

Lessons for Bankruptcy Practitioners from the Supreme Court's Ruling in *Rodriguez v. Fed. Deposit Ins. Corp.*

A Lexis Practice Advisor® Practice Note by
Kenneth N. Klee and Sasha M. Gurvitz, KTBS Law LLP



Kenneth N. Klee
KTBS Law LLP



Sasha M. Gurvitz
KTBS Law LLP

This article discusses the recent case of *Rodriguez v. Fed. Deposit Ins. Corp.* addressing the issue of which entity in a corporate group owns a tax refund issued to the group in respect of its consolidated tax return. Included is a discussion of lessons to be learned and guidance that can be gleaned from this case.

In a unanimous decision authored by Justice Gorsuch, the Court holds that state law, not federal law, supplies the rule of decision when determining which entity in a corporate group owns a tax refund issued in respect of the group's consolidated tax return. *Rodriguez v. Fed. Deposit Ins. Corp.*, No. 18-1269, 2020 U.S. LEXIS 1364, at *10 (2020) (*Rodriguez*). In so holding, the Court resolves a circuit split by overruling the judicially crafted federal rule—the so-called Bob Richards rule—applied by the Tenth Circuit below, on the basis that “[c]orporations are generally creatures of state law, and state law is well equipped to handle disputes involving corporate property rights.” *Rodriguez*, 2020 U.S. LEXIS 1364, at *9 (internal quotation marks and citation omitted).

Although the decision is brief, its admonition that “federal courts should exercise [care] before taking up an invitation to try their hand at common lawmaking,” *Rodriguez*, 2020 U.S. LEXIS 1364, at *10, will likely have broad implications for other doctrines of federal common law that courts have developed in bankruptcy jurisprudence.

Lesson to Be Learned

The primary lesson to be learned from the *Rodriguez* decision is that litigants should be extremely wary of advancing positions based on federal common law rules absent a strong showing that federal common lawmaking is strictly “necessary to protect uniquely federal interests.” See *Rodriguez*, 2020 U.S. LEXIS 1364, at *7 (internal quotation marks and citations omitted). In vindicating state law over federal common law, the *Rodriguez* decision reaffirms the Court’s mantra that state law governs the determination of property rights in the assets of a debtor’s estate. *Rodriguez*, 2020 U.S. LEXIS 1364, at *9 (citing *Butner v. United States*, 440 U.S. 48, 54 (1979)).

Legal Background

Rodriguez resolves a circuit split whether state law or federal law supplies the rule of decision when determining, in the absence of a tax allocation agreement (or in the case of a dispute concerning the interpretation of such an agreement), which entity in a corporate group owns a tax refund issued to the group in respect of its consolidated tax return. One line of authority, applied by the Sixth Circuit in *Fed. Deposit Ins. Corp. v. AmFin Fin. Corp.*, 757 F.3d 530 (6th Cir. 2014), turns to state law, whereas a second line of authority, applied by the Tenth Circuit in the *Rodriguez* case, turns to the so-called Bob Richards rule, which is a judicially created rule of federal common law. The Bob Richards rule provides that “in

the absence of a tax allocation agreement, a refund belongs to the group member responsible for the losses that led to it.” Rodriguez, 2020 U.S. LEXIS 1364, at *5 (citing *In re Bob Richards Chrysler-Plymouth Corp.*, 473 F.2d 262, 265 (9th Cir. 1973)). In some jurisdictions, including the Tenth Circuit, the Bob Richards rule governs even when the parties have an explicit tax allocation agreement, unless the agreement unambiguously specifies a different result. Rodriguez, 2020 U.S. LEXIS 1364, at *6.

Facts and Proceedings

The facts of the Rodriguez case are straightforward. United Western Bank (the “Bank”) entered receivership under the stewardship of the FDIC. Rodriguez, 2020 U.S. LEXIS 1364, at *3. The Bank’s parent, United Western Bancorp, Inc. (Bancorp) was forced into bankruptcy and a trustee was appointed. Id. Consistent with IRS regulations, the IRS issued a \$4 million tax refund to the corporate group without allocating the refund amongst the various entities. Id. The FDIC, on behalf of the Bank, and the trustee, on behalf of Bancorp, each claimed ownership of the tax refund, and the parties litigated that dispute in Bancorp’s bankruptcy case. Rodriguez, 2020 U.S. LEXIS 1364, at *4. In a lengthy opinion, the bankruptcy court determined the Bob Richards rule did not apply because the parties had a tax allocation agreement, and concluded that under that agreement, as construed in accordance with Colorado law, Bancorp had title to the tax refund, making it property of Bancorp’s bankruptcy estate under Bankruptcy Code Section 541, notwithstanding that the refund was generated on account of the Bank’s losses. *United Western Bancorp, Inc. v. Fed. Deposit Ins. Corp.* (*In re United Western Bancorp, Inc.*), 558 B.R. 409, 434, 437 (Bankr. D. Colo. 2016).

The FDIC appealed on behalf of the Bank and the district court reversed. *In re United Western Bancorp, Inc.*, 574 B.R. 876, 878 (D. Colo. 2017). The district court determined that, under Colorado law, the tax allocation agreement was ambiguous regarding ownership of the refund, and that, in accordance with the terms of the contract, that ambiguity should be resolved in favor of the Bank. *In re United Western Bancorp, Inc.*, 574 B.R. at 894 (citing a provision in the contract requiring ambiguity be resolved in favor of the Bank, with a view to effectuating the intent of the contract, to provide an equitable allocation of tax liability among Bancorp and the Bank). Finding that Bancorp held only bare legal title to the refund, whereas the Bank that sustained the losses held equitable title, the district court concluded that the refund belonged to the Bank and was not property of Bancorp’s estate. *In re United Western Bancorp, Inc.*, 574 B.R. at 895.

The trustee appealed on behalf of Bancorp, and the Court of Appeals for the Tenth Circuit affirmed. *In re United Western Bancorp, Inc.*, 914 F.3d 1262, 1264 (10th Cir. 2019). The Tenth Circuit determined that “[f]ederal common law,” namely, the Bob Richards rule, “provides a framework for resolving this issue.” *In re United Western Bancorp, Inc.*, 914 F.3d at 1269. Applying the Bob Richards rule and Tenth Circuit precedent (*Barnes v. Harris*, 783 F.3d 1185 (10th Cir. 2015)), the court determined it “must look to the terms of the [tax allocation] Agreement and, taking into account Colorado case law, decide whether it unambiguously addresses how tax refunds are to be handled and, if so, whether it purports to deviate from the general rule in *Barnes* and *Bob Richards*.” *In re United Western Bancorp, Inc.*, 914 F.3d at 1270. The court found the agreement to be facially “ambiguous with respect to the type of relationship it intends to create between [Bancorp] and . . . the Bank, regarding the ownership of refunds from the IRS.” *In re United Western Bancorp, Inc.*, 914 F.3d at 1273. In accordance with the contract provision requiring that ambiguities be resolved in favor of the Bank, the court “conclude[d] that the Agreement creates an agency relationship between [Bancorp] and the Bank, and that, consequently, the Agreement’s intended treatment of tax refunds does not differ from the general rule outlined in *Barnes* and *Bob Richards*.” *In re United Western Bancorp, Inc.*, 914 F.3d at 1274. The court thus affirmed the district court’s ruling below that the tax refund belonged to the Bank that generated the losses giving rise to the refund and was not part of Bancorp’s estate. Id.

Analysis

The Supreme Court frames the issue as follows: “the question we face isn’t who gets the money, only how to decide the dispute. Should federal courts rely on state law, together with any applicable federal rules, or should they devise their own federal common law test?” Rodriguez, 2020 U.S. LEXIS 1364, at *3. Admonishing that the “cases in which federal courts may engage in common lawmaking are few and far between,” the Court comes out in favor of state law supplying the rule of decision in Rodriguez. Id.

After summarizing the facts and proceedings below and identifying the circuit split regarding the Bob Richards rule, the Court begins its analysis at Constitutional first principles, explaining that “[j]udicial lawmaking in the form of federal common law plays a necessarily modest role under a Constitution that vests the federal government’s ‘legislative Powers’ in Congress and reserves most other regulatory authority to the States.” Rodriguez, 2020 U.S. LEXIS 1364, at *7. Aside from limited areas in which federal judges may appropriately craft the rule of decision, such as admiralty disputes and certain controversies between States, the Court

notes that federal judges generally may only claim a new area for common lawmaking when “necessary to protect uniquely federal interests.” *Id.*

Applying this rule, the Court finds no unique federal interest in “determining how a consolidated corporate tax refund, once paid to a designated agent, is distributed among group members.” *Rodriguez*, 2020 U.S. LEXIS 1364, at *8. Nor does the Bob Richards rule identify any uniquely federal interest in need of protection. *Id.* On the other hand, “[c]orporations are generally creatures of state law, and state law is well equipped to handle disputes involving corporate property rights.” *Rodriguez*, 2020 U.S. LEXIS 1364, at *9. Indeed, as the Court “has long recognized, ‘Congress has generally left the determination of property rights in the assets of a bankrupt’s estate to state law.’” *Id.* (quoting *Butner v. United States*, 440 U.S. 48, 54 (1979)).

The Court rejects the FDIC’s suggestion that “[e]ven if the Tenth Circuit’s reliance on Bob Richards’s analytical framework was mistaken,” the Court should nevertheless affirm because “the court of appeals proceeding to consult applicable state law.” *Rodriguez*, 2020 U.S. LEXIS 1364, at *9. The Court explains “we did not take this case to decide how this case should be resolved under state law,” rather, “[w]e took this case only to underscore the care federal courts should exercise before taking up an invitation to try their hand at common lawmaking.” *Rodriguez*, 2020 U.S. LEXIS 1364, at *10. The Court chastises Bob Richards as

a cautionary tale of “moving too quickly past important threshold questions at the heart of our separation of powers.” *Id.* Accordingly, the Court vacates and remands, indicating that the court below may consider on remand whether the case might yield the same or a different result without reliance on the now defunct Bob Richards rule. *Id.*

Initial Guidance

Prior to *Rodriguez*, the Bob Richards rule stood as a federal common law rule for over four decades. Following *Rodriguez*, not only is the Bob Richards rule itself dead, but practitioners should approach all federal common law rules with caution. Other areas of federal common law in bankruptcy jurisprudence that could be at risk in the wake of *Rodriguez* include the practices of substantive consolidation, recharacterization of debt into equity (and vice versa), and collapsing fraudulent transfer transactions. Litigants who wish to continue advancing positions in reliance on federal common law rules should be prepared to make a strong case that the rule is necessary to protect uniquely federal interests and to make arguments in the alternative on the basis of applicable state law.

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Kenneth N. Klee, Partner, KTBS Law LLP

Kenneth N. Klee is a nationally recognized expert on bankruptcy law. He became a Professor of Law Emeritus at the UCLA School of Law in 2014 and is a founding partner of KTBS Law LLP, specializing in corporate reorganization, insolvency, and bankruptcy law.

From 1974 to 1977, Professor Klee served as associate counsel to the Committee on the Judiciary, U.S. House of Representatives, where he was one of the principal drafters of the 1978 Bankruptcy Code. He served as a consultant on bankruptcy legislation to the U.S. Department of Justice in 1983–1984. From 1992 to 2000, he served as a member of the Advisory Committee on Bankruptcy Rules to the Judicial Conference of the United States. From 2000 to 2003, and previously from 1988 to 1990, Professor Klee has served since 2017 as a board member of the Ninth Judicial Circuit Historical Society and served as a member of the Advisory Board for several years before that. He has served three times as a lawyer delegate to the Ninth Circuit Judicial Conference. Professor Klee served as member of the executive committee of the National Bankruptcy Conference from 1985 to 1988, 1992 to 1999, 2005 to 2008, and 2011 to 2014, and in 2017–2018 served as Chair of its Membership Committee. He served from 2011 to 2014 as Chair of the NBC's Committee to Rethink Chapter 11 and also served as chair of its legislation committee from 1992 to 2000. Professor Klee is a past president and member of the board of governors of the Financial Lawyers Conference. Professor Klee was included in "The Best Lawyers in America" 2018 edition and has been included for at least 25 years. He has been named by *Who's Who Legal*, since 2012, as one of the top ten insolvency & restructuring attorneys in the world and was named by *The Legal 500* as one of the top nine leading attorneys in the municipal bankruptcy field for 2014. From 2003 to 2011 and periodically thereafter he was named by the *Daily Journal* as one of California's Top 100 Lawyers.

Professor Klee is an author or co-author of four books: *Bankruptcy and the Supreme Court: 1801–2014* (with Whitman L. Holt) (West Academic 2015); *Bankruptcy and the Supreme Court* (LexisNexis 2008); *Business Reorganization in Bankruptcy* (West 1996; 2d ed. 2001; 3d ed. 2006; 4th ed. 2012); and *Fundamentals of Bankruptcy Law* (ALI-ABA 4th ed. 1996).

He has authored or co-authored 32 law review articles on bankruptcy law. Recently, and within the past few years, Professor Klee has served as co-counsel for Bettina Whyte as COFINA agent in the Puerto Rico PROMESA restructuring cases; co-counsel for defendants Anadarko Petroleum Corp. and Kerr McGee in *Tronox v. Anadarko* (Bankr. S.D.N.Y.), and the Blavatnik defendants in *Weisfelner v. Blavatnik* (In re Lyondell Chemical Co.) (Bankr. S.D.N.Y.).

During the summer of 2010, Professor Klee served as the appointed Examiner in the Tribune chapter 11 cases. He also represented Jefferson County, Alabama, in its successful Chapter 9 case from 2011 to 2014. Professor Klee also serves clients as an expert witness, mediator, arbitrator, attorney, or consultant in his Chapter 11 business reorganization practice.

Sasha M. Gurvitz, Partner, KTBS Law LLP

Sasha M. Gurvitz is a member of KTBS Law, LLP. Ms. Gurvitz received her J.D. from the UCLA School of Law, where she graduated tenth in her class. Upon graduation, she was admitted to the Order of the Coif.

In recognition of outstanding achievement in bankruptcy coursework during law school, she was awarded the 2013 American Bankruptcy Institute Medal of Excellence. She was also a recipient of the Dean's Merit Scholarship at UCLA School of Law. Ms. Gurvitz received her undergraduate degree from the University of California, Berkeley, where she graduated with highest honors.

Since joining KTBS, Ms. Gurvitz has represented clients in a variety of roles in the restructuring context, both out of court and in chapter 11 proceedings in Delaware, New York, California, and Nevada. In particular, Ms. Gurvitz has represented several chapter 11 debtors in Delaware cases, including American Blue Ribbon Holdings, LLC; Woodbridge Group of Companies, LLC; Open Road Films, LLC; Pacific Sunwear of California, Inc.; USA Discounters, Ltd.; and VRG Liquidating, LLC (f/k/a Vestis Retail Group, LLC). Ms. Gurvitz also has experience representing purchasers of assets in section 363 sales, secured lenders, contract counterparties, landlords, equity holders, chapter 11 trustees, an environmental regulator, and various other creditor constituencies, including in chapter 11 cases such as In re Fresh-G Restaurant Intermediate Holding, LLC (f/k/a Garden Fresh Restaurant Intermediate Holding, LLC); In re Runway Liquidation Holdings, LLC (f/k/a BCBG Max Azria Global Holdings, LLC); In re Exide Technologies; In re Kamen; In re Bishop Gorman Development Corporation; and In re Lakes at Las Vegas Joint Venture, LLC.

Ms. Gurvitz represents the liquidating trustees of the Circuit City Stores, Inc. Liquidating Trust and the RSH Liquidating Trust and serves as appellate counsel to asbestos trusts J.T. Thorpe Settlement Trust and Thorpe Insulation Company Asbestos Settlement Trust. Ms. Gurvitz is a member of the State Bar of California, the Financial Lawyers Conference, and the Turnaround Management Association ("TMA") and serves as the co-chair of the NextGen Committee for the Southern California chapter of TMA.

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