



## MEMORANDUM OPINION

Before the Court is plaintiffs' motion asking the Court to either remand or abstain from hearing this adversary proceeding. The plaintiffs are CBI Eastchase, L.P. ("CBI") and Stephen Flory ("Flory") (collectively, the "Plaintiffs"). The Plaintiffs are investors in e2 Communications, Inc. ("e2" or the "Debtor").

The defendants are Jeffrey Farris ("Farris"), Jeff Cordes ("Cordes"), James Browne ("Browne"), Ian Bonner ("Bonner"), and Lehman Brothers, Inc. ("Lehman Brothers") (collectively, the "Defendants"). Farris and Cordes were shareholders, officers, and directors of the Debtor. Browne was an employee of Lehman Brothers and a shareholder and advisory director of the Debtor. Bonner was a shareholder and either an advisory director or director of the Debtor.

The intervenors are the e2 Litigation Trust (the "Litigation Trust") and the e2 Creditors Trust (the "Creditors' Trust") (collectively, the "Trusts"), acting through their trustee, Steven Metzger. The Trusts were created under the Third Amended Joint Plan of Reorganization for e2 (the "Plan"), which was confirmed by Order of this Court entered on February 10, 2003. In simplified terms, title to the Debtor's assets was transferred under the Plan to either the Creditors' Trust or the Litigation Trust for the benefit of creditors and Participating Investors.<sup>1</sup> Transferred assets included Causes of Action.

### **I. Background**

On November 10, 2003, the Plaintiffs filed suit against the Defendants in the 342<sup>nd</sup> Judicial District Court in Tarrant County, Texas (the "State Court Action"). In the Third Amended Petition

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<sup>1</sup>Capitalized terms used in this Memorandum Opinion that are not defined herein shall have the meaning ascribed to them in the Plan.

filed in the State Court Action (the “Petition”), the Plaintiffs allege four causes of action against the Defendants: (i) statutory fraud under section 27.01 of the Texas Business & Commerce Code; (ii) common law fraud; (iii) negligent misrepresentation; and (iv) violation of Article 581-33 of the Texas Securities Act. The Defendants have all answered in the State Court Action, substantial discovery has been undertaken, and the State Court Action was set for trial in mid-April 2005.<sup>2</sup>

On February 16, 2005, the Trusts intervened in the State Court Action and then removed the State Court Action to this Court. In their Notice of Removal, the Trusts allege that this Court has “related to” jurisdiction over the State Court Action under 28 U.S.C. § 1334(b) because “the Trusts have an interest in the subject matter and/or outcome” of the State Court Action. *See* Notice of Removal at p. 6. Specifically, the Trusts allege that (i) they own all or part of the claims asserted in the Petition, (ii) they have an interest in ensuring that there is no double recovery by the Plaintiffs for the same injury,<sup>3</sup> (iii) the Petition alleges claims for breaches of contracts to which e2 was a party,<sup>4</sup> (iv) the Plaintiffs’ prosecution of the claims in the State Court Action impairs the Trusts’

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<sup>2</sup>While set for trial in mid-April, the Defendants contend that trial of the State Court Action at that time is unlikely. According to the Defendants, significant discovery remains to be completed and a summer trial setting is more realistic.

<sup>3</sup>The Plaintiffs filed proofs of claim against the Debtor in the bankruptcy case. Moreover, the Plaintiffs objected to confirmation of the Plan. That objection was withdrawn based upon an agreement reached in connection with confirmation, pursuant to which the Plaintiffs were permitted to participate as Participating Investors in the Litigation Trust without prejudice to their right to assert an unsecured claim rather than an equity interest in the Debtor and without prejudice to the Creditors’ Trust’s right to object to that claim. But, the Plaintiffs agreed to cap their total recovery from the Debtor at \$740,000 – the amount of their investment. In the State Court Action, the Plaintiffs seek to recover from the Defendants their investment in the Debtor (\$740,000) and/or “benefit of the bargain” damages (perhaps as much as \$8 million). However, this Court can insure that the Plaintiffs do not receive a double recovery without having to determine the claims asserted by Plaintiffs in the Petition. The Creditors’ Trust has already objected to the Plaintiffs’ claim(s) in the bankruptcy case. If the Plaintiffs are successful in their pursuit of the claims alleged in the Petition and recover monies from the Defendants in the State Court Action, the trust can amend its claim objection to allege that a further recovery from the trust would be an impermissible double recovery. Accordingly, this purported basis for removal jurisdiction is of no legal significance.

<sup>4</sup>This is an inaccurate characterization of the claims asserted in the Petition. *See infra* at pp. 10-12.

interest in the same pool of insurance proceeds, and/or (v) the Plan contains provisions which vest exclusive jurisdiction in this Court.

The Plaintiffs now ask the Court to either remand the State Court Action or to abstain from hearing it for several reasons. First, the Plaintiffs contend that the State Court Action is not removable, as this Court lacks subject matter jurisdiction over the claims asserted in the Petition. In the alternative, the Plaintiffs contend that even if this Court has jurisdiction, it (i) must abstain from hearing the claims asserted by them in the State Court Action pursuant to 28 U.S.C. § 1334(c)(2), (ii) should exercise its discretion to abstain pursuant to 28 U.S.C. § 1334(c)(1), or (iii) should remand on equitable grounds pursuant to 28 U.S.C. § 1452(b).

The Trusts and the Defendants oppose remand or abstention for a variety of reasons. In simplified terms, the Trusts and the Defendants contend that this Court has jurisdiction over the claims asserted in the State Court Action and, because there are other adversary proceedings pending in this Court against Farris and Cordes (and against the insurance company who issued an insurance policy that should provide coverage for some or all of the Trusts' claims against Farris and Cordes), it makes sense for all of the litigation to proceed in one forum.

The Court held a hearing on the motion to remand or abstain on March 18, 2005. This Memorandum Opinion constitutes the Court's findings of fact and conclusions of law with respect to removal, remand, and abstention.

## **II. Discussion**

### **A. Subject Matter Jurisdiction**

#### **1. In General**

Removal of a civil action to the bankruptcy court is governed by 28 U.S.C. § 1452, which

provides:

- (a) A party may remove any claim or cause of action in a civil action other than a proceeding before the United States Tax Court or a civil action by a governmental unit to enforce such governmental units' police or regulatory power, to the district court for the district where such civil action is pending, if such district court has jurisdiction of such claim or cause of action under section 1334 of this title.

28 U.S.C. § 1452(a). Therefore, the first question is whether this Court has jurisdiction over the claims asserted in the State Court Action under section 1334. Generally, removal statutes must be strictly construed because removal jurisdiction “implicates important federalism concerns.” *Watts v. Tex. Workforce Comm’n*, No. Civ. A. 3:99-CV-1239, 1999 WL 812795, at \*1 (N.D. Tex. Oct. 7, 1999) (citing *Frank v. Bear Stearns & Co.*, 128 F.3d 919, 922 (5th Cir. 1997)). Furthermore, “any doubts concerning removal must be resolved against removal and in favor of remanding the case back to state court.” *Id.* (quoting *Cross v. Bankers Multiple Line Ins. Co.*, 810 F. Supp. 748, 750 (N.D. Tex. 1992)). The Trusts, as the removing parties, bear the burden of establishing federal jurisdiction under section 1334. *See Frank*, 128 F.3d at 921-22; *Faulk v. Owens-Corning Fiberglass Corp.*, 48 F. Supp. 2d 653, 658 (E.D. Tex. 1999). Section 1334 provides in relevant part:

- (a) Except as provided in subsection (b) of this section, the district courts shall have original and exclusive jurisdiction of all cases under title 11.

- (b) Notwithstanding any Act of Congress that confers exclusive jurisdiction on a court or courts other than the district courts, the district courts shall have original but not exclusive jurisdiction of all civil proceedings arising under title 11 or arising in or related to a case under title 11.

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- (e) The district court in which a case under title 11 is commenced or is pending shall have exclusive jurisdiction of all of the property, wherever located, of the debtor as of the commencement of such case, and of property of the estate.

28 U.S.C. § 1334.<sup>5</sup>

Because the Plan was confirmed in February 2003 and became effective in April 2003, prior to the filing of the State Court Action in November 2003 and its removal here in February 2005, the jurisdictional question facing this Court is even more difficult. As noted previously, the Trusts allege that this Court has “related to” jurisdiction over the claims asserted by the Plaintiffs in the Petition. *See* Notice of Removal at p. 6, ¶ 18. The Fifth Circuit has spoken on the extent of “related to” jurisdiction once a plan of reorganization has been confirmed and consummated. And, while the Trusts also argue that the Plan provides for this Court’s continuing jurisdiction, the Fifth Circuit has also addressed the extent to which a plan can serve as the basis for continuing jurisdiction, to which we now turn.

According to the Fifth Circuit, a reorganization plan functions as a contract in its own right. *In re U.S. Brass Corp.*, 301 F.3d 296, 307 (5th Cir. 2002); *U.S. v. Ramirez*, 291 B.R. 386, 392 (N.D. Tx. 2002) (stating that “a confirmed Chapter 11 plan constitute[s] a binding contract”). But, parties may not, by silence or agreement, confer upon the federal courts that jurisdiction which Congress has

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<sup>5</sup>In addition to “cases under title 11,” which refers to the original bankruptcy petition and is not at issue here, section 1334 lists three types of proceedings over which the district court has jurisdiction – those “arising under title 11,” those “arising in” a case under title 11, and those “related to” a case under title 11. *See In re Wood*, 825 F.2d 90, 92 (5th Cir. 1987). Claims that “arise under” or “arise in” a bankruptcy case are “core” matters. *WRT Creditors Liquidation Trust v. C.I.B.C. Oppenheimer Corp.*, 75 F. Supp. 2d 596, 606 (S.D. Tex. 1999). Claims that “relate to” a bankruptcy case, but do not arise under the Bankruptcy Code or arise in a bankruptcy case, are “non-core” matters. *Id.*

“Arising under” jurisdiction involves causes of action created or determined by a statutory provision of title 11. *Id.* at 96. “Arising in” jurisdiction is not based on a right expressly created by title 11, but is based on claims that have no existence outside bankruptcy. *Id.* Prior to confirmation of a plan of reorganization, “related to” jurisdiction exists if “the outcome of that proceeding could *conceivably* have any effect on the estate being administered in bankruptcy.” *Celotex Corp. v. Edwards*, 514 U.S. 300, 307 n.6 (1995) (discussing the Third Circuit test and noting its adoption by the First, Fourth, Fifth, Sixth, Eighth, Ninth, Tenth, and Eleventh Circuits); *In re Wood*, 825 F.2d at 93 (adopting the Third Circuit’s definition). The Fifth Circuit has further stated that “an action is related to bankruptcy if the outcome could alter the debtor’s rights, liabilities, options or freedom of action (either positively or negatively) and . . . in any way impacts upon the handling and administration of the bankrupt estate. Conversely, the bankruptcy court has no jurisdiction over a matter that does not affect the debtor.” *Feld v. Zale Corp. (In re Zale)*, 62 F.3d 746, 753 (5th Cir. 1995) (internal citations omitted). However, the Fifth Circuit has substantially narrowed the scope of “related to” jurisdiction after a plan of reorganization is confirmed for the debtor, which is the issue here. *See infra* at pp. 7-9.

withheld. *Smith v. Booth*, 823 F.2d 94, 96 (5th Cir. 1987); *Warren G. Kleban Eng'g Corp. v. Caldwell*, 490 F.2d 800, 803 n.2 (5th Cir.1974). Since federal courts are courts of limited jurisdiction, having “only the authority endowed by the Constitution and that conferred by Congress,” *Epps v. Bexar-Medina-Atascosa Counties Water Improvement Dist. No. 1*, 665 F.2d 594, 595 (5th Cir. 1982), the retention-of-jurisdiction provisions of the Plan cannot confer or expand the Court’s subject matter jurisdiction.<sup>6</sup> *U.S. Brass*, 301 F.3d 296, 303 (stating that “the source of the bankruptcy court’s subject matter jurisdiction is neither the Bankruptcy Code nor the express terms of the Plan. The source of the bankruptcy court’s jurisdiction is 28 U.S.C. §§ 1334 and 157”) (quoting *United States Tr. v. Gryphon at the Stone Mansion, Inc.*, 216 B.R. 764, 769 (W.D. Pa. 1997), *aff’d*, 16 F.3d 552 (3d Cir. 1999)). Thus, this Court must look solely to 28 U.S.C. § 1334 for its jurisdiction.

Moreover, the Fifth Circuit recently examined the parameters of post-confirmation jurisdiction in *Bank of La. v. Craig’s Stores of Tex., Inc. (In re Craig’s Stores of Tex., Inc.)*, 266 F.3d 388 (5th Cir. 2001). After confirmation of its plan, the debtor sued its prepetition credit card servicer (a bank) under the parties’ contract, which had been assumed under the debtor’s plan. The debtor asserted that it could bring its post-confirmation claims against the bank in the bankruptcy court eighteen months after confirmation because, as long as a bankruptcy case remains open, jurisdiction exists if a dispute is “related to” the bankruptcy under § 1334(b).

The Fifth Circuit rejected that expansive view, attaching critical significance to the debtor’s emergence from bankruptcy protection. The Fifth Circuit stated that “[a]fter a debtor’s reorganization plan has been confirmed, the debtor’s estate, and thus bankruptcy jurisdiction, ceases to exist, other

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<sup>6</sup> While a plan may not confer or expand subject matter jurisdiction, some courts find a retention of jurisdiction provision in a plan to be a prerequisite to post-confirmation jurisdiction. In other words, a plan which fails to retain subject matter jurisdiction may leave it lacking, but a plan cannot create jurisdiction where it does not otherwise exist.

than for matters pertaining to the implementation or execution of the plan.” *Craig’s Stores* 266 F.3d at 390. The Fifth Circuit concluded that the bankruptcy court lacked jurisdiction because: (i) the claims principally dealt with post-confirmation relations between the parties; (ii) there was “no antagonism or claim pending between the parties as of the date of the reorganization;” and (iii) “no facts or law deriving from the reorganization or the plan were necessary to the claim asserted by [the debtor] against the [b]ank.” *Id.* at 391. The Fifth Circuit, in rejecting the debtor’s argument that jurisdiction existed because the status of its contract with the bank would affect its distribution to creditors under the plan, noted that the “same could be said of any other post-confirmation contractual relations . . . .” *Id.*

The Fifth Circuit further refined its analysis of post-confirmation jurisdiction in *U.S. Brass Corp. v. Travelers Ins. Group (In re U.S. Brass Corp.)*, 301 F.3d 296 (5th Cir. 2002), initially noting that § 1334 does not expressly limit bankruptcy jurisdiction upon plan confirmation. However, the Fifth Circuit continued its analysis, stating that

several courts have adapted [sic] the broad “related to” test for application in post-confirmation disputes. Those courts find that a proceeding falls within the jurisdictional grant if it has a “conceivable effect on the debtor’s ability to consummate the confirmed plan . . . .” In the recent case of *In re Craig’s Stores of Texas, Inc.*, however, we rejected this expansive view in favor of a “more exacting theory”: “After a debtor’s reorganization plan has been confirmed, the debtor’s estate, and thus bankruptcy jurisdiction, ceases to exist, other than for matters pertaining to the implementation or execution of the plan.”

*U.S. Brass*, 301 F.3d 296, 304 (quoting *Craig’s Stores* 266 F.3d 388, 390-91) (citations omitted).

At issue in *U.S. Brass* was a post-confirmation debtor’s request for court approval of a proposed agreement to liquidate claims through binding arbitration where the confirmed plan provided that the claims would be resolved in a court of competent jurisdiction and determined by settlement or final judgment. Insurers objected to the proposed claim liquidation agreement on the ground that it

constituted an impermissible modification of the confirmed plan. In finding subject matter jurisdiction, the *U.S. Brass* court noted that the insurers were relying on the Bankruptcy Code's prohibition on modification of a substantially consummated plan, and the debtor was relying on its interpretation of the language of the plan. The Fifth Circuit noted that "[b]ankruptcy law will ultimately determine this dispute, and the outcome could affect the parties' post-confirmation rights and responsibilities. Furthermore, this proceeding will certainly impact compliance with or completion of the reorganization plan. Consequently, the . . . motion pertains to the plan's implementation or execution and therefore satisfies the *Craig's Stores* test for post-confirmation jurisdiction." *U.S. Brass* 301 F.3d 296, 305.

Applying these principles here, unless the claims asserted in the Petition were owned by the Debtor and are now owned by the Litigation Trust, or the continued prosecution of those claims somehow pertains to the implementation or execution of the Plan, this Court does not have subject matter jurisdiction over the claims asserted in the Petition.

## **2. Who Owns the Claims Asserted in the Petition?**

As relevant here, the Court must decide whether the claims asserted by the Plaintiffs in the Petition were owned by the Debtor when the order for relief was entered against the Debtor in its bankruptcy case.<sup>7</sup> If the Debtor owned the claims at that time, then the claims became property of the estate and were transferred to the Litigation Trust under the Plan for the benefit of certain

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<sup>7</sup>Certain creditors filed an involuntary petition under chapter 11 against e2 on January 25, 2002. On February 5, 2002, the petitioning creditors filed an emergency motion to appoint a gap period trustee, which the alleged debtor opposed. After the hearing, the Court entered an order appointing an interim trustee unless the alleged debtor consented to the order for relief by February 14, 2002. The alleged debtor did so, and an order for relief was entered on that date.

Participating Investors and the Creditors' Trust.<sup>8</sup> The parties agree that any causes of action belonging to the Debtor when the case was filed became property of the estate, *cf. La. World Exposition v. Fed. Ins. Co.*, 858 F.2d 233, 245 (5th Cir. 1988), and that this Court has exclusive jurisdiction over those claims. 28 U.S.C. § 1334(e). The parties also agree that, in order to determine whether a cause of action was property of the estate, the Court must look to state law. *See In re Educators Group Heath Trust*, 25 F.3d 1281, 1284 (5th Cir. 1994). The parties disagree, however, with respect to the proper characterization of the Plaintiffs' claims.

The Plaintiffs contend that the claims asserted in the Petition are owned by them. In short, the Plaintiffs contend that each of their claims is dependant upon their ability to prove some specific misrepresentation having been made *to them* by one or more of the Defendants at the time they elected to invest in the Debtor. According to the Plaintiffs, since their claims depend upon a misrepresentation having been made *to them*, the Debtor would have had no right to assert the claim on their behalf or in its own right when the Debtor's bankruptcy case was commenced.

The Court will begin its analysis of this ownership issue by reviewing the elements of each of the four claims pled in the Petition. First, the Plaintiffs state a claim for statutory fraud under section 27.01 of the Tex. Bus. & Comm. Code, which requires:

- (1) [a] false representation of a past or existing material fact, when the false representation is
  - (A) made to a person for the purpose of inducing that person to enter into a contract;
  - and
  - (B) relied on by that person in entering into that contract; or
- (2) [a] false promise to do an act, when the false promise is
  - (A) material;

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<sup>8</sup>Under the Plan, the Litigation Trust retains 75% of the net recoveries from Causes of Action (and will distribute those recoveries to Participating Investors – *i.e.*, those former interest holders of the Debtor who provided funding to the Litigation Trust), and the Creditors' Trust is entitled to 25% of the net recoveries from Causes of Action. The beneficiaries of the Creditors' Trust are the Debtor's unsecured creditors.

- (B) made with the intention of not fulfilling it;
- (C) made to a person for the purpose of inducing that person to enter into a contract;
- and
- (D) relied on by that person in entering into that contract.

Tex. Bus. & Com. § 27.01 (Vernon 2002).

The second claim asserted in the Petition is for common law fraud. The elements of common law fraud in Texas are: (1) a material misrepresentation; (2) that was either known to be false when made or was asserted without knowledge of its truth; (3) that was intended to be acted upon; (4) that was relied upon; and (5) that caused injury. *Rodriguez v. Elizabeth Lusk*, No. 08-03-00385-CV, 2004 WL 2307443, at \*3 (Tex. App. – El Paso, Oct. 14, 2004, no pet. h.) (citing *Dow Chem. Co. v. Francis*, 46 S.W.3d 237, 242 (Tex. 2001)). The cause of action for statutory fraud differs from common law fraud only in that it does not require proof of knowledge or recklessness as a prerequisite to the recovery of actual damages. *United Heritage Corp. v. Black Sea Investments, Ltd.*, No. 10-03-00139-CV, 2005 WL 375443, at \*6 (Tex. App. – Waco, Feb. 16, 2005, no pet. h.) (citing *Scott v. Sebree*, 986 S.W.2d 364, 377 (Tex.App. – Austin 1999, pet. denied)).

The third claim asserted in the Petition is for negligent misrepresentation. To establish its negligent misrepresentation claim, a plaintiff must show that: (1) the defendant made a representation in the course of its business or in a transaction in which it had a pecuniary interest; (2) the false information was supplied for the guidance of others in their business; (3) the defendant did not exercise reasonable care or competence in obtaining or communicating the information; and (4) the plaintiff suffered pecuniary loss by justifiably relying on the representation. *Clardy Mfg. Co. v. Marine Midland Bus. Loans Inc.*, 88 F.3d 347, 357 (5th Cir. 1996) (citing *Fed. Land Bank Ass'n of Tyler v. Sloane*, 825 S.W.2d 439, 442 (Tex. 1991)).

Finally, the fourth claim asserted in the Petition is for violation of Article 581-33 of the Texas

Securities Act, which provides:

Untruth or Omission. A person who offers or sells a security (whether or not the security or transaction is exempt under Section 5 or 6 of this Act) by means of an untrue statement of a material fact or an omission to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading, is liable to the person buying the security from him, who may sue either at law or in equity for rescission, or for damages if the buyer no longer owns the security.

Tex. Rev. Civ. Stat. Ann. § 581-33(2) (Vernon Supp. 2004).

After a review of the elements of each of their claims, the Court agrees with the Plaintiffs – to prevail on their claims against the Defendants, they must prove, among other things, that specific misrepresentations were made *to them* by some or all of the Defendants. In fact, that is what the Petition alleges. It alleges detailed false representations to the Plaintiffs concerning e2's existing and projected financial condition, its prospects for future business, the quality of its management, the extent of its capitalization, and its ability to obtain financing. The Petition further alleges that certain defendants misrepresented to the Plaintiffs their compensation arrangements with e2 and the nature and extent of their own investment in e2.

In *Educators Group Health Trust*, 25 F.3d 1281 (5th Cir. 1994), the Fifth Circuit noted that whether a particular claim is property of the estate depends upon (i) whether under state law the debtor itself could have raised the claim when the case was filed and (ii) the nature of the harm allegedly suffered by the party who wishes to assert the claim. Specifically, the Fifth Circuit stated:

[i]f a cause of action alleges only indirect harm to a creditor (*i.e.*, an injury which derives from harm to the debtor), and the debtor could have raised a claim for its direct injury under applicable law, then the cause of action belongs to the estate. Conversely, if the cause of action does not explicitly or implicitly allege harm to the debtor, then the cause of action could not have been asserted by the debtor as of the commencement of the case, and thus is not property of the estate.

*Id.* at 1284. In that case, the Fifth Circuit held that a cause of action alleging a misrepresentation to

plaintiffs, upon which the plaintiffs materially relied to their detriment, alleged a direct injury to the plaintiffs which was not derivative of any harm to the debtor, such that the claim belonged to the plaintiffs and not the estate. In so holding, the Fifth Circuit stated:

[W]e do agree, however, with the plaintiff school districts' contention that some of the causes of action allege a direct injury to themselves, which is not derivative of any harm to the debtor. For example, the plaintiff school districts allege in paragraph XI of the complaint that the defendants intentionally misrepresented *to them* the financial situation of EGHT, and that they materially relied on such representations to their detriment. To the extent that this cause of action and others allege a direct injury to the plaintiff school districts, they belong to the plaintiff school districts and not the estate.

*Id.* at 1285. In short, the Fifth Circuit held that claims based on fraud, conspiracy to commit fraud (to the extent those claims were premised upon false representations to the plaintiffs), and negligent misrepresentations concerning the financial condition of the debtor belonged to the plaintiffs and not to the debtor's estate. *See also Texas-Ohio Gas, Inc. v. Mecom*, 28 S.W.3d 129, 145 (Tex. App. – Texarkana, 2000, no pet. h.) (holding that automatic stay did not bar corporate creditor's fraud claims against corporate shareholders/employees; the claims did not belong to the estate as they involved misrepresentations directed at plaintiffs personally).

Here, as noted previously, each of the Plaintiffs' claims requires proof of a misrepresentation made to the Plaintiffs. The Debtor could not, as of the commencement of its bankruptcy case, have brought an action against the Defendants for misrepresentations the Defendants made to the Plaintiffs. Moreover, the injury to the Plaintiffs is direct and not derivative of any injury to the Debtor. By definition, the Debtor could not have suffered any injury as a result of misrepresentations made to the Plaintiffs. In fact, the Debtor benefitted from the Defendants' alleged misrepresentations, as those misrepresentations are alleged to have resulted in significant monies being invested in the Debtor by the Plaintiffs that would not otherwise have been invested.

For these reasons, the Court concludes that the claims now pled in the Petition were owned by the Plaintiffs on the date the Debtor's bankruptcy case commenced. However, according to the Trusts, that conclusion should not end the Court's analysis of the ownership issue, to which we now turn.

At the hearing on the motion to remand or abstain, the Trusts admitted that the claims specifically pled in the Petition belong to the Plaintiffs. But, with that said, the Trusts remain convinced that the Court must retain the State Court Action to protect the Litigation Trust Beneficiaries from potential prejudice in the State Court Action. Specifically, the Trusts point out that the Petition contains factual allegations about certain actions of the Defendants that occurred after the Plaintiffs made their decisions to invest in the Debtor, and those factual allegations give rise to claims against Cordes and Farris that the Debtor owned when its bankruptcy case commenced (and that the Trusts are currently asserting against Cordes and Farris in this Court in adversary proceeding nos. 04-3086 and 04-3087 (the "Trusts' Adversaries")). Therefore, the Trusts are concerned that the state court judge might allow the Plaintiffs to either (i) make a trial amendment to the Petition to assert claims which they do not own – *i.e.*, claims against Cordes and Farris for breaches of fiduciary duty that are now owned by the Litigation Trust and are pending here in the Trusts' Adversaries, and/or (ii) charge the jury on those additional factual allegations in the State Court Action and thereby inflate the value of their claims by inflaming the jury with the post-investment "bad acts" that the Defendants are alleged to have committed.<sup>9</sup>

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<sup>9</sup>In their Notice of Removal, the Trusts summarize the issue as follows: "The Trusts own all or part of the claims, damages, and/or remedies asserted by the Plaintiffs in the [Petition]." *See* Notice of Removal, p. 6, ¶ 19(A). The damages issue arises because the Plaintiffs seek to recover their actual investment and/or "benefit of the bargain" damages from the Defendants. Under Texas state law, however, "benefit of the bargain" damages are an appropriate measure of damage for the Plaintiffs' statutory and common law fraud claims. *Quest Medical Inc. v. Apprill*, 90 F.3d 1080, 1085 n.4 (5th Cir. 1996); *Fortune Prod. Co. v. Conoco, Inc.*, 52 S.W.3d 671 (Tex. 2000). So, if successful on the fraud claims asserted in the Petition, the Plaintiffs are entitled to recover the difference between the value of their

While the Court understands the Trusts' concerns about what might happen during the trial of the State Court Action, speculation about hypothetical events in state court does not provide a basis for this Court's post-confirmation subject matter jurisdiction. The claims specifically pled in the Petition are owned by the Plaintiffs, as the Trusts admitted at the hearing. On the face of the Petition, those are claims between non-debtor parties. And, unless the continued prosecution of those claims somehow pertains to the implementation or execution of the Plan, this Court does not have subject matter jurisdiction over them.

**3. Does the Continued Prosecution of the Claims Asserted in the Petition Pertain to the Implementation or Execution of the Plan?**

As the Fifth Circuit explained in *Craig's Stores*, something more than just an effect on distributions to creditors is required before the Court can exercise post-confirmation jurisdiction over the claims asserted in the Petition. *Craig's Stores* 266 F.3d 388, 391 ("Finally, while Craig's insists that the status of its contract with the Bank will affect its distribution to creditors under the plan, the same could be said of any other post-confirmation contractual relations in which Craig's is engaged. In sum, the state law causes of action asserted by Craig's against the Bank do not bear on the interpretation or execution of the debtor's plan and therefore do not fall within the bankruptcy courts post-confirmation jurisdiction."). Instead, according to the Fifth Circuit, post-confirmation jurisdiction will exist when "[b]ankruptcy law will ultimately determine [the] dispute and the outcome [of the dispute] could affect the parties' post-confirmation rights and responsibilities," *U.*

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investment in e2 as it was represented to be by the Defendants and its actual value at the time of their investment.

At the remand hearing, Plaintiffs' counsel explained why the Petition contains factual allegations about post-investment conduct of the Defendants. In essence, the Plaintiffs contend that, because they must prove materiality with respect to the alleged misrepresentations made to them, and prove that the Defendants intended to mislead them, the subsequent acts assist them in proving both the materiality of the misrepresentations when made and the Defendants' intention to mislead. Taken at face value, the explanation is credible.

*S. Brass*, 301 F.3d 296, 305, or where the “proceeding will . . . impact compliance with or completion of the reorganization plan.” *Id.*

Since bankruptcy law is not determinative of the claims asserted in the Petition, this Court’s post-confirmation subject matter jurisdiction turns on whether the continued prosecution of those claims will impact compliance with or completion of the Plan. To answer this question, the Court must understand the Plan and the relationship of the claims asserted in the Petition to the Plan. While many provisions of the Plan are relevant to the Court’s analysis, of particular significance are the provisions of Article VI, X, and XI of the Plan. Article VI, entitled “Means for Implementation of the Plan,” provides for the creation of the Creditors’ Trust (section 6.1) and the Litigation Trust (section 6.2), the funding of the Litigation Trust (section 6.3), the procedure for former shareholders to elect to become Participating Investors and fund the Litigation Trust (section 6.4), and identifies the sources of funding for creditors’ claims (section 6.5). Article X, entitled “Provision for the Discharge, Settlement and Adjustment of Claims,” preserves all of the claims held or assertable by the Debtor when its bankruptcy case commenced through the transfer of those claims to the Litigation Trust for the benefit of the Litigation Trust Beneficiaries (section 10.1) and appoints the Litigation Trustee as the “representative of the estate” in accordance with § 1123(b)(3) of the Bankruptcy Code (section 10.2). In turn, Article XI, entitled “Effect of Confirmation, Discharge, Releases, and Injunction,” provides that confirmation of the Plan vests certain property of the Debtor in the Creditors’ Trust (section 11.1), that all property dealt with by the Plan is free and clear of all claims of any party (section 11.2), that distributions provided for under the Plan are in satisfaction of all claims against the Debtor or “any of its assets or properties” (section 11.3), that confirmation of the Plan shall not affect any creditor’s rights against non-debtor third parties (section 11.4), that

the consideration distributed under the Plan is in complete satisfaction of the Debtor and its assets from all claims of any creditor or interest holder (section 11.5), and that all creditors and interest holders are permanently enjoined from commencing or continuing to prosecute any action against the Debtor or either of the Trusts on account of a claim or interest in the Debtor or from enforcing or attempting to collect a judgment against the Debtor, either of the Trusts, or any assets or property of those entities (section 11.6).

After reviewing these Plan provisions, the question remains: does the Plaintiffs' continued pursuit of the claims asserted in the Petition impact compliance with or completion of the Plan? For the reasons explained more fully below, the Court concludes that the answer to this question is no.

First, as previously explained, the claims pled in the Petition belong to the Plaintiffs. The Debtor did not own those claims when its bankruptcy case commenced; thus, those claims were not transferred to the Litigation Trust under the Plan. Moreover, section 11.4 of the Plan specifically provides that "nothing contained in the Plan or in the documents to be executed in connection with the Plan shall affect any Creditors' [sic] rights as to any third party." Accordingly, section 11.4 of the Plan specifically authorized the Plaintiffs' pursuit of their claims against the Defendants, unless the Plaintiffs are attempting to collect from assets of the Trusts, which would violate section 11.6 of the Plan.

We are finally at what the Court perceives to be the heart of the parties' dispute. By way of brief additional background, the Debtor purchased a "Directors, Officers and Organization Liability Insurance Policy" from Clarendon National Insurance Company ("Clarendon") on December 1, 2000 (the "Insurance Policy"). The Insurance Policy is a "claims made" policy with a policy limit of \$5 million. In addition to its rights as the owner of the Insurance Policy, the Debtor is a named insured

under the policy – *i.e.*, the “Insured Organization.” Thus, in the event there are covered claims made against the Debtor during the policy period, the Debtor is entitled to have Clarendon “pay to or on behalf of the Insured Organization Loss arising from Claims first made against it during the Policy Period . . . for Wrongful Acts.” *See* Insurance Policy at p. 2 of 17. However, the Insurance Policy also insures certain “Insured Persons,” which include the Debtor’s officers and directors, and Clarendon agrees to pay “to or on behalf of the Insured Persons Loss arising from Claims first made against them during the Policy Period . . . for Wrongful Acts.” *Id.*

Clarendon is defending against the claims asserted against certain of the Defendants in the State Court Action because they are Insured Persons under the Insurance Policy. While it is not clear from the record made at the remand hearing if Clarendon is defending the State Court Action under a reservation of rights, it is clear that the proceeds of the Insurance Policy are being diminished by the continued prosecution of the State Court Action (as of a couple of months ago, there remained about \$4.5 million of coverage), and the proceeds may be exhausted if the Plaintiffs’ claims are successful.

As noted previously, the Trusts are pursuing their own claims against Farris and Cordes in the Trusts’ Adversaries. The Trusts, Farris, and Cordes believe that those claims are also covered claims under the Insurance Policy. To date, however, Clarendon has refused to defend Farris and Cordes against the claims asserted in the Trusts’ Adversaries, claiming that the insured versus insured exclusion applies. As a result, Farris and Cordes have recently sued Clarendon in yet another adversary proceeding pending in this Court for a declaratory judgment that the claims asserted against them in the Trusts’ Adversaries are covered claims. The time for Clarendon to answer in that action has not run.

Armed with this understanding of the facts, it appears that the Trusts intervened in the State Court Action and removed it here to attempt to protect their competing interests to the proceeds of the Insurance Policy. The Trusts do not want the State Court Action to proceed to trial in the state court (which may result in the exhaustion of the policy limits of the Insurance Policy) before the Trusts can proceed to trial in the Trusts' Adversaries here. In short, the Trusts want this Court's help in insuring that they win the race to the proceeds of the Insurance Policy or at least tie in that race. While perhaps an admirable goal from the perspective of the Debtor's creditors generally, this Court can only retain the State Court Action if it has subject matter jurisdiction over the claims asserted in the Petition – *i.e.*, if the prosecution of the claims asserted in the Petition represents an attempt to collect from assets of the Trusts in violation of section 11.6 of the Plan. So, the question becomes, does either Trust own the proceeds payable “to or on behalf of the Insured Persons” for Claims made against them for wrongful acts under the Insurance Policy? If the Trusts do not own the proceeds payable to or for the benefit of the directors and officers for covered claims under the Insurance Policy, then the Plaintiffs' pursuit of their claims in the State Court Action cannot impact completion of or compliance with the Plan.

To answer this question, the Court must determine what interest(s) the Debtor had in the Insurance Policy when its bankruptcy case commenced because that/those interest(s) vested in the Creditors' Trust<sup>10</sup> upon confirmation of the Plan. *See* Plan, section 11.1. To do so, the Court must examine a trilogy of Fifth Circuit cases.

In *In re Louisiana World Exposition*, 832 F.2d 1391 (5th Cir. 1987), the Fifth Circuit

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<sup>10</sup>Under the Plan, the Litigation Trust was created to receive the Causes of Action. *See* Plan, §§ 2.37, 6.1, & 6.2. No other asset of the Debtor was transferred to it. Rather, all other property of the Debtor vested in the Creditors' Trust. *See id.* at § 11.1.

addressed the nature of a debtor's interest in a liability insurance policy. In that case, the debtor purchased a liability policy to cover claims that might be made against its officers and directors. However, that policy did not provide liability coverage for third-party claims against the debtor. In rejecting an argument that, because the debtor owned the policy, it therefore had an interest in the proceeds of the policy, the Fifth Circuit concluded that

the estate's legal and equitable interest in property rise no higher than those of the debtor, and the debtor had no ownership interest whatever in the proceeds from the liability coverage. With regard to the liability proceeds, the obligation of the insurance companies was only to the directors and officers and they are the named and the only insured. These proceeds would be paid only if the directors and officers incurred some covered legal expense or liability.

*Id.* at 1399. In addition, the Fifth Circuit concluded that “[o]ne having a pending unadjudicated tort claim against another does not . . . thereby have a property interest in liability insurance proceeds payable to the defendant; but the defendant does have a property interest . . . in such proceeds.” *Id.* Thus, in *Louisiana World Exposition*, the Fifth Circuit distinguished between ownership of the policy and an interest in the liability proceeds provided by the policy, recognizing them as distinct property rights.

Although the issue arose in a different procedural context, the Fifth Circuit revisited the issue of insurance policies, proceeds, and property of the estate in *In re Edgeworth*, 993 F.2d 51 (5th Cir. 1993). In that case, the debtor contended that certain malpractice insurance proceeds were property of his estate and that his chapter 7 discharge acted to bar any prepetition claims against the insurance policy. In rejecting this argument the Fifth Circuit concluded that

[i]nsurance policies are property of the estate because, regardless of who the insured is, the debtor retains certain contract rights under the policy itself. Any rights the debtor has against the insurer, whether contractual or otherwise, become property of the estate. Acknowledging that the debtor owns the policy, however, does not end

the inquiry. The question is not who owns the policies, but who owns the liability proceeds. . . . The overriding question when determining whether insurance proceeds are property of the estate is whether the debtor would have a right to receive and keep those proceeds when the insurer paid on a claim. When a payment by the insurer cannot inure to the debtor's pecuniary benefit, then that payment should neither enhance nor decrease the bankruptcy estate. In other words, when the debtor has no legally cognizable claim to the insurance proceeds, those proceeds are not property of the estate.

*Id.* at 55-56.

The Fifth Circuit again grappled with the issues surrounding insurance policies and the proceeds of those policies in *In re Vitek, Inc.*, 51 F.3d 530 (5th Cir. 1995). The Fifth Circuit summarized its prior holdings, noting that

[i]n this circuit, we are therefore in the position of knowing how to resolve cases on either end of the continuum, but we have not yet decided how to resolve cases lying somewhere along the continuum. On one extreme, when a debtor corporation owns a liability policy that exclusively covers its directors and officers, we know from *World Exposition* that the proceeds of the D&O policy are not part of the debtor's bankruptcy estate. On the other extreme, when a debtor corporation owns an insurance policy that covers its own liability vis-a-vis third parties, we – like almost all other courts that have considered the issue – declare or at least imply that both the policy and the proceeds of that policy are property of the debtor's bankruptcy estate. But we have not grappled with how to treat the proceeds of a liability policy when (1) the policy-owning debtor is but one of two or more coinsureds or additional named insureds, (2) the rights of the other coinsured(s) or additional named insured(s) are not merely derivative of the rights of one primary named insured, and (3) the aggregate potential liability substantially exceeds the aggregate limits of available insurance coverage.

*Id.* at 535. In dicta, the *Vitek* court noted that “[w]hen ultimately we are faced with such a mid-continuum case, we shall have to decide which one of two positions to take: either (1) the proceeds of a liability policy should be wholly included in the bankruptcy estate of the debtor that owns the liability policy – even though there are other coinsured or additional named insureds who have some ‘interest’ in the proceeds or (2) the proceeds should be divided among all coinsureds, either per

capita or in proportion to the potential or actual liability faced by each insured party.” *Id.*

Armed with this guidance, and recognizing that this is a mid-continuum case, the Court turns to the Insurance Policy and the proceeds of that policy at issue here. Taking the easy issue first, it is clear that the Debtor owned the Insurance Policy when its bankruptcy case commenced and that the Insurance Policy vested in the Creditors’ Trust in accordance with the terms of the Plan upon confirmation. It is also clear that the Debtor had an interest in the liability proceeds of the Insurance Policy when its bankruptcy case commenced, as it was the “Insured Organization” under the Insurance Policy, and that interest in the proceeds also vested in the Creditors’ Trust in accordance with the terms of the Plan. However, there are other named insureds under the Insurance Policy and those parties also had an interest in the liability proceeds of the Insurance Policy when the Debtor’s bankruptcy case commenced. So, this Court must now decide how to deal with the co-insureds’ interests in the proceeds in light of the Debtor’s bankruptcy filing.

In evaluating the two options identified by the *Vitek* court, this Court rejects the option which would cut off the co-insureds’ interests in the proceeds for at least two reasons. First, that result deprives non-debtor parties of valuable property rights for no reason other than they happened to “co-own” the property with the debtor. The Court can think of no other circumstance under the Bankruptcy Code where the mere bankruptcy filing by one co-owner of property serves, without more, to divest the other owner of his property rights. Second, concluding that all of the proceeds of a liability policy become property of the estate when a named insured files bankruptcy could result in a situation where only the insurance company is benefited. For example, if the debtor-named insured does not have covered claims asserted against it, but other non-debtor co-insureds do have covered claims asserted against them, then such a holding would mean that non-debtor co-insureds

are deprived of their entitlements under the insurance policy when the debtor could not reach its interest in the liability proceeds in any event – an unfortunate result for all but the insurance company.

Instead, this Court concludes that the second option identified by the *Vitek* court – *i.e.*, an allocation of proceeds among the various co-insureds, makes the most sense. While allocating proceeds among competing co-insureds may be procedurally and substantively complex in some cases, under the unique facts presented here, the Court concludes that it does not have to actually determine a precise allocation of proceeds among the co-insureds to decide if it has subject matter jurisdiction over the claims asserted in the Petition.<sup>11</sup>

As noted previously, the Debtor was the “Insured Organization” under the terms of the

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<sup>11</sup>Even if an allocation is required, it does not appear that there are any significant claims against the Insured Organization’s Proceeds (defined herein on p.24). According to the trustee of the Trusts, the only claim that has been asserted against the Debtor that could implicate the Insured Organization’s Proceeds is Farris’s indemnification claim. Interestingly, that indemnification claim has been asserted as a counterclaim in the Trusts’ Adversaries and is alleged to arise by virtue of an agreement entered into by the Debtor and Farris on September 25, 2000, pursuant to which Farris alleges that the Debtor agreed to indemnify him for any and all expenses he incurs in connection with any action brought against him that is based upon the fact that he is or was a director and/or officer of the Debtor. *See* First Amended Counterclaim and Answer of Jeffrey Farris in Adv. Pro. No. 04-3087 at pp. 8-10. Assuming that the agreement would also cover claims arising from the State Court Action, it is not clear that Farris’s claims for indemnity affect the Insured Organization’s Proceeds at all, as claims for indemnity do not appear to be “Claims . . . against [the Insured Organization] . . . for Wrongful Acts” as defined in the Insurance Policy. *See* Insurance Policy at pp. 5-6 of 17.

However, even assuming that Farris’s potential indemnity claim from the State Court Action could be a covered claim and could trigger a right to payment from the Insured Organization’s Proceeds, it does not appear to present a significant risk at this time. First, Clarendon is currently defending Farris in the State Court Action. Thus, unless Clarendon is defending under a reservation of rights, it is likely that any judgment taken against Farris in the State Court Action will be paid from the Insured Persons’ Proceeds. If the Plaintiffs are unsuccessful in the State Court Action, then only the Defendants’ defense costs will have been paid from the Insured Persons’ Proceeds and all remaining proceeds will be available to any of the co-insureds for other covered claims.

If the Plaintiffs obtain a judgment against Farris for an amount in excess of the policy limits, and an indemnity claim by Farris for that excess amount is a covered claim, it is true that there would be no proceeds remaining in the Insurance Policy to pay the claim. This alternative is the only one in which there could be a “conceivable effect” upon the Insured Organization’s Proceeds. While a conceivable effect on the estate being administered in bankruptcy is the test for “related to” jurisdiction during a bankruptcy case, the Fifth Circuit has rejected that test once a plan has been confirmed and consummated. *See supra* at pp. 7-9. Moreover, the Trusts have objected to Farris’s alleged indemnity right in the Trusts’ Adversaries, and would presumably object to any indemnity claim arising from the State Court Action on the same basis.

Insurance Policy. Accordingly, the Court will refer to the Debtor's interest in the proceeds of the Insurance Policy as the "Insured Organization's Proceeds." Similarly, the Debtor's officers and directors were among the "Insured Persons" under the terms of the Insurance Policy. Accordingly, the Court will refer to the officers' and directors' interests in the proceeds of the Insurance Policy as the "Insured Persons' Proceeds." Of course, the Debtor is only entitled to receive the Insured Organization's Proceeds if there are covered claims made against the Debtor during the policy period. Likewise, the Insured Persons are only entitled to receive the Insured Persons' Proceeds if there are covered claims made against them during the policy period.

What is at issue in the State Court Action is not the Insured Organization's Proceeds. Rather, the Plaintiffs are seeking to hold certain former officers and directors of the Debtor liable for misrepresentations allegedly made to the Plaintiffs at the time they made their decisions to invest in the Debtor. So, what is at issue in the State Court Action is the Insured Persons' Proceeds. The Debtor did not, and could not, own those proceeds. Thus, because the Debtor had no interest in the Insured Persons' Proceeds when its bankruptcy case commenced, the Creditors' Trust can have no interest in the Insured Persons' Proceeds. Accordingly, because the Plaintiffs are not attempting to collect from an asset of the Creditors' Trust, their continued pursuit of the claims asserted in the Petition does not impact completion of or compliance with the Plan, and this Court lacks subject matter jurisdiction over the Petition.

Moreover, the fact that the Litigation Trust has a potentially competing claim against the Insured Persons' Proceeds in the Trusts' Adversaries does not provide a basis for subject matter jurisdiction over the claims asserted in the Petition in this Court. In *Louisiana World Exposition*, the Fifth Circuit concluded that "[o]ne having a pending, unadjudicated tort claim against another

does not . . . thereby have a property interest in liability insurance proceeds payable to the defendant, but the defendant does have a property interest, recognized in bankruptcy, in such proceeds.” *La. World Exposition*, 832 F.2d 1391, 1399. Thus, the existence of the Litigation Trust’s pending claims against Farris and Cordes does not give the Litigation Trust a property interest in the Insured Persons’ Proceeds. Accordingly, because the Plaintiffs are not attempting to collect from an asset of the Litigation Trust, their continued pursuit of the claims asserted in the Petition does not impact completion of or compliance with the Plan, and this Court lacks subject matter jurisdiction over the Petition.

Finally, the fact that the Plaintiffs may be able to proceed to trial in the State Court Action prior to the time that the Trusts may be able to establish liability and coverage of claims in connection with the Trusts’ Adversaries here does not confer subject matter jurisdiction over the claims asserted in the Petition in this Court. While the Plaintiffs’ successful pursuit of the Defendants (and their interests in the Insured Persons’ Proceeds) may adversely affect what, if any, Insured Persons’ Proceeds remain to be collected as a result of the Trusts’ successful pursuit of the Trusts’ Adversaries, that potential adverse affect does not confer post-confirmation subject matter jurisdiction on this Court. *See Craig’s Stores* 266 F.3d 388, 391 (rejecting contention that an effect on distributions to creditors under the plan was a sufficient nexus for post-confirmation jurisdiction).<sup>12</sup>

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<sup>12</sup>An analogy may explain the fundamental problem with the Trusts’ position here. For example, the law is clear that confirmation of a plan does not affect a guarantor’s liability on a debt for which a bankruptcy debtor is a co-liable party. 11 U.S.C. § 524(e); *In re Applewood Chair Co.*, 203 F.3d 914 (5th Cir. 2000). If the creditor holding such a guaranty (the “Guaranteed Creditor”) chooses to pursue the guarantor after confirmation of the debtor’s plan, it may do so and it may attempt to collect its debt from the guarantor’s assets once it has obtained a judgment against the guarantor. Now, assume that the debtor also happens to have a claim against the guarantor which was preserved in the debtor’s plan for the benefit of the debtor’s unsecured creditors. While the debtor will want to pursue its claim against the guarantor to enhance its plan distributions to unsecured creditors, the debtor has no legal right to ask this Court to protect its contingent interest in the guarantor’s assets from the competing claims of the Guaranteed Creditor. Who ever gets to

#### **4. Conclusion**

In sum, this case involves non-debtors pursuing other non-debtors in state court on claims which the Debtor never owned, to recover property that neither the estate nor the Creditors' Trust ever had any interest in. This Court simply does not have jurisdiction over the claims asserted in the Petition.

Stated another way, and using the tests for post-confirmation jurisdiction articulated by the Fifth Circuit, because (i) the claims asserted in the Petition will not be determined by reference to bankruptcy law, (ii) no fact or law deriving from the Debtor's reorganization or the Plan is necessary to an adjudication of the Plaintiffs' claims against the Defendants, (iii) the outcome of the claims asserted in the Petition will not affect the parties' post-confirmation rights and responsibilities, and (iv) the continued pursuit of the claims asserted in the Petition will not impact compliance with or completion of the Plan, the Court does not have post-confirmation subject matter jurisdiction over the Plaintiff's claims. Accordingly, the motion to remand must be granted.

#### **B. Abstention and/or Equitable Remand**

In the alternative, and assuming that there is a sufficient nexus between the claims asserted in the Petition and the Plan so that this Court has subject matter jurisdiction over those claims, the Plaintiffs ask this Court to abstain from hearing them either because it must in accordance with 28 U.S.C. § 1334 (c)(2) or because it should in accordance with 28 U.S.C. § 1334 (c)(1). Finally, the Plaintiffs ask this Court to remand the State Court Action on equitable grounds in accordance with 28 U.S.C. § 1452(b).

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the guarantor's assets first will get paid first. Similarly, the Court cannot protect the Trusts from the Plaintiffs' pursuit of the Insured Persons' Proceeds.

Turning first to mandatory abstention, section 1334(c)(2) provides:

Upon timely motion of a party in a proceeding based upon a State law claim or State law cause of action, related to a case under title 11 but not arising under title 11 or arising in a case under title 11, with respect to which an action could not have been commenced in a court of the United States absent jurisdiction under this section, the district court shall abstain from hearing such proceeding if an action is commenced, and can be timely adjudicated, in a State forum of appropriate jurisdiction.

28 U.S.C. § 1334(c)(2). Although there is a split in authority whether mandatory abstention applies to cases removed to federal court on the basis of bankruptcy jurisdiction, the Fifth Circuit follows the majority rule that mandatory abstention does apply to such cases. *Southmark Corp. v. Coopers & Lybrand (In re Southmark Corp.)*, 163 F.3d 925, 929 (5th Cir. 1999) (rejecting the assertion that mandatory abstention does not apply to cases removed to federal court on the basis of bankruptcy jurisdiction and endorsing the majority rule). Based on the language of section 1334(c)(2), courts have held that if the following six requirements are met, the court must abstain:

- (1) A party to the proceeding must file a timely motion to abstain;
- (2) The proceeding is based on a state law claim;
- (3) The proceeding is a “related to” proceeding;
- (4) There is no basis for federal court jurisdiction other than section 1334;
- (5) An action is pending in state court; and
- (6) The state court action can be timely adjudicated.

*Gabel v. Engra, Inc. (In re Engra, Inc.)*, 86 B.R. 890, 894 (Bankr. S.D. Tex. 1988); *see also Broyles v. U.S. Gypsum*, 266 B.R. 778, 782-83 (E.D. Tex. 2001).

Applying these requirements to the State Court Action, the Court finds that all of the requirements for mandatory abstention have been satisfied. The Plaintiffs sought mandatory

abstention under section 1334(c)(2) in a timely fashion.<sup>13</sup> The claims stated in the Petition are founded solely in Texas state law and implicate no federal question. At best, this Court’s jurisdiction over the claims asserted in the Petition is based upon “related to” jurisdiction under 28 U.S.C. § 1334(b). *See* Notice of Removal at p. 6, ¶ 18 (which alleges only “related to” jurisdiction); *see also* pp. 6-9, *supra*. All of the parties involved in the State Court Action are Texas citizens or Texas entities, with the exception of Defendant Lehman Brothers. Thus, the Court has no federal diversity jurisdiction over the State Court Action. 28 U.S.C. § 1332(a); *see Owens Equip. & Erection Co. v. Kroger*, 437 U.S. 365, 373 (1978). Had the Debtor not filed for bankruptcy, the action could not have been brought in federal court. Moreover, the State Court Action was commenced in state court in November 2003 and, upon its remand, could be timely adjudicated there. When removed, the State Court Action was set for trial in April 2005. While there is a dispute over whether the State Court Action will be tried in April if it is remanded, even the Defendants agree that a trial setting in the summer of 2005 is realistic. Thus, the State Court Action can be adjudicated in a timely fashion in the state court.

Because all of the requirements for mandatory abstention are met, even if this Court has post-confirmation “related to” jurisdiction over the claims asserted in the Petition, this Court must abstain from hearing it. Accordingly, the Court need not address the Plaintiffs’ requests for either

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<sup>13</sup> The Notice of Removal was filed on February 16, 2005. The Amended Motion to Remand, in which the Plaintiffs seek abstention, was filed on March 12, 2005. The Trusts argue that the Plaintiffs’ abstention motion was untimely filed under both 28 U.S.C. § 1447(c) and Fed. R. Civ. Proc. 7 & 15(a). *See* Opposition of e2 Litigation Trust and e2 Creditors Trust to Amended Motion to Remand or to Abstain at pp. 3-4 (arguing in part that “this Court should deny the request to abstain for failing to meet the timing deadlines set forth in 28 U.S.C. § 1447(c)). This argument is unfounded for two reasons. First, the timeliness of an abstention motion is governed by 28 U.S.C. § 1334(c)(2), which merely requires that the abstention motion be “timely” filed. *See In re Adams*, 133 B.R. 191, 195 (Bankr. W.D. Mich. 1991) (finding that an abstention motion was timely when filed twenty-one days after an application for removal was filed). Second, even if the timing deadlines of § 1447(c) did apply to the filing of an abstention motion, the Plaintiffs’ Amended Motion to Remand was filed twenty-four days after the Notice of Removal (well within the 30-day requirement set forth in § 1447(c)).

discretionary abstention or equitable remand.

For either of these reasons, the State Court Action will be returned to state court. An order remanding the State Court Action, or abstaining from hearing it, will be entered separately.

**### End of Memorandum Opinion ###**