normally treated as a grantor trust for the benefit of the beneficiaries of that trust. Revenue Procedure 94-45, 1994-2 C.B. 684, sets forth guidelines for taxpayers to obtain a private letter ruling that a trust created pursuant to a bankruptcy plan of reorganization in a Chapter 11 case will be treated as a liquidating trust. Rev. Proc. 94-45 states that a transfer to a liquidating trust for the benefit of creditors must be treated for all purposes of the IRC as a transfer to the creditors. In other words, the transfer is treated as a deemed transfer to the beneficiary-creditors followed by a deemed transfer by those creditors to the trust.

Under IRC Section 671, when it is specified in Subpart E (*e.g.* IRC Sections 677 and 673) that the grantor shall be treated as the owner of any portion of a trust, "there shall then be included in computing the taxable income and credits of the grantor . . . those items of income, deductions or credits . . . which are attributable to that portion of the trust."

The fact that the grantor trust rules apply to an escrow account or trust formed for commercial purposes is supported by case law. *See Rameau A. Johnson v. Commissioner*, 108 T.C. 448 (1997) (court applied the grantor trust rules to hold that investment income earned by an escrow account was taxable to certain sponsoring motor vehicle dealerships when escrow income was used to discharge dealerships' warranty obligations).

Under IRC Section 677, a grantor is to be treated as the owner of any portion of a trust whose income (without the approval or consent of any adverse party) may be distributed to the grantor or held or accumulated for future distribution to the grantor. Treas. Reg. §1.677(a)-1(d) is more specific and states in relevant part:

> (d) *Discharge of legal obligation of grantor or his spouse.* Under Section 677 a grantor is, in general, treated as the owner of a portion of a trust whose income is, or in the discretion of the grantor or a nonadverse party, or both, may be applied in discharge of a legal obligation of the grantor.

Under IRC Section 673(a), a grantor is treated as the owner of any portion of a trust in which it has a reversionary interest in either the corpus or the income therefrom, if the value of such interest exceeds five percent (5%) of the value of such portion of the trust. Similarly, under Treas. Reg. §1.673(a)-1(d), "[i]t is immaterial that a reversionary interest in corpus or income is subject to a contingency if the reversionary interest may, taking the contingency into consideration, reasonably be expected to take effect in possession or enjoyment within ten years."

The potential application of these statutory rules to trump the desired tax treatment of liquidating trusts would swallow up the entire tax concept of a liquidating trust if the debtor was treated as the beneficiary of the liquidating or litigation trust. The requirement of Rev. Proc. 94-45 that the initial transfer to the liquidating trust be treated by all of the parties as a transfer to the creditors for all federal income tax purposes is the Service's way of isolating liquidating trusts from IRC Sections 671, 677, and 673.

Rev. Proc. 94-45 lists a number of features that a trust must possess in order for it to qualify as a liquidating trust for federal income tax purposes. Thus, any trust agreement should contain requirements such as the following:

1. The trust must be established for the primary purpose of liquidating the assets transferred to it with no objective to continue or engage in the conduct of a trade or business.

2. The transfer of assets to the trust must be treated by all parties as a transfer of the assets to the creditors.

3. The beneficiaries must be treated as the grantors and deemed owners of the assets of the trust for federal income tax purposes.

4. Consistent valuations of the transferred assets must be used by the trustee and the creditors for all federal income tax purposes.

5. All of the trust's income must be treated as subject to tax on a current basis, and the ruling request must explain, in accordance with the plan, how the trust's taxable income will be allocated and who will be responsible for the payment of any income tax due.

6. The Trust instrument must contain a fixed or determinable termination date that is generally not more than 5 years from its date of creation.

Rev. Proc. 94-95 lists other procedural requirements, which should be met by the terms of a trust agreement. Note that requirement No. 5 listed above requires that the trustee determine how taxable income will be allocated among the beneficiaries of the Trust.

As long as a trust agreement and the related facts comport with the requirements of Rev. Proc. 94-45, a trust should qualify as a liquidating trust, with its income taxable to the trust beneficiaries (generally the unsecured creditors) as the deemed grantors of the trust. Of course, consistent with a characterization as a grantor trust for the benefit of the beneficiaries, the initial transfers to the trust are taxable events to the beneficiaries (again, probably the unsecured creditors), with the actual tax implications dependent on the beneficiaries' tax basis in their claims and the origin of those claims (e.g., trade receivables versus tort claimants).

Even though a debtor may at times be required to issue Form 1099 to beneficiaries (i.e., unsecured creditors) with respect to transfers to the trust, if the income is not fixed and determinable, such up front reporting obligation would not apply. *See* Treas. Reg. §1.6041-1(c). Consistent with this, backup withholding would not apply to the transfers either. *See* Treas. Reg. §31.3406(b)(3)-1(a). To be protected against penalties for failing to backup withholding, however, the debtor should retain or obtain the beneficiaries' taxpayer identification numbers. Treas. Reg. §31.3406(a)-1.

Consistent with requirement No. 5 above, the trustee must develop a rational and consistent method of allocating trust income among the beneficiaries each year. The trustee will be required to file an IRS Form 1041 reporting any income and deductions for the trust, and include schedules reporting each beneficiary's pro rata share of the income and deductions. An experienced tax accountant should be engaged early on to address how these filing obligations will be fulfilled.

Risk of Treatment as a Taxable Trust

Despite the above discussion of liquidating trusts, the Service has issued a few rulings in which it has treated funds nominally set up as liquidating trusts as taxable IRC Section 641 trusts, rather than as grantor trusts, where the powers of the trustee were greater than the normal powers of a liquidating trustee. In Priv. Ltr. Rul. 8524052 (March 19, 1985), a Chapter 11 debtor corporation deposited money into a fund held by a disbursing agent for creditors. The Service ruled that the powers (1) to increase the fund by avoiding transfers of the debtors' property that were voidable under the Bankruptcy Code, and (ii) to increase the fund by pursuing causes of action of the debtors for money claims and for liability of officers and directors, permitted the fund to be increased and were designed to make the fund productive, so as to require the Service to rule that the fund was a taxable trust under Code Section 641.

Similarly, in Priv. Ltr. Rul. 8848019 (August 31, 1988), a fund was established for the benefit of unsecured creditors. The fiduciary of the fund was authorized to prosecute any cause of action arising under Chapters 3 and 5 of the Bankruptcy Code. The fiduciary of the fund had the power to invest and reinvest its assets in cash equivalents. In part because of these powers, the Service ruled that the fund was a taxable Section 641 trust.

These rulings indicate the importance for the trustee of liquidating trusts to possess relatively limited powers. Note, however, that these rulings predate Revenue Procedure 94-45.

Regardless, with the advent of the check-the-box entity-classification regulations of Treas. Reg. §301.7701-3 in 1997, an entity formed since then with too much power to be treated as a liquidating trust, should arguably, in the worst case, be taxed as a partnership (unless it makes an unlikely election to be taxed as a corporation). Henderson & Goldring, *Failing and Failed Businesses* §903 (1999). If there is any fear that a trustee of a particular liquidating or litigation trust may possess significant powers to increase the corpus of a trust, it may be wise to specify in the trust agreement that the trustee has the power to file income tax returns as a partnership rather than as a trust. A thorough analysis of the implications of filing income tax returns as a partnership needs to be undertaken first, with some consideration of state income tax implications (because some states, such as New Jersey, impose a per partner "fee" on a partnership).

Conclusion

Litigation and liquidating trusts are valuable tools and their use is consistent with the Bankruptcy Code's intent to foster the debtor's quick and equitable reorganization. Yet, in order to be effective, the creation of a trust requires that the plan of reorganization comply with the requirements of Section 1123(b)(3)(B) of the Bankruptcy Code and clearly identify the claims and interests initially belonging to the bankruptcy estate that will be transferred to and retained by the trust and provide for the appointment of a party to act as a representative of the estate to prosecute those causes of action for the benefit of the estate in general, and typically unsecured creditors in particular. In addition, the creation of a post-confirmation trust requires an understanding of various issues related to the tax obligations and potential liabilities of the trust.

Accompanying this outline is a form of Litigation Trust Agreement. In furnishing this form agreement, we emphasize that it is purely a form that must be tailored to the facts and circumstances presented by the particular case at hand. It is not intended to be, and should not be relied upon as a complete document that would satisfy the requirements under the Bankruptcy Code, Internal Revenue Code, federal or state securities laws or other applicable law. We specifically do not make any representation, warranty or prediction of results with respect to the terms of the form agreement, which represents only one of many possible trust scenarios and should not be viewed as the most likely or standard scenario.