SOUTHERN DISTRICT OF TEXAS BENCH BAR CONFERENCE 2012

BANKRUPTCY CASE LAW REVIEW

March 2011 – June 2012

PRESENTED BY:

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<u>RECENT SUPREME COURT DECISIONS</u>

RadLAX Gateway Hotel, LLC et al. v. Amalgamated Bank, 566 U.S. ___ (2012) (Credit Bidding)
JUDGES: Justice Scalia delivered the opinion of the Court, in which all other Members joined, except Justice Kennedy, who took no part in the decision of the case.

> The Debtors in their Chapter 11 bankruptcy cases pursued a cramdown plan over the objection of a secured creditor through its trustee, Amalgamated Bank ("Bank"). The Bank had a lien on substantially all of the Debtors' property in connection with a $142 million loan to finance the construction of a parking structure at Los Angeles International Airport. The plan proposed selling substantially all of the Debtors' property at an auction and using the sale proceeds to repay the Bank. Under the proposed auction procedures, the Bank would not be permitted to credit bid for the property. The bankruptcy court denied the Debtors' sale and bid procedures motion, finding that the restriction on credit bidding violated §1129(b)(2)(A)'s cramdown requirements. On direct appeal, the Seventh Circuit affirmed. The Supreme Court affirmed, holding that, while plans confirmed over the objection of a "class of secured claims" must meet one of the three requirements in §1129(b)(2)(A)(i)-(iii), when the debtor proposes selling the secured creditor's collateral free and clear of liens, §1129(b)(2)(A)(ii), the specific provision dealing with the sale of collateral and that provides that such sale is subject to the rights of the secured creditor to credit bid under § 363(k), must be satisfied. The debtor may not elect to satisfy §1129(b)(2)(A)(iii), a general provision allowing the plan to provide the secured creditor with the "indubitable equivalent" of their claim, as a substitute. Because clause (ii) is subject to §363(k), which provides "unless the court for cause orders otherwise the holder of such claim may [credit bid at the auction of the collateral]", any sale of collateral must provide the secured with an opportunity to credit bid. The Court did not allow the petitioner to satisfy clause (iii) instead of clause (ii) because to do so would allow the general, clause (iii), to govern the specific, clause (ii), which is contrary to established canons of statutory construction.

Hall Et Ux. v. U.S., 566 U.S. ___ (2012) (Chapter 12)
JUDGES: Justice Sotomayor delivered the opinion of the Court, in which Chief Justice Roberts and Justices Scalia, Thomas, and Alito joined. Justice Breyer filed a dissenting opinion, in which Justices Kennedy, Ginsburg, and Kagan joined.

> Debtors sold their farm shortly after filing for bankruptcy under Chapter 12 and proposed a reorganization plan that used the proceeds of the sale to pay off outstanding liabilities. The IRS objected, asserting a claim for income taxes on the capital gains from the farm sale. The Debtors amended their plan, proposing that the tax be treated as a general, unsecured claim, payable to the extent that funds were available. The IRS objected once more, and the bankruptcy court sustained the objection because a Chapter 12 estate cannot "incur" taxes for the purposes of § 503(b). Therefore, these taxes are not eligible to be stripped of their priority under § 1222(a)(2)(A). The district court reversed the decision. On appeal, the Court of Appeals for the Ninth Circuit reversed the district court. The Supreme Court affirmed the Ninth Circuit's ruling, holding that a tax "incurred by the estate" is a tax for which the estate itself is liable. The Court reasoned that these taxes are neither collectable nor dischargeable in a Chapter 12 plan because the Internal Revenue Code makes it clear that Chapter 12 estates are not liable for taxes; the debtor, not the trustee, is liable for taxes and files the only tax return. (*See* 26 U.S.C. §§ 1398 and 1399). The Court also draws support from the treatment of taxes in Chapter 13 cases and the interplay between Bankruptcy Code § 346 Internal Revenue Code §§1398 and 1399.

ATTORNEYS' / PROFESSIONALS' FEES

In re Velazquez, 660 F.3d 893 (5th Cir. 2011).
JUDGES: King, Davis, and Garza, Circuit Judges.

> The Velazquezes filed for Chapter 13 after defaulting on the deed of trust securing their home. Countrywide held the note secured by the deed of trust and filed a proof of claim that included amounts for postpetition attorney's fees and fees for the preparation and prosecution of the fee application. The deed of trust required debtor "to pay for whatever is reasonable or appropriate to protect lender's interest in the property *and* rights under this security agreement" (emphasis added). The bankruptcy and district courts both denied the fee application, literally interpreting "and" to mean and. The Fifth Circuit reversed. In reviewing the contractual language, the Fifth Circuit found "that consideration of Section 9 as a whole required construing 'and' to mean 'either or both' to effectuate the clear intent of the parties." In n.5, the court noted its disagreement with a recent Fifth Circuit panel decision (*Wells Fargo Bank v. Collins (In re Collins)*, No. 10-20658, 2011 WL 3568910 (5^{th} Cir. Aug. 15, 2011)) that interpreted language similar to that as issue when affirming *denial* of fees for want of reversible error.

In re SBMC Healthcare, LLC, Case No. 12-33299, Dkt. No. 101 (Bankr. S.D. Tex. June 18, 2012)
JUDGE: Jeff Bohm, United States Bankruptcy Judge.

> The bankruptcy court approved the employment of a law firm ("Law Firm") by the debtor in possession in a Chapter 11 case even though the Law Firm had received a payment during the preference period and maintained a claim for payment of prepetition fees against the sole shareholder of the debtor that would be paid only if there were sufficient proceeds following the sale of estate assets to pay all creditors in full and result in a distribution to the shareholder. Here, the Law Firm had represented the debtor in prepetition state court litigation and had been paid \$50,000 during the preference period but was still owed approximately \$110,000 as of the petition date. The debtor filed an application to employ the Law Firm as general bankruptcy counsel for the debtor and disclosed the payment and the claim against the debtor for unpaid fees. The United States Trustee ("UST") objected to the application on the grounds that the Law Firm was a creditor of the estate and could not qualify under § 327(a) as a disinterested person. The debtor filed an amended application that stated that the Law Firm agreed to waive any claim against the estate, but not against the individual shareholder, and that it would serve as special counsel while at the same time a different firm would be hired as general bankruptcy counsel. The Law Firm, while special counsel, would assist the other law firm (consisting of one attorney) with some bankruptcy matters. The UST continued to object, taking the position that although the Law Firm was no longer a direct creditor of the debtor, it was still not disinterested because it was looking in the first instance to payment of its claim out of estate assets. The Law Firm argued that because it waived its claim against the debtor, it was no longer a creditor of the debtor and, therefore, met the disinterestedness test.
>
> The court agreed with the debtor, rejecting a per se test of disinterestedness when a law firm receives a payment during the preference period and hold a prepetition claim (albeit indirect) and, instead, applied a "totality of the circumstances" test. After analyzing the application of fourteen factors, the court determined that, under the totality of the circumstances, it would approve the amended application.

In re IRH Vintage Park Partners, L.P., 456 B.R. 673 (Bankr. S.D. Tex. 2011).
JUDGE: Jeff Bohm, United States Bankruptcy Judge.

> Secured creditor objected to the fee application filed by the Chapter 11 debtor's' experts because the experts' services would be paid out of the secured creditor's cash collateral and the secured creditor realized no benefit from such services. The bankruptcy court ruled that the secured creditor was bound by the terms of the confirmed plan, which provided for payment in full of court-approved professional fees and other administrative expenses, and could not belatedly object on the grounds that the fees sought would be paid from its cash collateral. However, the experts could not adequately prove their fees. The court concluded that the services and expenses for which the experts sought compensation did not provide an identifiable, tangible, or material benefit to the debtors' estates because the plan for which experts testified was not confirmed and the testimony was neither mentioned in the court's oral findings nor relied upon for the court's ruling (thus failing the retrospective review under the *Pro-Snax* analysis).

In re MSB Energy, Inc., 450 B.R. 659 (Bankr. S.D. Tex. 2011).
JUDGE: Jeff Bohm, United States Bankruptcy Judge.

> WGB, counsel for debtor MSB, filed a fee application that was challenged by MSB's creditors. WGB attached fee statements to the fee application detailing the dates of services rendered, the professional providing the service, a comprehensive description of the services provided, the hours billed, rate charged, and total amount sought for each billing entry. The fee statements also itemize WGB's expenses for each month of service. Unlike counsel in *Pro-Snax*, WGB assisted the debtor in obtaining plan confirmation and in liquidating the debtor's assets. While the court acknowledged that the debtor did not achieve 100% payment to all creditors as originally contemplated in prior versions of the Plan, the circumstances of the case did not place WGB in a position where it should have known from the outset that the proposed payout would not be achieved. Moreover, professional fees may be compensable even though unsecured creditors are not paid. The bankruptcy court held WGB's services resulted in an identifiable, tangible, and material benefit to the Debtor's estate. Further, the actual, necessary fees and expenses WGB sought met the requirements set forth in § 330 and applicable Fifth Circuit law, and the court found no cause to either increase or decrease the total award. The court granted WGB's fee application in full.

In re Broughton Ltd. P'ship, 2012 WL 1437289 (Bankr. N.D. Tex. 2012)
JUDGE: D. Michael Lynn, United States Bankruptcy Judge.

> Debtor retained special counsel ("Firm") to negotiate the sale of 22 residential lots. Despite substantial efforts, negotiations failed and the sales did not close. Firm filed an application for compensation and the Office of the US Trustee objected on the grounds that Firm's efforts did not result in an "identifiable, tangible, and material benefit to the estate," as required by *Pro-Snax*. After analyzing the standards for fee awards applied by various circuits, the bankruptcy court made several observations. First, it seems clear that professionals serving a debtor or other fiduciary in a Chapter 11 case cannot be limited in their compensation to those activities that actually add to the estate. To do so would exclude from compensation many critical functions performed by professionals (such as operational oversight, disputes respecting control, steps in the plan process such as extensions of exclusivity, and other actions). Second, work that a professional undertakes doesn't always lead to success. The very fact that § 328(b) permits (but does not require) retention of professionals on a contingency basis demonstrates that Congress did not intend all professional services to be compensable only on that basis. With respect to the

"benefit" requirement, the bankruptcy court looked to the *Melp* case, which was cited by the *Pro-Snax* Court. According to *Melp*, in undertaking a "benefit analysis," a court should consider (1) whether the debtor's attorney's actions duplicated the duties of the trustee or the trustee's counsel under § 1106, (2) whether the services have obstructed or impeded the administration of the estate, and (3) whether the debtor's attorney's actions are consistent with the debtor's duties under § 521. With respect to "actual and necessary," the court construed the language in § 330(a)(1)(A) in light of the identical language in § 503(b)(2) and the Supreme Court's ruling in *Reading*, finding that success cannot be a prerequisite to compensation outside of a contingency arrangement. Rather, the conclusion that a professional was justifiably pursuing a legitimate, realizable goal of the fiduciary client should be enough benefit to the estate to satisfy *Pro-Snax*. In conclusion, the bankruptcy court held "that a professional provides an 'identifiable, tangible and material benefit' to a bankruptcy estate within the meaning of *Pro-Snax* through assisting the estate representative in administering an asset of the estate, whether or not the effect of administration of the asset is enhancement of the estate, so long as the professional's services are performed at the direction of the estate representative and the estate representative is acting in accordance with the Code and its sound business judgment."

In re Whitley, 2011 Bankr. LEXIS 4545 (Bankr. S.D. Tex. 2011).
JUDGE: Jeff Bohm, United States Bankruptcy Judge.

Bankruptcy court issued a show cause order as to why debtor's counsel should not disgorge all fees paid with respect to two separate bankruptcy cases filed on behalf of a Chapter 7 debtor. The court found that disgorgement was warranted because counsel violated his duty of disclosure under § 329 by failing to timely disclose in either case his compensation received, including property transferred from the debtor to counsel in payment of fees, and his connections to the debtor. The court further found that, because no discharge was received and the cases only delayed foreclosure on the debtor's properties, the services rendered provided no reasonable value under § 330. The court ordered disgorgement of all fees, including the unwinding of various property transfers that had been made in payment to counsel.

Waldron v. Adams & Reese, L.L.P. (In re Am. Int'l Refinery Inc.), 2012 WL 1034028 (5th Cir. 2012).
JUDGES: Benavides, Stewart, and Graves, Circuit Judges.

Liquidating trustee brought adversary proceeding against former counsel for Chapter 11 debtors, seeking disgorgement of attorney fees awarded during the bankruptcy based upon allegations that: (a) law firm failed to timely disclose that its retainer was paid by a creditor of the estate, (b) law firm failed to disclose its relationship with creditor that paid the retainer, and (c) law firm's prepetition advice to debtor on how to characterize payments made to officers and directors disqualified it from serving as debtors' counsel. Following bench trial, the U.S. Bankruptcy Court for the Western District of Louisiana ruled that law firm did not have a disqualifying adverse interest, but imposed sanctions of $135,000 for the firm's failure to adequately disclose various connections that it had to debtors and creditors. Trustee appealed. The district court affirmed, and trustee appealed. The Fifth Circuit also affirmed, holding: (a) addressing an issue of apparent first impression, in determining whether payment of a bankruptcy retainer by a third party is a disqualifying interest, the totality of the circumstances approach, as opposed to the per se approach, is the better test; (b) under the totality of the circumstances, creditor's payment of the bankruptcy retainer of debtors' counsel did not create a disqualifying interest (though failure to disclose this fact lead to sanctions); (c) law firm's previous representations of debtors did not create a disqualifying interest; and (d) $135,000 was an appropriate sanction for firm's failure to make adequate disclosures.

In re Bechuck, 2012 WL 1144611 (Bankr. S.D. Tex. April 4, 2012)
JUDGE: Jeff Bohm, United States Bankruptcy Judge.

> Chapter 7 panel trustee filed an application to employ general counsel under section 327(a). Although the court found that the firm had no adverse interest to the estate and was disinterested, the court *sua sponte* denied the application, without prejudice, finding that additional disclosures were required under Rule 2014.
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> Specifically, Rule 2014 requires the trustee to include six categories of information in an application, of which the court focused on two: the specific facts demonstrating the necessity for employing the attorney and the reasons for selecting the attorney. The court further found that case law requires the applicant "to come forward with facts pertinent to eligibility."
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> The application was denied under this framework because, among other things it (1) failed to provide any description of the applicant's past success in representing the trustee (instead giving vague references to the firm's general bankruptcy experience), (2) it lacked any discussion of how often the proposed attorneys had actually undertaken the specific tasks for which they were being retained, (3) it improperly recited as grounds for employment the trustee's friendship with the applicant firm (which the court found as an irrelevant basis), and (4) it was signed by one of the proposed attorneys with the trustee's permission (indicating the application was nothing more than a form document and the application was not the result of the trustee's concerted effort to fulfill his fiduciary duty to find the best counsel).
>
> In its conclusion, the court reiterated that it has "substantial discretion in approving applications to employ" and that the opinion is not a bar to the employment of recently-licensed attorneys.
> Three key factors in the court's future analysis of applications will be: "(1) How well have those less experienced attorneys done on those tasks on which they have already worked in other cases—that is, have their services rendered a tangible, identifiable, and material benefit?; (2) Do the less experienced attorneys have the willingness and savvy to aggressively prosecute the adversary proceeding and tenaciously negotiate with opposing counsel?; and (3) What are their hourly rates compared to the hourly rates of more experienced attorneys who are competing against them for trustee representation? It is this Court's duty to make these assessments on a case-by-case basis, just as it is a trustee's duty to consider these issues on a case-by-case basis."

Vasser v. Vasser (In re Vasser), 2011 WL 6780898 (Bankr. S.D. Tex. December 27, 2011)
JUDGE: Letitia Z. Paul, United States Bankruptcy Judge.

> Plaintiff filed a complaint seeking denial of debtor's discharge, asserting that debtor knowingly and fraudulently made false statements in her schedules, statement of financial affairs, and an amended petition. Defendant failed to file a timely answer and plaintiff moved for default judgment. Defendant thereafter filed a document described in its title as an answer, stating in full: "1. The allegations contained in Movant [sic] complaint are DENIED. 2. Debtor request [sic] that Movant's Complaint for Relief be Denied." Plaintiff's counsel then served defendant's counsel with a proposed motion for sanctions and moved to strike defendants' answer under Bankruptcy Rule 7008 (requiring that general denials be permitted only if the answering party intends in good faith to deny all of the allegations, including the jurisdictional grounds). Defendant's counsel then failed to appear at a court-ordered status conference, but an amended answer was filed that addressed the allegations within the complaint. Due to counsel's actions, the court issued an order to show cause as to why defendant's counsel should not disgorge his

attorneys fees and be sanctioned for failure to appear and properly represent defendant. After the hearing, plaintiff's attorney filed a motion for sanctions. The court held that (a) the amended answer corrected the grounds set forth in the motion for sanctions; thus, sanctions were not available under Rule 9011. Under Bankruptcy Rule 7016, however, sanctions were ordered due to defendant's counsel's failure to appear at the status conference and the delays and costs resulting therefrom.

AUTOMATIC STAY

Halo Wireless, Inc. v. Alenco Communication Inc., et al., Case No. 12-40122 (5th Cir. June 18, 2012)
JUDGES: Jolly, Benavides, and Dennis, Circuit Judges.

Various privately-owned telephone companies initiated twenty separate suits against telecommunications company Halo Wireless, Inc. ("Halo") before ten state public utility commissions ("PUCs") regarding the type of service Halo provides and whether or not Halo was properly compensating local companies for the call traffic it transfers to them. Halo filed for bankruptcy as a result of these actions, and then removed the various PUC actions to federal court and filed motions to have those actions transferred to the bankruptcy court. Thereafter, the telephone companies requested that the bankruptcy court determine that the various PUC actions were excepted from the automatic stay under section 362(b)(4) (police and regulatory power). The bankruptcy court found that the section 362(b)(4) exception applies to the PUC proceedings, because "[i]t is the nature of the action[, not] the identity of the parties which initially precipitat[e] the action[,] that determines whether Section 362(b)(4) applies." The bankruptcy court ruled that, although the PUC proceedings could go forward, the PUCs may not issue any ruling or order to liquidate the amounts of any claims against Halo or take any actions that would affect the debtor-creditor relationship. Halo filed a notice of appeal, which the bankruptcy court certified for direct appeal to the Fifth Circuit (as a question of law with no controlling precedent pursuant to 28 U.S.C. § 158(d)(2)). The Fifth Circuit affirmed.

As framed by the Fifth Circuit, the two main issues on appeal where (1) whether the PUC proceedings are being "continued by" a governmental unit and (2) whether those proceedings are in furtherance of states' police and regulatory powers.

As to issue (1), Halo argued that none of the PUC proceedings should be exempted from the stay because an action must be prosecuted by and in the name of a governmental unit in order to qualify. The Fifth Circuit, however, found this argument unpersuasive, citing to, among other cases, actions seeking to vindicate workers' rights. Courts have recognized that these types of actions may have similarities to private litigation, but they also promote the public interest by enforcing state laws and regulations. Further, the PUC proceedings were "continued by" a governmental unit, as the PUCs continued to preside over them. Finally, the language of section 362(b)(4) itself excepts suits continued by a governmental unit, without regard to who initially filed the complaint.

As to issue (2), courts have applied two related and overlapping tests when determining whether proceedings fall within the police or regulatory power exception: (1) the pecuniary purpose test, which asks whether the government is effectuating public policy rather than adjudicating private rights, and (2) the public policy test, which asks whether the government primarily seeks to protect a pecuniary interest, as opposed to the public safety and health. The Fifth Circuit found that the PUC actions passed both tests because the suits are not strictly pecuniary (particularly since, per the lower court's order, the PUCs could not take any actions to affect the debtor-creditor relationship) and the proceedings contemplate exercise of the PUC's regulatory powers. Further, the Federal Telecommunications Act, 47 U.S.C. §§ 151 et seq. ("FTA") and various state statutes indicate that regulation of telecommunications carriers serves the public interest.

Halo also argued that, in any event, some of the claims made by the telephone companies would need to be decided by a federal court. The Fifth Circuit noted that this may be correct, but the FTA contemplates a "federal-state balance" that "erects a scheme of cooperative federalism." The telephone companies brought claims under both federal and state telecommunications law, and interpretation and enforcement of interconnection agreements ("ICAs") is entrusted in the first instance to state commissions, with state PUC rulings being subject to federal court review. Thus, Halo was not being denied a federal forum by the requirement that it first subject to the jurisdiction of the PUCs (to whose jurisdiction it had consented by doing business in the various states). In conclusion, the Fifth Circuit held that "[i]f Halo is permitted to stay all of the PUC proceedings, it will have used its bankruptcy filing to avoid the potential consequences of a business model it freely chose and pursued."

In re Turner, 462 B.R. 214 (Bankr. S.D. Tex. 2011).
JUDGE: Jeff Bohm, United States Bankruptcy Judge.

Chapter 13 debtors had an account with First Community Credit Union ("First Community"), and also listed FCCU as having (1) a lien on their car for $3,225 and (2) an unsecured claim of $1,837. Postpetition, when the debtors tried to deposit or withdraw funds, they were unable to do so because First Community had frozen their accounts. First Community's bankruptcy officer also called the debtors to inquire if they would be paying their debts outside the Chapter 13 bankruptcy. First Community eventually unfroze the debtors' accounts over a year after they filed, although the debtors still experienced difficulties with the accounts. The bankruptcy court held that First Community violated the automatic stay by calling the debtors about paying their debts and by using auto debits to remove amounts from the debtors' accounts to pay the loans owed to First Community. These funds were placed back in the debtors' accounts; thus, while the automatic stay was violated twice, neither resulted in damages to the debtors. First Community violated both *Strumpf* requirements by failing to promptly file a motion for relief from stay and then continuing the administrative freeze for a significant, if not indefinite, period of time. For these reasons, the bankruptcy court held that First Community willfully violated 11 U.S.C. § 362(a)(7), although the violation resulted in no actual damages to the debtors. The court further held that stress and anxiety alone do not equate to actual damages, there must be more. Although First Community violated the automatic stay three times, the court did not award any punitive damages or attorney's fees to the debtors.

In re Nguyen, 2011 Bankr. LEXIS 4670 (Bankr. S.D. Tex. 2011).
JUDGE: Letitia Paul, United States Bankruptcy Judge.

On February 1, 2011, at a foreclosure sale conducted by a substitute trustee, debtor's ownership interest in real property located in Richmond, Texas was sold to movant. Movant recorded the substitute trustee's deed in the real property on February 7, 2011. Debtor filed a voluntary petition under Chapter 13 of the Bankruptcy Code on September 27, 2011. Debtor contended that the foreclosure sale was wrongful, asserting that the entity which appointed the substitute trustee lacked authority to appoint a substitute trustee. Movant offered into evidence certified copies of the deed of trust and the substitute trustee's deed. Neither movant nor debtor presented other evidence. Movant's Motion for Relief from Automatic Stay and Co-Debtor Stay to Permit Eviction was granted. In the instant case, Debtor has made no offer of adequate protection, and there is no evidence that she has any ability to provide adequate protection of Movant's interest in the property. The court concludes that Debtor has not met her burden of proof on the question of cause for lifting of the stay.

In re Rodriguez, 2011 Bankr. LEXIS 5077 (Bankr. S.D. Tex. 2011).
JUDGE: LETITIA Z. PAUL, United States Bankruptcy Judge.

> Chapter 11 debtors filed a motion to extend the automatic stay as to all creditors. A bank holding promissory notes secured by real property objected. The debtors filed a joint case under Chapter 11 within one year after a preceding Chapter 11 joint case was pending. The court granted the motion to all creditors and conditioned the motion as to the bank. The stay was extended as to the bank if the debtors made a set monthly payment during the course of the case until a plan was confirmed or the bank was paid in full. The court concluded that the presumption of bad faith filing did not apply under § 362(c)(3)(C)(i)(III). The preponderance of the evidence supported the debtors' contention that the current case would be concluded with a confirmed plan that would be fully performed. The debtors entered into listing agreements to sell their homestead and all of their business properties, and their schedules reflected that the value of their assets substantially exceeded their liabilities. Thus, the debtors rebutted the presumption that the case was filed in bad faith.

In re LeBlanc, 2011 Bankr. LEXIS 5076 (Bankr. S.D. Tex. 2011).
JUDGE: LETITIA Z. PAUL, United States Bankruptcy Judge.

> Debtor claimed real property as exempt. HK Investment Partnership, Ltd held a security interest in the property and conceded that the Debtor had approximately $5,712.13 equity in the property. HK Investment Partnership, Ltd sought relief from the automatic stay on the basis that the Debtor had not paid the real property taxes for 2009 and 2010 and had failed to provide a certificate of insurance reflecting insurance coverage on the property as required under the Debtor's Deed of Trust. HK's motion to lift the stay was denied on condition of Debtor modifying plan to provide for tax payment. The court found that the Debtor had offered adequate protection in the form of modifying her plan to include payment of the taxes for 2009 and 2010. As to the 2011 taxes, because of the contingent nature of receiving a refund and the amount thereof, and the Debtor not having used her 2009 or 2010 tax refunds to pay Movant, the court found that the proposal did not provide the Movant with adequate protection that the 2011 taxes would be paid.

Dolan v. Dolan, 2012 U.S. Dist. LEXIS 13648 (S.D. Tex. 2012).
JUDGE: Gray H. Miller, United States District Judge.

> Prepetition, creditor obtained a judgment and the state court permitted Dolan (the eventual Chapter 13 debtor) to deposit shares of stock in the court's registry in lieu of posting a supersedes bond on appeal. Dolan filed for bankruptcy during his appeal of the state court judgment, which was ultimately affirmed. Creditor then sought and received relief from the automatic stay to release the shares of stock from the state court's registry. Upon receiving relief from stay, however, creditor also abstracted the judgment in the state court, causing certain distributions payable to debtor to cease. The bankruptcy court found that (a) creditor was dissatisfied with simply holding the stock while she waited to receive payment through the debtor's Chapter 13 plan, (b) by recording her abstract of judgment, creditor intended to disrupt the debtor's receipt of payments and divert those payments to herself, and (c) creditor's action of recording her abstract of judgment was a continuing willful violation of the automatic stay. The bankruptcy court awarded debtor actual damages ($1,000) and attorney's fees/costs ($19,757.50), and imposed

punitive damages in the form of an offset against creditor's prepetition claim, effectively reducing the claim to $0. Creditor appealed. The district court affirmed, finding that (a) creditor's own testimony established that she understood the difference between the shares of stock and the debtor's income, (b) the stay violation was willful, and (c) the creditor exhibited a complete disregard for the bankruptcy process by abstracting her judgment, and intentionally acted to punish the debtor for seeking bankruptcy protection, which was sufficient to constitute "egregious conduct" justifying punitive damages (so the bankruptcy court's award of punitive damages was not clear error).

BANKRUPTCY CRIMES

United States v. Spurlin, 664 F.3d 954 (5th Cir. 2011).
JUDGES: Smith, Barksdale, and Benevides, Circuit Judges.

Husband and wife defendants were convicted of (1) concealment of bankruptcy assets, 18 U.S.C. §152(1), for not disclosing interests in property, (2) false statements under penalty of perjury, 18 U.S.C. §152(3), and (3) bankruptcy fraud. With respect to § 152(1), the wife argued that she could not be convicted of concealment because the joint bankruptcy petition, of which she did not participate in supplying information, was filed on her behalf using a general power of attorney. The court affirmed the wife's conviction, holding that a general power of attorney may be used to file for bankruptcy on another's behalf because entrusting another with the management of one's bankruptcy is not on the same level of personal matters as divorce or military enlistment in which a power of attorney is considered inappropriate (especially since the case can be dismissed if the debtor feels the bankruptcy was improper). Moreover, at the 341 meeting, the wife did not object to any of the answers given by her husband, despite express instruction to do so if she disagreed, and she did not reveal the inaccuracies in the filings. The court further found that the wife knew about and benefited from the concealed assets. The court also affirmed the wife's conviction under § 152(3) because, among other things, the wife admitted in her testimony that she knew that a response given on the trustee's questionnaire was false, but again claimed innocence because she did not fill out the form. The Fifth Circuit found this argument again unavailing because the wife personally signed the trustee's questionnaire under penalty of perjury and she did not object when the trustee questioned whether the answers were true at the 341 meeting. Husband's conviction on this count, however, was reversed because the question at issue was ambiguous (and the husband had not admitted he knew the answer was false, as had the wife). Finally, on the bankruptcy fraud conviction, husband argued that his scheme to defraud was completed before he filed for bankruptcy and, thus, the filing did not help him conceal any allegedly fraudulent scheme. The Fifth Circuit rejected this argument under a plain reading of the statue and explained that, by filing for bankruptcy, the husband was able to conceal his scheme by discouraging his victim from expending additional funds to investigate a debt that would ultimately be discharged. This sentence was vacated and remanded for resentencing.

CASH COLLATERAL

In re Gow Ming Chao, 2011 Bankr. LEXIS 4543 (Bankr. S.D. Tex. 2011).
JUDGE: Jeff Bohm, United States Bankruptcy Judge.

Chapter 11 case was *sua sponte* converted to Chapter 7 due to debtor's material failures to comply with bankruptcy requirements, including, among other things, failing to (1) take credit counseling, (b) file a certificate from an approved nonprofit budget and credit counseling agency, (c) maintain insurance on their properties, (d) close prepetition books, records, and accounts and opening new DIP accounts, and (e) obtain authority to use cash collateral. The debtors moved for reconsideration of the conversion order and contended that they were represented by inexperienced counsel who failed to advise them of the duties of debtors in possession and that their failure to comply with Chapter 11 requirements was due to their inability to comprehend the English language. The court denied the motion for reconsideration and held that each party voluntarily chooses his own attorney and is deemed bound by the acts of that attorney, including being considered to have notice of all facts (notice of which can be charged upon the attorney). Since bad legal advice does not relieve the client of the consequences of his own acts, the remedy for bad legal advice lies in malpractice litigation.

CLASS ACTIONS

Teta v. TWL Corp., 2012 U.S. Dist. LEXIS 18345 (E.D. Tex. 2012).
JUDGE: Rodney Gilstrap, United States District Judge.

Teta was employed by TWL Corporation and its subsidiary (together "TWL") until September 9, 2008, when he was laid off along with approximately 110 other employees. On October 19, 2008, TWL filed a voluntary petition for relief under Chapter 11, and on November 4, 2008, Teta filed a Class Action Adversary Proceeding Complaint against TWL on "behalf of himself and the similarly-situated former employees of [TWL] for violations of the WARN act." TWL moved to dismiss Teta's adversary proceeding and Teta moved for class certification pursuant to Rule 7023. The bankruptcy court abated both motions at the request of the parties until the size of the estate could be determined. On April 2, 2010, TWL's bankruptcy converted to Chapter 7, and a trustee was appointed who also opposed Teta's motion for class certification. On March 23, 2011, the bankruptcy court denied the motion for class certification and dismissed the adversary proceeding for several reasons. First, the bankruptcy court noted that TWL's employees had filed claims, participated in the ordinary claims resolution process, and that the proposed class action would "negate" that process. Second, the bankruptcy court found that a class action was not the "superior method" for resolving appellant's claims, since Teta was the only individual who asserted a timely WARN Act claim. Finally, the court noted that Teta had failed to meet the numerosity requirement, since the number of proposed class action plaintiffs was modest (at most 130, and likely far less).

CLAIMS – PROOFS

Conway v. United States, 647 F.3d 228 (5th Cir. 2011).
JUDGES: Jolly, Haynes, and Graves, Circuit Judges.

Conway, founder and CEO of National Airlines, appealed from a district court summary judgment determination that, pursuant to 26 U.S.C. § 6672, he was personally liable for excise taxes that National collected from its passengers but failed to pay over to the US during his tenure as CEO. The Fifth Circuit affirmed. Liability under § 6672 is composed of two elements: (1) that the taxpayer was a “responsible person” and (2) that the taxpayer willfully failed to collect, account for, and pay over such taxes. As to the first prong, Conway was a responsible person as the founder, CEO, president, and chairman of National during the relevant periods. He was also one of the largest individual stockholders and had the most individual authority. As to the second prong, a person acts “willfully” if he “knows the taxes are due but uses the corporate funds to pay other creditors” or “he recklessly disregards the risk that the taxes may not be remitted to the government.” Conway argued that he had reasonable cause to defeat a finding of willfulness, alleging (1) he relied on the advice of counsel, (2) the airlines Stabilization Act justified non-payment, (3) National lacked the unencumbered funds to pay, and (4) he believed that the taxes had been fully paid and otherwise lacked intent to avoid paying the taxes. The Fifth Circuit found each of these points unavailing, finding that Conway failed to provide sufficient proof.

In re Stewart, 647 F.3d 553 (5th Cir. 2011).
JUDGES: Higgenbotham, Clement, and Owen, Circuit Judges.

Stewart filed for Chapter 13 and Wells Fargo Bank, which held a mortgage on her house, filed a proof of claim. Stewart's attorney asked for a full accounting from Wells Fargo. The bank did not cooperate with Stewart's request. It provided a list of charges by type, but did not include the amount, date, or payee. At a hearing, the bankruptcy court found Wells Fargo had overstated its claim by as much as $10,000. The bankruptcy court did not find that Wells Fargo acted in bad faith, but did issue an injunction that required the bank to audit every proof of claim filed in the district from April 13, 2007 going forward and to provide a complete loan history on every account and file it with the appropriate court. Wells Fargo appealed. The Fifth Circuit held that (1) debtor lacked Article III standing for district-wide injunction because there was no demonstrated likelihood that debtor would ever again be the subject of an incorrect proof of claim filed by the servicing agent (there were no class claims involved) and (2) bankruptcy court's inherent power to protect its jurisdiction and judgments and to control its docket did not authorize injunction.

In re Capco Energy Inc., 669 F.3d 274 (5th Cir. 2012).
JUDGES: Clement, Owen, and Higginson, Circuit Judges; Owen, Circuit Judge, concurring and dissenting.

Tana Exploration Company, LLC ("Tana") decided to sell certain oil and gas properties in the Gulf of Mexico. Tana retained a financial advisor ("Tristone") to assist in the sales process and an engineering firm ("Ryder") to prepare a report estimating the reserves, future production, and income attributable to the properties (the "April Report"), data from which was used to prepare a Confidential Evaluation Brochure ("CEB") for parties interested in the properties. The debtors purchased the properties prepetition. Postpetition, the debtors sued Tana, Tristone, and Ryder seeking, among other relief, rescission of the bill of sale and damages, alleging that Ryder breached its professional obligations and its alleged contract with debtor. Debtor also alleged that Tana and Tristone made fraudulent representations regarding the properties. The bankruptcy court granted summary judgment in favor of defendants and the district court affirmed. The Fifth Circuit also affirmed, holding that (1) debtor's claims for professional liability against Ryder were dependent on the existence of a contract (express or implied), which did not exist and (2) the debtor could not show that it had relied on the alleged misrepresentations. The Fifth Circuit specifically pointed to disclaimers and waivers of reliance provisions in various documents signed by debtors, including the CEB, a confidentiality agreement, and the purchase agreement, where the parties disclaimed any responsibility for the accuracy of the information and where debtor agreed that it would rely solely on its own independent evaluation and analysis.

In re Pilgrim's Pride Corp., 453 B.R. 684 (N.D. Tex. 2011).
JUDGE: John McBryde, United States District Judge.

The Hardens were parties to broiler-grower agreements with Pilgrim's Pride Corp ("PPC"). After PPC filed for Chapter 11, the bankruptcy court entered an agreed order allowing PPC to reject the agreements with the Hardens. Following PPC's rejection, the Hardens filed a proof of claim alleging violations of the Age Discrimination in Employment Act (ADEA) and § 1921 of the

Packers and Stockyards Act (PSA), to which PPC objected. PPC moved for summary judgment in the bankruptcy court. Because the Hardens' claims involved ADEA violations, the district court withdrew the reference with respect to the Hardens' claims (the district court adopted an expansive view of the term "personal injury torts" under § 28 U.S.C. § 157(b)(5)). The court held that the Hardens were independent contractors who maintained day to day control over their operation and possessed ultimate responsibility for their farm; thus, they did not have an employment relationship with PPC and ADEA claims could not survive summary judgment. Further, there was no evidence that PPC's rejection of the agreements had an anti-competitive effect on the poultry industry, as required to support the PSA claims under Fifth Circuit precedent; thus, the PSA claims could not survive summary judgment.

McCarthy v. Bank of Am., NA, 2011 U.S. Dist. LEXIS 147685 (N.D. Tex. 2011).
JUDGE: John McBryde, United States District Judge.

Plaintiff executed a note payable to Countrywide Home Loans, Inc. ("Countrywide") and a deed of trust. The deed of trust designated Countrywide or any holder of the note who is entitled to receive payment of the note as "Lender." The deed of trust named Mortgage Electronic Registration Systems ("MERS"), solely as Countrywide's nominee, as beneficiary under the deed of trust. The note made no reference to MERS. MERS later purported to assign the note and deed of trust to Bank of America ("BOA"), when plaintiff was in default on payment of the note. A foreclosure on the home was then conducted by, or at the behest of, BOA at a time when the record did not indicate that BOA owned or held the note that was secured by the deed of trust pursuant to which the foreclosure was conducted. In denying defendants' motion to dismiss, the district court held that, although the grounds of the motions to dismiss appeared to have merit, there was one major impediment to granting the motions – the separation of the note from the deed of trust. If the holder of the deed of trust does not own or hold the note, the deed of trust serves no purpose and cannot be a vehicle for depriving the grantor of the deed of trust of ownership.

In re Phillips, 2012 Bankr. LEXIS 368 (Bankr. S.D. Tex. 2012).
JUDGE: Letitia Z. Paul, United States Bankruptcy Judge.

A creditor filed a proof of claim in a debtor's bankruptcy case for arrearage in the debtor's mortgage payments, but the debtor objected to the claim on the basis that it was allegedly discharged in a prior bankruptcy case filed in 2004. Specifically, the debtor contended that, after making all payments to the trustee due under the debtor's plan in the prior bankruptcy case, the debtor received a discharge that included the debt to the creditor. The bankruptcy court held that the debt was not discharged in the prior bankruptcy since it was being paid to the creditor outside the debtor's plan and the last payment due to creditor was due after the final payment to the trustee under the plan. Thus, the claim for arrearages should be allowed as filed, because the note was within the purview of § 1322(b)(5) in the prior case, and thus, pursuant to § 1328(a)(1), the debt was not discharged in the prior case.

In re Goldston, 2012 Bankr. LEXIS 35 (Bankr. S.D. Tex. 2012).
JUDGE: Letitia Z. Paul, United States Bankruptcy Judge.

A Chapter 13 debtor filed an objection and amended objection to a secured creditor's proof of claim on the grounds that the creditor failed to file a complete loan history as required by Bankr. S.D. Tex. R. 3001-1 and failed to provide documentation to support the sums referenced as escrow balances. In addition, the debtor alleged that the loan history did not reflect two of her payments. The amended proof of claim was allowed as filed except for the amount of $530. The creditor's proof of claim was based on money loaned to the debtor and secured by a deed of trust on real property owned by the debtor. The creditor was the assignee of the original mortgagee. An employee of the creditor testified that the debtor owed an amount representing the current monthly payment, past due payments, escrow, insurance, late charges, and additional charges. A monthly billing statement showed a "corporate advance" balance that included payments for insurance, property taxes, and legal fees. That amount was due at a later date. The court found that $530 in advances made by the original mortgagee was not substantiated by the evidence. Other than that amount, the court found that the creditor provided a detailed explanation and the documentation to support its proof of claim. The creditor's proof of claim included the requisite loan history, which reflected that the debtor's account was credited with all payments. The court found that the debtor successfully rebutted the prima facie validity of the creditor's claim by her testimony. The creditor established by a preponderance of the evidence the validity of its claim except as to the $530 unaccounted for amount.

CLAIMS – PRIORITY

In re Scopac, 649 F.3d 320 (5th Cir. 2011).
JUDGES: Jones, Chief Judge, Prado, Circuit Judge, and Ozerden, District Judge.

This appealed involved a dispute over compensation for diminution in the value of collateral during the pendency of a Chapter 11 bankruptcy. Appellants, holders of notes secured by the timber and non-timber assets of Scotia Pacific Co., LLC ("Scopac"), sought review of the district court's dismissal of their appeal for lack of subject matter jurisdiction and contended that the bankruptcy court erred in denying their "superpriority" admin claim against the bankruptcy estate. The Fifth Circuit held that (a) the pendency of a confirmation appeal did not deprive the district court of subject matter jurisdiction over an appeal from denial of a superpriority claim (despite the fact that allowance of the claim could affect the plan); (2) appeal was not subject to dismissal for equitable mootness because of, among other considerations, the possibility of even a fractional recovery; (3) noteholders' lien on proceeds from postpetition sales had to be recognized in fixing value of superpriority admin claim; (4) payments made to creditors' professionals out of cash collateral proceeds were improperly deducted in calculating superpriority admin claim; and (5) determination that value of collateral had not declined postpetition was not clearly erroneous. The Fifth Circuit then vacated and remanded with "instructions to enter judgment for the Noteholders for a $29.7 million administrative priority claim against the reorganized debtors." 624 F.3d 274 (5th Cir. Oct. 19, 2010). On August 4, 2011, the Fifth Circuit modified its earlier opinion to read "instructions to enter judgment for the Noteholders and against the reorganized debtor for an administrative priority claim of *up to* $29.7 million." 649 F.3d 320, 322. In both opinions, the Fifth Circuit "recognized that, in appeals from substantially consummated plans, courts may fashion whatever relief is practicable for the benefit of appellants." By allowing partial recovery, the court could avoid the problem of equitable mootness. "So long as there is the possibility of fractional recovery, the Noteholder need not suffer the mootness of their claims." Partial recovery may be necessary, however, if an award of full recovery would be impractical or would undermine the plan. The Fifth Circuit had not intended to rule that the entire $29.7 million was due.

In re Munoz, 459 B.R. 621 (Bankr. S.D. Tex. 2011).
JUDGE: Richard S. Schmidt, United States Bankruptcy Judge.

> Debtors filed for Chapter 13 and Mobile Home Ranch ("MRH") filed a proof of claim as a secured creditor. The debtors crammed down MRH's claim to the value of the collateral in their plan; MRH did not object. Debtors failed to keep up with their Chapter 13 payments, and their bankruptcy was dismissed. After the debtors filed their second Chapter 13 bankruptcy, MRH again filed a proof of claim, but this time claimed the mobile home was subject to a lease. Debtors objected to the claim and proposed a Chapter 13 plan that again treated MHR's claim as secured. The court held that MRH was judicially estopped from taking an inconsistent position in the second bankruptcy with respect to the alleged nature of its claim.

In re Bigler, L.P., 458 B.R. 345 (Bankr. S.D. Tex. 2011).
JUDGE: Jeff Bohm, United States Bankruptcy Judge.

> Prepetition secured lender to Chapter 11 debtors ("Amegy") brought adversary proceeding to determine the priority of its liens with respect to liens of creditor that supplied and installed process piping system at the debtors' petrochemical plant ("Shaw") and creditor that furnished industrial boilers and related equipment to the plant ("Halgo"). Amegy's lien was properly perfected. Shaw admitted that it failed to timely perfect its statutory lien, but the parties stipulated that Shaw was a "mechanic" or "artisan" entitled to a constitutional lien on the process piping system. The parties stipulated that Halgo was a "materialman" but not a "mechanic" or "artisan" (Halgo sized and packaged boiler units to meet its customers' needs, but did not manufacture). Shaw and Halgo each requested that the court enter a judgment declaring that they supplied "removables" to the debtors' plant and, therefore, their liens have priority over Amegy's. Following trial, the court found that Halgo had a valid and properly perfected statutory lien (but did not meet the requirements for a constitutional lien). Although Shaw failed to perfect its statutory lien, the court found it was entitled to a constitutional lien. A constitutional mechanics' lien is self-executing and arises independently and apart from any legislative act and can exist even if the lienholder fails to comply with the legislative requirements for statutory liens. A party is entitled to a constitutional lien if: (1) is qualifies as a "mechanic," an "artisan," or a "materialman," and (2) makes repairs to an "article" or "building." An M&M lien is superior to a prior recorded deed of trust lien if the materials furnished can be removed without material injury to the land, the preexisting improvements, or the materials themselves. After an analysis of the relevant factors, the court found: (1) Shaw's piping system was not removable, (2) Halgo's boiler system was not removable, and (3) the boilers themselves were removable.

United States v. Smith, 2011 U.S. Dist. LEXIS 138623 (E.D. Tex. 2011).
JUDGE: Ron Clark, United States District Judge.

> A mortgagor defaulted on a mortgage held by the United States on a vessel. The mortgagor filed for bankruptcy after the US filed suit to foreclose. The bankruptcy court entered an order abandoning the estate's interest in the vessel, which was sold at auction for $3.3 million. Plaintiff, acting on behalf of a vacation plan and a retirement plan, argued that unpaid contributions to the plans should constitute seaman wage's that take priority over the mortgage with respect to the proceeds. Although court's generally find that contributions paid to and commingled in union benefit plans are not wages entitled to priority, the contractual provisions of the vacation plan made it distinguishable from the plans analyzed in prior cases (including, among others, provisions that the payments were based entirely on service to the vessel, there were no administrative fees or expenses payable, and the employee was directly liable to the seaman, not

the trustee). The unpaid contributions to the vacation plan were found to be wages, whereas the unpaid contributions owed to the retirement account plan were found not to be seamen's wages.

In re Tepera, 2012 Bankr. LEXIS 773 (Bankr. S.D. Tex. 2012).
JUDGE: Letitia Paul, United States Bankruptcy Judge.

Debtor filed a petition under Chapter 13 of the Bankruptcy Code, and an attorney who represented the debtor's former spouse in a divorce action filed a claim from a state court judgment in the amount of $129,388 against the debtor's bankruptcy estate, asserting that the claim was entitled to priority under § 507(a)(1)(A) as a "domestic support obligation." The debtor filed an objection to the attorney's claim, contending that the award was not a domestic support obligation because the attorney was not his spouse, former spouse, or child, or the parent, legal guardian, or responsible relative of his children. The bankruptcy court noted that courts were split on the issue of whether an award that was made directly to an attorney in a divorce decree was a domestic support obligation under the Bankruptcy Code, but found that the majority view that such an award was a "domestic support obligation" under § 101(14A) that was entitled to priority under § 507(a)(1)(A) was the better view.

COLLATERAL ESTOPPEL

Leon v. Rabalais, 2012 WL 42101 (Bankr. S.D. Tex. 2012).
JUDGE: David R. Jones, United States Bankruptcy Judge

Creditor filed a complaint seeking to deny discharge of a debt owed to it pursuant to § 523(a)(2). Creditor filed suit in a California state court against the Debtor and affiliates. The state court complaint alleged that the Debtor, through his affiliates, engaged in fraudulent conduct. The Debtor appeared and defended the case in its initial stages. However, the Debtor did not respond to a motion for entry of a default judgment. The state court conducted an evidentiary hearing on the motion and made a number of statements on the record regarding the fraudulent conduct of the Debtor. A default judgment, without express evidentiary findings, was entered against the Debtor by the state court. Creditor filed a motion for summary judgment in the adversary proceeding based on the state court judgment and record. The bankruptcy court analyzed whether collateral estoppels was appropriate. Specifically, the Court considered: 1) whether the Debtor had knowledge of the state court proceedings, 2) whether the state court case was 'actually litigated" even though a default judgment was entered, and 3) whether application of collateral estoppel furthers judicial economy and preserves the integrity of the judicial system. The Court found the answer to each question to be "yes" and granted the motion for summary judgment.

DISCHARGE EXCEPTIONS

In re Shcolnik, 2012 U.S. App. LEXIS 2609 (5th Cir. 2012).
JUDGES: Jones, Chief Judge, and Haynes, Circuit Judge, and Crone, District Judge. Haynes, Circuit Judge, concurring and dissenting.

Appellant company was awarded $50,000 in attorneys' fees after it prevailed in prepetition arbitration that resolved debtor's allegations that he owned an interest in the company. After debtor filed for Chapter 7, company filed a complaint alleging that the award was nondischargeable under 11 U.S.C. § 523(a)(4) (fraud or defalcation while acting in a fiduciary capacity) and (a)(6) (willful and malicious injury). The district court affirmed a bankruptcy court's summary judgment against the company and the company appealed. The debtor, as a former company officer, could have been a fiduciary under § 523(a)(4), but the debt at issue was not for fraud or defalcation while acting in a fiduciary capacity; it was attorneys' fees awarded in an arbitration that resolved his allegations of an ownership interest. Summary judgment on the § 523(a)(4) claim was proper. The debtor allegedly engaged in a course of contumacious conduct that required the company to file meritorious litigation against him, resulting in the fee award. Thus, the summary judgment on the § 523(a)(6) claim was reversed and the case was remanded for trial on the merits. That Texas law allowed the arbitrator to assess fees without specifically finding willful and malicious injury was not conclusive. If the facts were as the company alleged, the debtor either had the motive to inflict harm or acted so as to create an objective substantial certainty of harm. His behavior resulted in willful and malicious injury if his claims of ownership were made in bad faith as a pretense to extract money. The litigation costs he forced upon the company were different from the money claim he made against it, but they were neither attenuated nor unforeseeable from his alleged intentionally injurious conduct. The § 523(a)(6) claim should have survived.

In re Peterson, 452 B.R. 203 (Bankr. S.D. Tex. 2011).
JUDGE: Jeff Bohm, United States Bankruptcy Judge.

Party who was injured when struck by Chapter 7 debtor prepetition brought adversary proceeding to liquidate amount of resulting indebtedness and for determination that debt was nondischargeable pursuant to 11 U.S.C. § 523(a)(6) (willful and malicious injury). The court made four holdings. First, the debtor did not act in self-defense or in defense of others in punching inebriated party guest with whom he had history of animosity. Second, medical bills that were not paid either by tort victim or by tort victim's insurer, but which were simply written off by medical providers from which tort victim received treatment, could not be included in compensatory damages assessed against debtor. Third, that debtor had acted with malice in punching inebriated guest at party which both were attending, so as to permit award of punitive damages against him under governing Texas law, was sufficiently established by requisite clear and convincing evidence. And fourth, the debtor's conduct was conduct that had an objective substantial certainty of causing harm, and which debtor also subjectively intended to cause harm, so as to preclude discharge of resulting debt on “willful and malicious injury” theory.

In re Ritz, 459 B.R. 623 (Bankr. S.D. Tex. 2011) (on appeal).
JUDGE: Jeff Bohm, United States Bankruptcy Judge.

This adversary proceeding concerned an individual Chapter 7 debtor who authorized transfers of funds out of one corporation into the accounts of several other companies—all of which he controlled. As a result of these transfers, the one corporation was drained of all of its cash and could not pay its creditors. One of these creditors, Husky, filed suit against the debtor, alleging that, because of the debtor's actions, he has become personally liable for the debt owed by the corporation and this debt was nondischargeable under 11 U.S.C. §§ 523(a)(2)(A), (a)(4), and (a)(6). The court held that debtor had no liability to creditors under § 21.223(b) of the Texas Business and Commerce Code (“TBOC”) and, thus, no debt to discharge. Previously, Texas law allowed for the corporate veil to be pierced under three expansive categories: “(1) the corporation is the alter ego of its owners and/or shareholders; (2) the corporation is used for illegal purposes; and (3) the corporation is used as a sham to perpetrate a fraud.” However, TBOC §21.223(b) imposes a new requirement for parties seeking to pierce the corporate veil on a breach of contract claim, such as the one at issue in this case. The plaintiff must now also establish that the defendant shareholder “caused the corporation to be used for the purpose of perpetrating and did perpetrate an actual fraud on the obligee primarily for the direct personal benefit of the holder.”

The record did not include any misrepresentation of a material fact from the debtor to the plaintiff that would satisfy the elements of fraud. Thus, the court held that the plaintiff's common law fraud claim failed. The court also held that debtor did not owe a fiduciary duty to the plaintiff and, therefore, Husky cannot prevail under 11 U.S.C. § 523(a)(4). In its holding, the court cited to both *Conway v. Bonner,* 100 F.2d 786, 787 (5th Cir. 1939) ("holding that directors do not owe a fiduciary duty to creditor "so long as [the corporation] continues to be a going concern, conducting its business in the ordinary way, without some positive act of insolvency, such as the filing of a bill to administer its assets….) and *Carrieri v. Jobs.com, Inc.*, 393 F.3d 508, 534 n.24 (5th Cir. 2004) (stating, in dicta, that "[o]fficers and directors that are aware that the corporation is insolvent, or within the 'zone of insolvency' as in this case, have expended fiduciary duties to include the creditors of the corporation."), finding that the *Carrieri* statement was not binding because (1) the statement was dicta and (2) where two previous holdings conflict, the earlier opinion controls. Moreover, the company was still operational at the time of the subject transaction, making the trust fund doctrine inapplicable. Finally, the court held that Husky failed to prove that debtor committed willful and malicious injury to Husky or to Husky's property and, therefore, Husky cannot prevail under 11 U.S.C. § 523(a)(6) (noting that the court found no case law where an unsecured trade creditor obtained a judgment for nondischargeability under § 523(a)(6) where the debtor simply failed to honor a contractual obligation to pay).

<u>ABSOLUTE PRIORITY RULE</u>

In re Lively, 2012 WL 959286 (Bankr. S.D. Tex. 2012, March 21, 2012).
JUDGE: Marvin Isgur, United States Bankruptcy Judge

Lively, an individual Chapter 11 debtor, filed a plan that proposed a 7.38% payment to general unsecured creditors, but allowed Lively to retain property. The plan was not accepted by all voting classes and, as a result, Lively attempted to cram down the plan. The issue before the bankruptcy court was whether BAPCPA abrogated the absolute priority rule for individual Chapter 11 cases. Noting a split among courts, the bankruptcy court sided with the majority in holding that BAPCPA did not abrogate the absolute priority rule with respect to individual Chapter 11 debtors (narrowly interpreting the phrase "included in the estate under section 1115" to mean property *added* to the estate by § 1115). As such, an individual Chapter 11 debtor may retain assets in which he acquired an interest postpetition, but not estate assets that the debtor had as of the commencement of the case. The memorandum opinion was issued in support of the bankruptcy court's certification of its order denying confirmation of Lively's plan for direct appeal to the Fifth Circuit.

Friedman v. P+P, LLC (In re Friedman), 466 B.R. 471 (9^{th} Cir. BAP 2012)
JUDGES: Jury, Kirscher, and Clarkson (Clarkson sitting by designation) (Jury dissenting)

Bankruptcy court entered order refusing to confirm plan proposed by individual Chapter 11 debtor on ground that plan, under which debtors would retain their equity interests in businesses did not provide for a 100% distribution to general unsecured creditors. Debtors appealed. The BAP reversed and held that, by its plain terms, the absolute priority rule was inapplicable in individual Chapter 11 cases ("[a] plain reading of §§ 1129(b)(2)(B)(ii) and 1115 together mandates that the absolute priority rule is not applicable to individual chapter 11 debtor cases").

DISMISSAL

In re Noram Res., Inc., 2011 Bankr. LEXIS 4268 (Bankr. S.D. Tex. 2011).
JUDGE: Marvin Isgur, United States Bankruptcy Judge

> Plaintiff, a Chapter 7 trustee for two debtors, filed a complaint against defendant directors and officers (collectively, the directors), alleging that they breached their duty of care as officers and directors of one of the debtor corporations. The directors filed motions to dismiss for failure to state a claim. The court granted, in part, the directors' motions to dismiss as to a claim relating to non-insider executive compensation. As to other claims, the court converted the motions to dismiss to motions for summary judgment and required the parties to file stipulations. The court applied the internal affairs doctrine in determining that the laws of the province of Alberta, Canada applied. Thus, the trustee's claims against the directors were based on their alleged violations of the Alberta Business Corporations Act. The court determined that an exculpation clause, an indemnification clause, and the statute of limitations did not affect its analysis of whether the trustee had stated claims. Rather, it considered the trustee's allegations in light of the Canadian business judgment rule. Taking all of the allegations as true, the court concluded that the trustee stated a claim for breach of the duty of care with respect to the directors' decision to cause the purchase of a large number of oil and gas leases. The court's doubts about whether a well investment was outside the range of reasonableness were insufficient for dismissal of that claim. The trustee's excessive compensation claim was dismissed, except as to salaries of three directors and except as to certain bonuses. The business judgment rule's presumption of reasonableness did not apply to those directors' decisions regarding their own salaries.

In re Bray & Jamison, PLLC, 2012 Bankr. LEXIS 103 (Bankr. S.D. Tex. 2012).
JUDGE: Letitia Paul, United States Bankruptcy Judge.

> The bankruptcy court issued an order to show cause why a Chapter 11 debtor's case should not be dismissed pursuant to § 1112(b) in light of the appearance that the debtor had almost no operations other than continuing with a few state court lawsuits and that the debtor might have filed the case in order to obtain unfair advantage in litigation it commenced in state court. The debtor, a law firm, was engaged in litigation against its former clients. The litigation was commenced in state court and removed to the bankruptcy court. The debtor also had two other litigation matters pending in which it sued its former clients to collect fees. The debtor's other operations consisted of seeking new business, but it had not yet obtained any new business. The court found that there was no indication of any ongoing business to reorganize. The court dismissed the debtors' Chapter 11 case. Were the instant case to remain in Chapter 11, the court likely would be compelled to appoint a Chapter 11 trustee because of the apparent self-dealing between the debtor and other entities owned by its two partners. The court could not compel the individual partners to practice law solely through the debtor entity, and the evidence indicated that they had practiced, both separately and together, through other entities. The court concluded, under the totality of the circumstances, that the Chapter 11 case should be dismissed.

In re Tex. EMC Mgmt., LLC, 2012 Bankr. LEXIS 700 (Bankr. S.D. Tex. 2012).
JUDGE: Letitia Paul, United States Bankruptcy Judge.

> On November 30, creditors filed involuntary petitions under Chapter 7 against debtor. Separate judgments were entered providing for the court's abstention and dismissing the cases. Section 305(a)(1) provided that the court, after notice and a hearing, could dismiss a case under Title 11, or could suspend all proceedings in a case under Title 11, at any time if the interests of creditors

and the debtor would be better served by such dismissal or suspension. Courts determining whether the interests of creditors and the debtor would be better served by dismissal or suspension had considered the totality of the circumstances, including seven listed considerations. In the instant case, all of the alleged creditors were either limited partners in the alleged debtor entities, purchased assets of the debtor in foreclosure, or were affected by a state court suit. It was clear that one of the petitioning creditors' reasons for filing the involuntary petitions had to do with obtaining leverage against the alleged debtors in the suit filed in Montgomery County, Texas. The involuntary bankruptcy cases did not appear to have been filed in order to reorganize debt or to provide for an orderly disposition of assets. The court concluded that the alleged debtors and the creditors were better served by dismissal of the involuntary petitions.

EXEMPTIONS

In re McCombs, 659 F.3d 503 (5th Cir. 2011).
JUDGES: Before OWEN and HAYNES, Circuit Judges.

The Debtor, McCombs, and his wife (“Atkinson”) bought a home and an adjoining lot in Katy, Texas in 2004. In March, 2006, H.D. Smith obtained a judgment against McCombs for $538,016.46, and filed an abstract of judgment in the Harris County real property records. In November, 2006, McCombs filed a petition for relief under Chapter 7 of the Bankruptcy Code, but Atkinson did not join the petition. McCombs claimed a homestead exemption on the house and lot for $125,000. The Trustee sold the house and netted almost $400,000, after paying the mortgage and other expenses. The funds were placed in an escrow account pending the bankruptcy court's determination of how to distribute the funds. Smith filed an adversary proceeding against the Trustee and Atkinson to recover his judgment from the proceeds. The Trustee and Atkinson each counterclaimed claiming entitlement to the proceeds. Meanwhile, the Trustee issued a check to McCombs and Atkinson for $125,000, the value of the homestead exemption as limited by Bankruptcy Code § 522(p). While the bankruptcy court was considering Smith's claim, the Trustee sold the unimproved lot, recovering over $516,000 in proceeds after the payment of the mortgage and expenses, which was also placed in escrow.

The bankruptcy court granted Smith's motion for summary judgment, holding that Smith’s judgment lien attached to the homestead, was perfected prior to McComb’s bankruptcy filing, and was enforceable against the homestead after the homestead limit under Bankruptcy Code § 522(p) was applied. The court rejected Atkinson's claims that: (1) the property had been gifted or partitioned; (2) her homestead rights trump the dollar limit in § 522(p), (3) she was entitled to compensation for the homestead right, and (4) failure to compensate her for the homestead right was an unconstitutional taking.

The Trustee and Atkinson filed a notice of appeal to the district court and a joint certification for direct appeal to the Fifth Circuit pursuant to 28 U.S.C. § 158(d). The Trustee and Atkinson each filed a statement of issues and a designation of record in the district court. The Fifth Circuit granted leave to file the direct appeal. Neither the Trustee nor Atkinson filed a statement of issues or a designation of record in the Fifth Circuit following the Fifth Circuit’s granting leave to file the direct appeal.

On direct appeal, the Fifth Circuit reiterated the established proposition that property rights, and, therefore, whether Smith had an interest in the excess proceeds from the sale of the homestead, was governed by state law – here, Texas law. Under Texas law, a judgment lien is unenforceable against a homestead. However, the property or proceeds of the sale of a homestead could become subject to seizure if the property ever ceases to be the debtor's homestead. Here, the Fifth Circuit looked to the status of Smith's lien as of the filing of the bankruptcy petition. Because the homestead was exempt from seizure as of the petition date, Smith did not have an enforceable lien as of that date.

Smith argued that the homestead cap in § 522(p) acted to convert his lien into an enforceable lien in the proceeds. The Fifth Circuit rejected this argument, holding that because the non-exempt excess proceeds became non-exempt but virtue of federal law and not state law, "[t]he bankruptcy laws that place a cap on the value of a homestead did not convert [Smith's] lien *on the homestead* from one that was unenforceable pre-petition to one that was enforceable *as to the homestead* post-petition."

The Fifth Circuit found that Atkinson had waived her issues on appeal by failing to identify them on her statement of issues on appeal filed with the district court, which the Fifth Circuit considered, even though she and the Trustee had been required by the rules to file a separate statement of issues on appeal upon the Fifth Circuit's granting of leave to file the direct appeal. Atkinson argued that the inclusion of the issues in her certification for direct appeal was sufficient. Again, the Fifth Circuit rejected her arguments, stating that a "certification for direct appeal may be analogized to a district court's certification for interlocutory appeal, which does not specify or restrict the scope of the court of appeal's review of the appealed order." In any event, the bankruptcy court's certification order merely identified the central issue warranting certification: "whether the Debtor's pre-petition homestead exemption prevented the perfection of H.D. Smith's judgment lien."

Based on these reasons, the Fifth Circuit reversed the summary judgment in favor of Smith and remanded to the bankruptcy court for further proceedings.

FRAUDULENT CONVEYANCES

U.S. Bank Nat'l Ass'n v. Verizon Communications, Inc., 817 F.Supp. 934 (N.D. Tex. 2011).
JUDGE: Joe Fish, Senior United States District Judge.

U.S. Bank, as the trustee ("Trustee") for the litigation trust created under the Chapter 11 plan of Idearc, Inc. (a former subsidiary of Verizon Communications, Inc. in the business of publishing domestic print and internet yellow pages directories), brought action against corporation's former parent and two former affiliates and former sole director of Idearc's board in connection with spin-off transaction, asserting claims for actual and constructive fraudulent transfer under the Bankruptcy Code and the Texas Business and Commerce Code, and breach of fiduciary duty, aiding and abetting breach of fiduciary duty, and unlawful dividend under Delaware law. Defendants moved to dismiss under Fed. R. Civ. P. 9(b) the claims for actual fraudulent transfer as not having been plead with sufficient particularity and under Fed. R. Civ. P. 12(b)(6), with respect to the remaining claims other than claims based upon constructive fraud, for failure to state a claim for which relief can be granted. After noting that the Fifth Circuit had not yet addressed whether the heightened pleading rule of Rule 9(b) applies to claims for fraudulent transfer based upon actual fraud, the district court held that, in any event, the Trustee had alleged with sufficient particularity, even under Rule 9(b), an actual intent to defraud by parent that was imputed to the Debtor under the control rule which required allegations that (i) the controlling transferee possessed the requisite intent to hinder, delay, or defraud the debtor's creditors, (ii) the transferee was in a position to dominate or control, and (iii) the domination and control related to the debtor's disposition of the property. As to the remaining claims, the district court found that

(a) the Trustee had standing to assert breach of fiduciary duty claim against the former sole director; (b) the Trustee adequately alleged breach of fiduciary duty claim against director and that parent knowingly aided and abetted director's breach of fiduciary duty; (c) in pari delicto doctrine did not bar claim against parent for aiding and abetting breach of fiduciary duty; and (d) the trustee adequately alleged that spin-off involved payment of "dividend," as required to state unlawful dividend claim under Delaware law. The district court noted that in order to survive a Rule 12(b)(6) dismissal the well-pleaded facts must lead the court to conclude that there is more than a mere possibility that misconduct has occurred – the allegations should "nudge" the claims against the defendant "across the line from conceivable to plausible."

In re IFS Fin. Corp., 2012 U.S. App. LEXIS 1706 (5th Cir. 2012).
JUDGES: Before Garza, Clement, and Southwick, Circuit Judges.

In the years leading up to Debtor's Chapter 7 bankruptcy filing, the Debtor corporation funneled $3 million out of subsidiary bank accounts that were titled in the name of two subsidiaries and as to which the Debtor had no signatory authority. The Trustee sued the transferees of these funds for recovery of fraudulent transfers under the Bankruptcy Code and under Texas law, fraud, aiding and abetting fraudulent transfers and conspiracy. The bankruptcy court found that (i) the bank accounts titled in the subsidiaries' names were actually owned and controlled by the Debtor, (ii) the Debtor exercised exclusive control over the accounts, (iii) funds were transferred out of the accounts to pay antecedent debts in furtherance of a fraudulent scheme, and (iv) the defendants knew or should have known of the fraudulent scheme. The Fifth Circuit was addressed an issue of first impression: whether legal ownership of bank accounts is required to show ownership. In answering the question, the Fifth Circuit determined that "control is more decisive than ownership" and held that "control may be sufficient to show ownership in what is ultimately a fact-based inquiry that will vary according to the peculiar circumstances of each case." Although the bankruptcy court had not allowed the Trustee to argue veil piercing or earmarking doctrines, the Fifth Circuit found that the law underlying those doctrines was instructive and lent support to its holding that the Debtor was the owner of the funds in the subsidiary bank accounts. The Fifth Circuit opined that Texas law and the Bankruptcy Code "navigate us toward the conclusion that control is the primary determinant of ownership of bank accounts such as those central to this appeal" and "is central to assessing whether they are to form part of a bankruptcy estate." But, the court cautioned that "in this necessarily fact-based inquiry, control, while primary, may not always be decisive, and legal ownership is not irrelevant." As to the case at hand, the court stated, "That it obscured its power to transfer in an intentionally complicated corporate structure suggests that control is decisive, and that legal title is irrelevant where, as here, a debtor organization has taken care to mask its activities through fictional divisions." In affirming the bankruptcy court's and district court's conclusions that a fraudulent transfer occurred, the Fifth Circuit noted the lower courts' findings that the transfers were made in the face of litigation, while burdened with substantial debt, and while seeking to liquidate a large portion of assets before filing for bankruptcy. In addition to other indicia of fraudulent intent, the Fifth Circuit pointed out that "[e]vidence that a company operated as a fraudulent enterprise at the time of the transfer . . . may be sufficient to establish fraudulent intent."

In re Apex Long Term Acute Care-Katy, L.P., 2011 Bankr. LEXIS 5162 (Bankr. S.D. Tex. 2011).
JUDGE: Marvin Isgur, United States Bankruptcy Judge.

Plaintiff trustee filed four separate adversary proceedings against defendant businesses, seeking a determination that transfers made by the debtor to them in the 90 days before the debtor sought relief under Chapter 11 of the Bankruptcy Code were preferential transfers that could be avoided under Bankruptcy Code § 547. The trustee sought dismissal of three of those adversary proceedings that had been settled with prejudice and a default judgment in the fourth adversary proceeding. Two of the defendants had filed proofs of claim, while the other two defendants had not. The court held that it had the authority under *Stern v. Marshall* to enter separate orders that dismissed the three adversary proceedings that were settled with prejudice and to issue a default judgment in favor the trustee in the fourth adversary proceeding. In so holding, the court stated that

> [t]he determination of avoidance [of preferential transfers] falls within the bankruptcy court's *in rem* jurisdiction over the estate. Because the preferentially transferred property is part of the bankruptcy estate, a turnover order under § 550(a) would be in furtherance of the bankruptcy court's *in rem* jurisdiction. And even when the defendant has not filed a proof of claim, the preference action is necessary to determine the amount of the defendant's claim against the estate on the basis of the antecedent debt.

The court further stated that "[p]reference actions stem from the bankruptcy itself and would necessarily be resolved in the claims allowance process. They fall within the boundaries of the public rights doctrine."

<u>JUDICIAL ESTOPPEL</u>

Love v. Tyson Foods, Inc., 677 F.3d 258 (5th Cir. 2012)
JUDGES: King, Weiner, Circuit Judges; Haynes, Circuit Judge, dissenting.

Debtor, Love, filed a petition for relief under Chapter 13 on May 1, 2008. On May 30, 2008, he filed a charge of discrimination with the EEOC, asserting that Tyson Foods, Inc. ("Tyson") had discriminated against him and had fired him in retaliation for prior complaints of racial discrimination. Love's plan was confirmed on September 22, 2008. On March 12, 2009, Love filed a case against Tyson asserting federal claims arising from the alleged discrimination and retaliatory action and certain state-law claims. Tyson moved for summary judgment, alleging Love was judicially stopped from pursuing the claims because he failed to disclose the claims in his bankruptcy case. Love then amended his schedules to include the claims but did not file a motion to modify or amend his plan (which provided for no payment to unsecured creditors). The district court granted summary judgment in favor of Tyson, and Love filed a pro se appeal.

Love's argument on appeal was that his failure to disclose the claims in his bankruptcy case was inadvertent and that, therefore, he should not be judicially stopped. The Fifth Circuit noted that judicial estoppels applies, generally, when "(1) the party against whom judicial estoppels is sought has asserted a legal position which is plainly inconsistent with a prior position; (2) a court accepted the prior position; and (3) the party did not act inadvertently" and that inadvertence is found, generally, only when the debtor has no knowledge of the undisclosed claims or has no motive to conceal them. The court then affirmed the judgment of the district court, which found that Love had not shown that there was a genuine issue of material fact with respect to the issue of inadvertence, particularly, as to the issue of motive. The court agreed with the district court that once Tyson offered a motivation for the concealment (i.e., the prospect that Love could keep any recovery for himself), the burden shifted to Love to show lack of motivation or inadvertence. The court found that "[i]n response to Tyson's motion for summary judgment, Love failed to set forth any argument or otherwise create a fact issue regarding whether he acted inadvertently" and that any arguments he made regarding his motivations or conduct, post-disclosure were irrelevant because it was his motivation at the time of the failure to disclose that was at issue.

The court addressed the arguments of the dissent (by Judge Haynes) that Tyson's proferred motivation that Love stood to gain personally from concealing the claims was incorrect as a matter of law and that Love's arguments in the district court were sufficient to create an issue of fact regarding inadvertence. As to the first issue, the court stated that the dissent "essentially eliminates consideration of a debtor's motives from the calculus" because the dissent argues that the fact that the claims belonged to the estate necessarily meant that the debtor was acting on behalf of his creditors (even while concealing the claims). The court also noted that the dissent wrongfully looked to post-disclosure motives. The court argued that the dissent's argument that the debtor's statement that he would not derive an unfair advantage if not estopped created an issue of fact conflated the issues of the debtor's motives at the time of nondisclosure with the issue of whether he would enjoy an unfair advantage if estoppels were not applied.

The dissent, on the other hand, argued that the majority's opinion "improperly place[d] the summary judgment burden of th[e] affirmative defense [of judicial estoppels] on Love" and that even if Love should be estopped from recovering on the claims, the bankruptcy estate and its creditors should not. The dissent argued that "[s]ince we ascribe 'knowledge' of the bankruptcy laws to the detriment of debtors, we should also assess the debtor's 'motive' in light of the 'knowledge' that he would not take 'free and clear' if he lied in his schedules." The dissent defends her opinion against the majority's attacks by saying that she was not attributing good motives to the debtor, she was just saying that Tyson had not necessarily shown bad motives. It was a question for trial. The dissent discounted the majority's opinion that Love did not provide any basis for concluding that nondisclosure was inadvertent, saying that it was irrelevant that Love made the argument after disclosure because in every case like this, any argument regarding motive will be made after disclosure. The dissent found that the majority's opinion effectively makes judicial estoppels mandatory in every case where the debtor has knowledge of the claim but fails to disclose it and concludes that "any debtor who fails to disclose a claim has a nefarious motive to do so." The dissent argued that "[t]his reasoning, however improperly presumes fraudulent intent from the outset." The dissent also seemed to argue that there is no difference between the "innocent trustee" in Kane and Reed and Love: "This distinction is irrelevant, however, because he debtors in those cases were in the same position as Love, and the characterization of the trustee's role as 'innocent' has nothing to do with the imposition of judicial estoppels where that trustee's duty, imposed post-disclosure, is to act on behalf of the estate." The dissent argued that where creditors stand to be harmed Reed and Kane (in which judicial estoppel was not applied to prevent the trustee from pursuing claims) "bind us here." The dissent concluded by stating that "[a]t the very least, the remedy espoused in Reed could be utilized here in preventing unnecessary harm to creditors while preventing an allegedly deviant debtor from 'playing fast and loose' with the courts" and that "[t]here are other legal avenues [other than judicial estoppel] to punish, and obtain relief from, fraudulent debtors without imposing a windfall on an alleged tortfeasor to the detriment of innocent creditors."

Reed v. City of Arlington, 650 F.3d 571 (5th Cir. 2011).
JUDGES: Jones, Chief Judge, and King, Jolly, Davis, Smith, Garza, DeMoss, Benavides, Stewart, Dennis, Clement, Prado, Owen, Elrod, Southwick, and Haynes, Circuit Judges. King, Circuit Judge, joined by Jolly, David, Smith, Garza, Benavides, Stewart, Dennis, Prado, Owen, Elrod, Southwick, and Hayes, Circuit Judges. Jones, Chief Judge, with whom DeMoss and Clement, Circuit Judges, join, dissenting.

> Kim Lubke, a former firefighter, won a judgment against the City of Arlington for over one million dollars pursuant to the Family Medical Leave Act ("FMLA"). Afterwards, Lubke filed for Chapter 7 bankruptcy, but did not list the judgment from the city or the associated legal fees and did not tell his attorney from the FMLA case about his bankruptcy filing. After the bankruptcy was closed, Lubke was negotiating with the city over payment of his judgment when his attorney learned of the bankruptcy. The attorney then notified the bankruptcy trustee, Diane Reed ("Reed"), of the judgment. Reed moved to reopen the bankruptcy, to have the debtor's discharge revoked, and to have herself substituted in the case against the city as the real party in interest.
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> The City filed a petition with the Fifth Circuit for a rehearing on the FMLA judgment and supplemented that petition by asserting a take-nothing judgment against Lubke, whom the City argued should be judicially estopped from collecting the judgment due to his failure to schedule the judgment as an asset in his bankruptcy case. Meanwhile, the bankruptcy court revoked Lubke's discharge. Subsequently, the Fifth Circuit denied the City's petition for rehearing of the FMLA judgment but remanded to the district court for a recalculation of damages and for an initial ruling on the City's judicial estoppel claim.
>
> On remand, the district court found that the elements of judicial estoppel were met as to Lubke but *not* as to Reed, who had been substituted for Lubke as the proper party. The district court held that Reed should be permitted to pursue collecting the FMLA judgment against the City but must return any remaining funds not disbursed to creditors back to the City (to prevent Lubke from retaining any the funds). The district court justified its implementation of this novel remedy by balancing the policy of requiring a debtor to disclose all of his assets and of satisfying creditor claims to the greatest extent possible. Moreover, "the judgment was no longer [Lubke's] property, but the estate's" after Lubke filed his bankruptcy petition, and "a take-nothing judgment . . . would deprive Lubke's creditors of their remedy."
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> The City appealed the judicial estoppel ruling as to Reed.
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> In reversing the district court's ruling, the original Fifth Circuit panel first acknowledged that its rulings on judicial estoppel "create, to put it kindly, a mosaic." In *Browning Mfg. v. Mims (In re Coastal Plains, Inc.)*, 179 F.3d 197 (5th Cir. 1999), the Fifth Circuit ruled that judicial estoppel prevented a debtor's successor obtaining the benefits of a judgment that the debtor had obtained by pursuing, outside of bankruptcy, a claim that had not been disclosed by the debtor in the bankruptcy case. In *In re Superior Crewboats*, 374 F.3d 330, 332-33, 336 (5th Cir. 2004), where a debtor misinformed the bankruptcy trustee that her personal injury claims against Superior Crewboats were prescribed but she filed suit against that company during bankruptcy anyway, the debtor was judicially estopped from pursuing that suit, and the trustee's motion to substitute for the debtor in the tort suit was, accordingly, denied as moot. Finally, in *Kane v. Nat'l Union Fire Ins. Co.*, 535 F.3d 380, 387 (5th Cir. 2008), the Fifth Circuit distinguished both *Coastal Plains* and *Superior Crewboats* and held that, despite the presence of intentional concealment and duplicitous conduct in the bankruptcy court by the debtor, equity favored the trustee (from whom

the debtor concealed the existence of a tort suit), and the court refused to estop a trustee form pursuing the tort suit.

In concluding that the district court erred, by not considering specific relevant facts, the Fifth Circuit explained that the district court should not have distinguished the conduct of the debtor from that of the trustee because the trustee "succeeds to the debtor's claim with all its attributes, including the potential for judicial estoppel." Thus, the district court's ruling allowing the trustee to recover from the City but not Lubke, was not acceptable. The panel also found that equity did not favor allowing Reed to recover because the primary creditors in the bankruptcy case were attorneys. In addition, Lubke's concealment created additional costs and fees that would not have been incurred in an ordinary appeal. Finally, the panel found that Lubke benefitted by his concealment of the judgment (even though his was denied his discharge) because he was able to enjoy other assets he did not include in his bankruptcy (a retained business, farm income, livestock, and a mineral lease). Thus, the panel found that the district court had abused its discretion and held that both Lubke and the Trustee were judicially stopped from pursuing the FMLA claim against the City.

On February 22, 2011, the Fifth Circuit granted *en banc* rehearing of *Reed. Reed v. City of Arlington*, 634 F.3d 769 (2011). The grant of *en banc* rehearing vacated the Fifth Circuit panel opinion.

On August 11, 2011, the Fifth Circuit sitting *en banc* entered an order affirming the district court order. 650 F.3d 571, 2011 WL 3506100 (5th Cir. Aug. 11, 2011).

The *en banc* court explained that the issue before it was "whether judicial estoppel bars a blameless bankruptcy trustee from pursuing a judgment that the debtor – having concealed the judgment during bankruptcy – is himself estopped from pursuing." The court held that it does not. The court affirmed the district court and "state[d] a general rule that, absent unusual circumstances, an innocent trustee can pursue for the benefit of creditors a judgment or cause of action that the debtor fails to disclose in bankruptcy."

The court began by discussing the doctrine of judicial estoppel and explained that it is intended to be flexible and that its application may be different depending upon the specific facts of the case. The court provided four main justifications for applying judicial estoppels to Lubke but not to the Trustee:

1. The FMLA claim and judgment became an asset of the bankruptcy estate immediately upon the filing of the bankruptcy petition, at which point, the trustee became the sole person with standing to assert the claim. The court pointed out that "[b]ecause the City could not have asserted judicial estoppels against Lubke based on the facts as the existed before the commencement of the bankruptcy, the Trustee received the judgment asset free of this affirmative defense."

2. "Estopping the trustee from pursuing the judgment against the City would thwart one of the core goals of the bankruptcy system – obtaining a maximum and equitable distribution for creditors – by unnecessarily 'vaporizing' the assets effectively belonging to innocent creditors." The court explained that "[j]udicial estoppel is an equitable doctrine, and using it to land another blow on the victims of bankruptcy fraud is not an equitable application."

3. The court reconciled the result with its prior rulings in *Kane*, *Superior Crewboats*, and *Coastal Plains*. The court pointed out that its ruling was consistent with *Kane*'s ruling that a trustee is not

estopped because both cases involved a Chapter 7 trustee who substituted into a cause of action to pursue a claim that a debtor had wrongfully concealed and the trustee had not abandoned. *Superior Crewboats* was distinguishable in that it involved the debtors themselves that were estopped from pursuing a lawsuit for their own benefit, and the trustee had abandoned the estate's interest in the claim, which reverted back to the debtors. *Coastal Plains* was also distinguishable because in that case, even though the trustee was estopped along with a debtor, the trustee had entered into a sharing agreement with the debtor's successor which would have provided a disproportionate recovery (85%) to the perpetrator of the fraud.

4. Finally, the court noted that its result was consistent with other circuits' opinions. "The Eleventh Circuit has decided, and the Seventh and Tenth Circuits have opined, that judicial estoppel should not be applied against an innocent trustee with standing to pursue a claim."

In re Oparjai, 458 B.R. 881 (S.D. Tex. 2011).
JUDGE: Sim Lake, United States District Judge.

In 2004, the debtor initiated a Chapter 13 bankruptcy case. The debtor's plan was confirmed and the debtor subsequently filed three separate motions to modify the plan for the purposes of curing post-petition arrearages and payment defaults. Following each motion, Wells Fargo filed an amended proof of claim asserting different arrearages and amounts due, including post-petition arrearages. The bankruptcy court approved each of the debtor's modifications. Ultimately, the Chapter 13 case was dismissed based upon the debtor's default under the modified plan, and the debtor did not receive a discharge. Four months later, the debtor initiated a second bankruptcy case under Chapter 13. Wells Fargo filed a proof of claim that included amounts that were not included in the various proofs of claim that had been filed in the first bankruptcy case even though the amounts were past due as of the filing of the proofs of claim. The debtor brought an adversary proceeding, alleging that both equitable estoppel and judicial estoppel applied to bar Wells Fargo from asserting claims in case that were inconsistent with proofs of claim filed in the first bankruptcy case and seeking sanctions against Wells Fargo and its attorneys for filing false proofs of claim. The bankruptcy court (Isgur, J.) granted summary judgment for the debtor on the judicial estoppel theory, denied the equitable estoppel claim as moot, and granted summary judgment for the lender and its attorneys on the sanctions claim. On appeal by Wells Fargo, the district court affirmed the bankruptcy court's summary judgment in favor of the debtor. The district court held that (1) Bankruptcy Code § 349 (addressing effect of case dismissal) did not preclude the bankruptcy court from applying judicial estoppel to bar Wells Fargo from asserting claims for post-petition arrearages that were not disclosed in proofs of claim filed in debtor's prior case; (2) the determination that Wells Fargo took inconsistent positions in prior and present cases and that the bankruptcy court had accepted the prior position was not abuse of discretion;(3) the determination that inconsistency in amounts of arrearages claimed by Wells Fargo was not inadvertent was not abuse of discretion; and (5) equity did not preclude bankruptcy court from applying judicial estoppel to Wells Fargo.

Wells Fargo argued that a pre-discharge dismissal under Bankruptcy Code § 349 places the parties in the position they were before the case was filed and, therefore, it could not be bound by the proofs of claim it had filed in the first bankruptcy case. The district court rejected this argument, stating that § 349 "is expressly qualified by the phrase '[u]nless the court, for cause, orders otherwise,'" such that the bankruptcy court did not abuse its discretion in applying judicial estoppel with respect to Wells Fargo position taken in the first bankruptcy case.

Wells Fargo also argued that it was not required to file a proof of claim for post-petition arrearages and, therefore, it was not required to include all post-petition arrearages in the claim it filed, even if it chose to include some post-petition arrearages. Thus, the proof of claim in the second case that included all post-petition arrearages could not be inconsistent with the claims filed in the first case that included only some. The district court rejected this argument, stating,

The Bankruptcy Code does not require creditors to claim or even to disclose the entire amount of a debtor's post-petition arrearages. However, once Wells Fargo chose to seek post-petition arrearages, and represented to the bankruptcy court via multiple amendments to its proof of claims that the arrearages sought were "total arrearages," the bankruptcy court could reasonably conclude that when, in a subsequent proceeding, Wells Fargo presented a vastly different representation of the earlier post-petition arrearages, that the two representations were inconsistent.

The district court also rejected Wells Fargo's argument that the dismissal of the earlier bankruptcy case had the effect of a reversal of a judgment on appeal, where at least one court has held is a situation where judicial estoppel should not apply. The district court found that the dismissal here was not analogous to the reversal on appeal situation "[b]ecause neither of the reasons for dismissing the First Bankruptcy reversed or otherwise impacted the bankruptcy court's acceptance of Wells Fargo's prior, inconsistent position regarding claims for post-petition arrearages." *Id.* at 895.

Finally, the district court found that the bankruptcy court did not abuse its discretion in finding that Wells Fargo's inconsistency was not inadvertent because Wells Fargo did not introduce any evidence that supported its assertion that any inconsistency was a mistake and because there were plausible motives for Wells Fargo to file a claim that intentionally omitted some or all of the post-petition arrearages – to save money by including unverified amounts in its proof of claim rather than spending money to investigate the proper amount, to avoid spending legal fees litigating over the proper claim amount, or to facilitate the debtor's success in the Chapter 13, which it may have believed would result in a higher recovery on its claim.

JURISDICTION, AUTHORITY, AND VENUE

In re Rhee, 2011 Bankr. LEXIS 4221 (Bankr. S.D. Tex. 2011).
JUDGE: Marvin Isgur, United States Bankruptcy Judge.

Plaintiffs filed a civil action in Texas state court, alleging that Defendant, Rhee, failed to pay a commission from a sale of real estate as the parties had agreed. The real estate sold was property of the bankruptcy estate in another case. Rhee filed a Chapter 7 "no-asset" bankruptcy after commencement of the state court action and removed the Plaintiff's state court lawsuit the following day to the bankruptcy court. The bankruptcy court remanded, *sua sponte*, for lack of subject matter jurisdiction, finding that (1) the proceeding was not a core proceeding to determine dischargeability of a particular debt under 28 U.S.C. § 157(b)(2)(I) – in fact, a separate dischargeability complaint had been filed by the plaintiffs; (2) it was not a core proceeding adjusting the debtor-creditor relationship under 28 U.S.C. § 157(b)(2)(O) because the proceeding neither invoked a substantive right created by federal bankruptcy law nor arose only in the context of a bankruptcy case; (3) "related to" jurisdiction did not exists because the resolution of the issues at hand would have no conceivable effect on either of the bankruptcy cases before this court; and (4) the risk of inconsistent judgments was not a factor to be considered when determining whether the court has subject matter jurisdiction.

In re England, 2011 Bankr. LEXIS 4852 (Bankr. S.D. Tex. 2011).
JUDGE: Letitia Z. Paul, United States Bankruptcy Judge.

> Plaintiff-Creditors filed an involuntary petition under Chapter 7 against England on December 23, 2009. The debtor did not dispute the involuntary petition (and, in fact, never appeared in any matter in the case), and an order for relief was entered on May 11, 2010. The United States Trustee commenced an adversary proceeding seeking a denial of the debtor's discharge, and a default judgment was entered against the Debtor. The Plaintiffs filed an adversary proceeding against the debtor for money had and received and breach of contract. Plaintiffs had previously filed proofs of claim that had not been objected to. Plaintiffs sought a default judgment against the debtor. The bankruptcy court dismissed the adversary proceeding for lack of subject matter jurisdiction, finding that there was no conceivable effect on the administration of the estate because the debtor had already been denied his discharge and the Plaintiffs were not seeking to liquidate their claims or present them in a centralized forum. The court noted that the instant proceeding was not like a nondischargeability proceeding, which is a core proceeding, which would allow the court to effectively enter judgment on the underlying claim because proving up the basis and amount of the debt would be necessary for proving nondischargeability. Here, there was no underlying core proceeding.

Faulkner v. Kornman, 2012 Bankr. LEXIS 436 (Bankr. S.D. Tex. 2012).
JUDGE: Marvin Isgur, United States Bankruptcy Judge.

> The bankruptcy court entered a contempt order finding Kornman in civil contempt for not complying with a document production order. Kornman argued that the bankruptcy court did not have subject matter jurisdiction to enforce the final judgment handed down by the Bankruptcy Court for the Northern District of Texas. Kornman filed a motion for stay pending appeal and for certification for direct appeal to the Fifth Circuit pursuant to 28 U.S.C. § 158(d)(2)(A)(i) (arguing there was no controlling decision as to four issues and that the issues involved a matter of public importance – the extent of bankruptcy court jurisdiction) and (iii) (arguing that a direct appeal would materially advance the progress of the proceeding because both he and Faulkner would appeal an adverse district court ruling). The bankruptcy court refused to certify a direct appeal to the Fifth Circuit. The bankruptcy court found that controlling decisions existed as to the issues of law of the case and subject matter jurisdiction and that simply questioning the proper application of the controlling decisions to the facts of the case does not satisfy § 158(d)(2)(A)(i). The bankruptcy court further found that the remaining issue of whether Faulkner had followed proper procedures in registering the judgment was a question of fact not appropriate for certification of direct appeal. Addressing the issue of its subject matter jurisdiction, the bankruptcy court held that it had jurisdiction over the enforcement proceeding relating to a judgment registered in the district, stating that bankruptcy jurisdiction under 28 U.S.C. § 1334 is not venue specific and not limited to a "home court." The bankruptcy court also held that it had post-confirmation jurisdiction over the enforcement proceeding because it pertained to the implementation and execution of the plan that had been confirmed in the Northern District of Texas, finding that "in the context of the Northern District's confirmed plan, the collection of funds from Kornman's fraudulent conduct was the *sine qua non* of the plan."

LIEN VALIDITY

Pioneer Austin East Dev. I, Ltd. v. Pioneer, Inc. (In re Pioneer Austin East Dev. I, Ltd.), 2012 U.S. Dist. LEXIS 19110 (N.D. Tex. 2012).
JUDGE: Joe Fish, Senior United States District Judge.

> The district court reviewed the bankruptcy court's recommendations and proposed findings and conclusions in a non-core matter involving a lien priority dispute. The dispute was between two creditors: one, Grencorp ("Grencorp"), who was the assignee of certain deeds of trust and related notes in 2005 but who did not record the deeds of trust until August of 2007 and the other creditor, Liberty Bankers ("Liberty") who claimed to have an equitable lien on the property based on a loan made in 2006, but where the deeds of trust filed referred to a different parcel of land (allegedly by mistake), and the corrected deeds were not recorded until October of 2007. The district court adopted the bankruptcy court's recommendation and concluded that because the Grencorp's lien was created before Liberty's alleged equitable lien and was filed of record before Liberty recorded its corrected deed, it was superior to Liberty's alleged equitable lien.

PLAN CONFIRMATION

Bank of N.Y. Mellon Trust Co. NA v. Humboldt Redwood Co., 2012 U.S. Dist. LEXIS 2032 (S.D. Tex. Jan. 9, 2012).
JUDGE: Nelva Gonzales Ramos, United States District Judge.

> The Fifth Circuit remanded to the bankruptcy court the question of "the value of [the] administrative priority claim and the extent to which relief is available." The Fifth Circuit expressed concern that an unpaid account of $11.1 million owed to the Debtor by another affiliated debtor was not properly added into the collateral valuations used to determine the amount of the Indenture Trustee's secured claim claim(s) for purposes of determining whether the plan satisfied the cramdown requirements in Bankruptcy Code § 1129(b). Under § 1129(b), the plan needed to provide for the payment in full of the secured claim, valued as of the confirmation date. On remand, the bankruptcy court held that the $11.1 million amount was properly considered in the mathematical calculation and that the original valuation of the collateral, and the consequent determination of the Indenture Trustee's claim(s) stood. The district court affirmed the bankruptcy court's holding on remand that the calculations were correct. The evidence produced at bankruptcy court showed that the $11.1 million asset (accounts receivable) was properly included in the calculation of the value of the collateral as of the petition date. The district court noted that the bankruptcy court could have set the value of the secured claim and then reduced it by the secured creditor's administrative claim to get to a value for the secured claim as of the confirmation date. However, it was deemed not necessary because "when the dust settled, using the petition-date values rather than the confirmation-date values compensated the Indenture Trustee for its secured claim and its administrative claim in one evaluation that maximized the Indenture Trustee's position."

POST-CONFIRMATION

In re Davis Offshore, L.P., 644 F.3d 259 (5th Cir. 2011).
JUDGES: Jones, Chief Judge, and Jolly and Garza, Circuit Judges.

> Chapter 11 plan, in which the family-owned debtor's assets were sold to an investor consortium including Gregg Davis, one of the family members, and the family members received

approximately $31 million on account of their equity interests, was confirmed within less than a week from the petition date. One of the family member's trust (the "Trust"), the appellant, did not oppose the plan and did not appeal the confirmation order, which became final. All parties were represented by sophisticated legal counsel. Six months later, appellant sought to revoke the confirmation order based upon allegations of fraud. The bankruptcy court held that no fraud had occurred and refused to revoke the confirmation order. On appeal, the district court vacated the bankruptcy court's ruling but held that the appeal was moot because the plan had been substantially consummated. The Trust did not appeal. Instead, the Trustee filed a motion with the district court seeking leave to pursue damages against the buyers, including Gregg Davis, and an advisor for fraud. The district court referred the matter to the bankruptcy court because the matter involved an interpretation of the release and exculpation provisions of the plan and confirmation order. The bankruptcy court rejected the motion as an impermissible collateral attack on the confirmation order. The Trust appealed the bankruptcy court's order to the district court, but on the motion of the appellees, the Fifth Circuit certified the appeal for direct review under 28 U.S.C. § 158(d).

The Fifth Circuit first concluded that the bankruptcy court had jurisdiction to over the Trust's motion for leave to file suit for damages post-confirmation because it had core jurisdiction to interpret the plan and the confirmation order. The Fifth Circuit then addressed whether the plan and confirmation order barred the assertion of fraud claims against the appellees and whether a confirmation order that goes beyond the terms of the plan prevails if the plan and confirmation order are inconsistent. The Fifth Circuit found that the mutual releases contained in the plan barred the Trust from pursuing its damages claims against all of the appellees except for Gregg Davis. The Fifth Circuit then looked to the exculpation provisions of the plan and found that these provisions did not bar the Trust from pursuing its fraud claims against Gregg Davis because it either excepted acts of willful misconduct and gross negligence or, as it applied to acts related to solicitation of acceptances of the plan (which did not except acts of willful misconduct or gross negligence) because Gregg Davis was not one of the parties to which the exculpation clause applied. The court then went on to address the confirmation order, which it found to separately and inconsistently with the plan to bar the fraud claims against Gregg Davis. The bankruptcy court had adopted the reasoning that the confirmation order is always dispositive if the terms of a plan and confirmation order are in conflict. The Fifth Circuit rejected this legal conclusion for several reasons: there was only minimal and non-controlling authority cited by the bankruptcy court and if a confirmation order always controls over a plan if the two conflict, it would encourage errors and abuse. Thus, the Fifth Circuit did not defer to the bankruptcy court's ruling but nevertheless found that Gregg Davis had been exonerated from liability for fraud by the confirmation order. The court found that the confirmation order was ambiguous because it contained exculpation provisions that were inconsistent and different from the plan's exculpation provisions by, among other things, not excluding acts of willful misconduct or gross negligence. The court resolved the ambiguity in Gregg Davis' favor because (i) it was consistent with the stated goal of the plan to end all litigation that might get in the way of the sale, (ii) neither the plan nor confirmation order were "foisted on the Trust," and (iii) the Trust was at all times represented by sophisticated counsel and was routinely included in correspondence among the family members and their counsel.

In re Tex. Wyo. Drilling, Inc., 647 F.3d 547 (5th Cir. 2011).
JUDGES: Davis, Clement, and Elrod, Circuit Judges.

The Fifth Circuit addressed the issue of whether the terms of the Chapter 11 plan at issue had effectively preserved certain causes of action against former shareholders such that the claims could be pursued post-confirmation under the "bright-line" test that the court had established in its 2008 decision in *Dynasty Oil & Gas, L.L.C. v. Citizens Bank (In re United Operating, L.L.C.)*, 540 F.3d 351, 355 (5th Cir. 2008). In *United Operating*, the Fifth Circuit established that, in order for a post-confirmation reorganized debtor or litigation trust to have standing to bring claims held by the estate and retained under the plan for prosecution after confirmation, the plan must contain "specific and unequivocal" language regarding the retention of claims.

Bankruptcy courts in the Fifth Circuit, since *United Operating*, were split on the issue of the proper interpretation and practical application of the *United Operating* test. Judge Bohm in the Southern District of Texas, in *In re MPF Holding US, LLC*, 443 B.R. 736 (Bankr. S.D. Tex. 2011), interpreted the "specific and unequivocal" language in *United Operating* as requiring a debtor to (i) investigate all claims prior to confirmation to determine which claims it wanted to pursue postconfirmation, (ii) identify specific defendants that *would* be sued (not *might* be sued), and (iii) the legal basis for the suit, while Judge Lynn in the case before the Fifth Circuit, *Dynasty Oil & Gas, L.L.C. v. Citizens Bank (In re United Operating, L.L.C.)*, 540 F.3d 351, 355 (5th Cir. 2008), and Judge Houser, in *Moglia v. Ketih (In re Manchester, Inc.)*, 2009 WL 2243592 (Bankr. N.D. Tex., July 16, 2009), found that a generic reservation of claims that might be brought postconfirmation satisfied the *In re United Operating* bright-line test.

The bankruptcy court in *Texas Wyoming Drilling* held that a generic and categorical reservation under the plan of preference claims without naming specific defendants or specific claims was sufficiently "specific and unequivocal" to satisfy the bright-line test established in *United Operating* for *purposes* of retaining and prosecuting, post-confirmation, causes of action, stating that "nowhere does *United Operating* state that the specific and unequivocal language must include identification of specific claims against specific defendants." The bankruptcy court certified the order denying the defendants' motion for summary judgment for direct appeal under Bankruptcy Code § 158(d)(2).

On direct appeal, the Fifth Circuit quoted its decision in *United Operating* for the proposition that "after confirmation of a plan, the ability of the debtor to enforce a claim once held by the estate is limited to that which has been retained in the [bankruptcy] plan." If the claims are not effectively reserved under the plan, the reorganized debtor or litigation trust has no standing to pursue the claim postconfirmation. Under *United Operating*, the purpose of the requirement that the reservation under the plan be "specific and unequivocal" is to put creditors on notice of any claim against them that the debtor wants to pursue post-confirmation to enable those creditors to make an informed decision as to whether to vote in favor of the plan. *Id.*
In addressing the issue of whether the fraudulent transfer causes of action at issue had been properly reserved and, thus, whether the reorganized debtor had standing to bring the claims against the defendant, Laguna Madre Oil & Gas, LLC, the Fifth Circuit first clarified that the disclosure statement may be considered in determining whether a post-confirmation debtor has standing to pursue causes of action reserved under the plan:

In light of the role served by the disclosure statement, the purpose behind the rule in *In re United Operating*, and the fact that, in similar contexts, courts routinely consider the disclosure statement to determine whether a claim is preserved, we hold that courts may consult the disclosure statement in addition to the plan to determine whether a post-confirmation debtor has standing.

The language in the plan at issue and the disclosure statement identified the former shareholders as a group (but did not identify individual shareholders) and that they might be sued for recovery of certain dividends paid as fraudulent transfers. Thus, while the Fifth Circuit noted that "*In re*

United Operating's citation to *In re Ice Cream Liquidation*'s holding [that a categorical reservation of preference claims is sufficiently specific and that the plan need not itemize individual transfers] supports the trustee's argument that a plan need not identify the prospective defendants," it found that it need not address whether a plan that fails to identify *any* prospective defendants satisfies the *United Operating* test.

The court held that "where the plan and disclosure statement reserved the right to pursue the Avoidance Actions against pre-petition shareholders of TWD, the reorganized debtor specifically and unequivocally retained these claims under *In re United Operating*." The court did not require identification of individual defendants, and the court did not require a statement in the plan or disclosure statement that the reorganized debtor *would* sue. It was enough to generically refer to avoidance actions against a group of defendants that *might* be brought postconfirmation by the reorganized debtor.

In re Pierrotti, 645 F.3d 277 (5th Cir. 2011).
JUDGES: King, Wiener, and Clement, Circuit Judges.

On direct appeal, the Fifth Circuit addressed the issue of whether a Chapter 13 plan may modify a secured claim for a tax deficiency into a long-term debt payable over a period longer the five years permitted under Bankruptcy Code § 1322(d)(1). The debtor sought to combine his ability to modify a secured claim pursuant to § 1322(b)(2) with his ability to cure and maintain a long-term debt pursuant to § 1322(b)(5) to modify the IRS secured debt to provide for payment over a fifteen year term. The court stated that § 1322(b)(5) applies only to long-term debts, such as home mortgages, whose original payment terms establish a final payment date after the conclusion of a Chapter 13 plan's statutorily mandated term. The court rejected the debtor's attempt to bootstrap § 1322(b)(2) and (b)(5) into a vehicle for extending payment of the IRS's secured claims, which were due and payable before he even filed for bankruptcy, past the maximum term allowed under a Chapter 13 plan. The court affirmed the bankruptcy court's denial of confirmation and remanded the case.

Sandburg Financial Corp. v. American Rice, Inc. (In re American Rice, Inc.), 2011 U.S. App. LEXIS 19590 (5th Cir. Sept. 22, 2011).
JUDGES: King, Smith, and Graves, Circuit Judges.

After the July 7, 1999 confirmation of debtor's reorganization plan, debtor entered into an indemnity and release contract and a covenant not to sue contract with Sandburg Financial, one of its creditors. Under the contracts, the debtor agreed to pay after June 30, 2008 any damages Sandburg Financial incurred and any judgment Sandburg Financial obtained against the debtor and reaffirmed its guarantee to pay after June 30, 2008, the obligations of its affiliated entities. In exchange, Sandburg Financial agreed not to execute upon or enforce any judgment, not to enforce any guaranty contracts, and not to sue or assert any claims against the debtor prior to June 30, 2008. On October 23, 2009, Sandburg Financial filed suit against the debtor in Texas state court seeking to collect amounts allegedly due from the debtor and its affiliates under certain pre-petition contracts. Upon the debtor's motion, the district court reopened the bankruptcy case and found that Sandburg Financial's petition in state court violated the discharge injunction and confirmation order.

On appeal, Sandburg Financial argued that the post-confirmation contracts were enforceable and did not violate the confirmation order or the discharge injunction because the contracts represent new contracts supported by new and independent consideration. The Fifth Circuit rejected this argument, agreeing with other courts that when even a part of the consideration for a contract is discharged debt, the contract must comply with the reaffirmation provisions of Bankruptcy Code § 524. Here, consideration for the post-confirmation contracts was at least, in part, discharged debt of the debtor. The contracts were not enforceable because the contracts failed to comply with the provisions of § 524, namely, they were not made before the discharge was granted, they were not filed with the court, and they did not contain the required disclosures. The Fifth Circuit also agreed with the district court's determination that, even if the "new and independent consideration" exception applied, the contracts at issue were not supported by new and independent consideration.

Viegelahn v. Essex, 452 B.R. 195 (W.D. Tex 2011).
JUDGE: Xavier Rodriguez, United States District Judge.

Debtors filed a Chapter 13 petition and the U.S. Trustee objected to the plan claiming the debtors did not file their plan in good faith. The plan called for payments of $3,717.00 for a period of sixty months and proposed to pay approximately a 1% dividend to non-priority unsecured creditors with the dollar amount to be paid to non-priority unsecured creditors totaling not less than $1,956.41. Meanwhile, the debtors proposed to retain their homestead with a mortgage of approximately $656,000 in which the debtors had virtually no equity. The mortgage payments would constitute 51% of the debtor's monthly income and was four times higher than the IRS standard for housing and utilities combined. In addition, the home was purchased during a time when the debtors had not paid income taxes, which resulted in an IRS debt of over $250,000, of which over $130,000 was unsecured, resulting in a payment to the IRS on its unsecured claim of only $1,366.82. The bankruptcy court confirmed the plan over the Trustee's objections, finding that Chapter 13 was designed to allow debtors to keep their homes and that the upper limit for secured debt set by Congress for eligibility to file Chapter 13 set the upper limit for a mortgage allowed in a Chapter 13.

On appeal by the Trustee, the district court reversed the bankruptcy court and remanded for further consideration. In doing so, the court first noted that although a factual finding should be reviewed on appeal based upon the "clear error" standard of review, a de novo review was required where, as here, the bankruptcy court's finding of fact was based upon a legal conclusion.

The district court noted that there was no reasonableness requirement in the means test under § 707(b)(2)(A)(iii)(II) (referenced in § 1325(b)(3)) with respect to the monthly payments necessary for a debtor to maintain possession of his primary residence. So, the question remained whether a proposed expenditure could be lawful under § 1325(b)(3) yet constitute a lack of good faith under § 1325(a)(3). The district court found a Northern District of Texas bankruptcy case, *In re Owsley*, 384 B.R. 739, 750 (Bankr. N.D. Tex. 2008), to be persuasive. In *Owsley*, the court found that expenses found to be reasonably necessary under § 1325(b)(3) would be presumed to be asserted in good faith under § 1325(a)(3), but that the presumption could be rebutted or negated by aggravating circumstances.

Considering the totality of the circumstances, the district court found that sufficiently aggravating circumstances existed in this case to negate the presumption of good faith.

In re Yazoo Pipeline Co., L.P., 459 B.R. 636 (Bankr. S.D. Tex. 2011).
JUDGE: Marvin Isgur, United States Bankruptcy Judge.

Sterling was an oil and gas exploration and production company. Yazoo was an oil and gas pipeline company, transporting Sterling's and other companies' oil and gas to shore. Matagorda was the general partner and manager of Sterling. The three Debtors filed voluntary Chapter 11 petitions on December 23, 2008. The cases were converted to cases under Chapter 7 on December 8, 2009. An adversary proceeding was brought in 2010 by the Chapter 7 trustee, Mining Oil, Inc. ("Mining"); and Randall O. Sorrels (collectively, "Plaintiffs") against New Concept Energy, Inc. ("NCE"); Coastland Operations, LLC ("Coastland"); Gulf Coast Exploitation, LLC ("Gulf Coast"); Dave Morgan; Charles Cheatham; and John Thibeaux (collectively, "Defendants") for undue influence or control, conversion, avoidance of pre-petition transfer, injunctive relief, and breach of fiduciary duty/aiding and abetting and concert of action. The Plaintiffs amended their complaint and added claims for conspiracy, fraud, unjust enrichment/self-dealing, respondeat superior, and avoidance of post-petition transfer. Defendants other than Coastland filed motions to dismiss, which were denied in part and granted in part. Plaintiff and certain of the Defendants filed motions to reconsider the court's ruling on the motions to dismiss. In addition, all Defendants except Cheatham demanded a jury trial, and NCE filed a brief in support of its motion to withdraw the reference. Coastland filed a brief in support of the motion to withdraw the reference. Before the court could rule on the motions for reconsideration or the motion to withdraw the reference, the Plaintiffs filed a motion for leave to file a Second Amended Complaint.

None of the defendants alleged undue delay or repeated failure to cure deficiencies or that the Plaintiffs were in bad faith or that the Defendants would suffer undue prejudice (any of which could be a reason for denying a motion to amend a complaint). The only other basis to deny the motion to amend was that the amendment would be futile. In addressing this issue (and whether the court should reconsider its order dismissing certain claims in light of the proposed amendments), the court found that the Plaintiffs failed to state a claim for fraud, but that it would allow the Plaintiffs to amend. The court found that, with respect to the equitable defense of *in pari delicto* as it related to misrepresentations that occurred prior to the conversion and appointment of the Trustee could not independently defeat a Trustee's standing to bring a claim and that under the Fifth Circuit's ruling in *Reed v. City of Arlington*, the equitable defense of *in pari delicto* may not ultimately apply to a Trustee. In any event, the court found the Trustee had standing to bring the fraud claims, "If the estates had fraud claims at the time of the Trustee's appointment, the Trustee may assert those claims on behalf of the estates." As to the post-conversion claims, the court noted that post-appointment claims are not subject to the *in pari delicto* defense. However, the court found that the Trustee had not sufficiently alleged reliance by the estate as an element of fraud. The court also found that the other Plaintiffs had not alleged how any misrepresentation or their reliance on such misrepresentation caused them injury. Although the court found that the proposed amendments would be futile, the court indicated that it would permit the Plaintiffs to file another amendment upon motion for leave to do so.

As to the reconsideration of the dismissals, the court reconsidered its dismissal of the claims of conversion of cash collateral and seismic data, based upon the proposed amendments, but found that its dismissal of the conversion of business opportunities claim was still proper even if the amendments were allowed. The court found that the Plaintiffs failed to allege a claim for breach of fiduciary duty by corporate usurpation as to all defendants except Cheatham and allowed Plaintiffs to file another amendment to allege that Morgan was a de facto officer of one or more of the debtors – a necessary element of the cause of action. The court granted leave to amend as to the aiding and abetting breach of fiduciary duty claim against Morgan.

The court also denied the motion to amend as to the conspiracy claims, but stated it would allow the Plaintiffs to replead.

Flagship Hotel, Ltd. V. City of Galveston (In re Flagship Hotel, Ltd), 2012 WL 2149908 (Bankr. S.D. Tex. June 12, 2012) (Exhaustion of Administrative Remedies)
JUDGE: Letitia Z. Paul, United States Bankruptcy Judge

Bankruptcy court abated adversary proceeding between debtor, Flagship Hotel, Ltd. and the City of Galveston where debtor sought turnover of $215,920.15, asserting it was entitled to a refund of amounts it alleged were overpaid for water and sewer services. Over a year post-confirmation, the City filed a motion to dismiss, arguing that the court lacked subject matter jurisdiction because relief pursuant to section 542 was not available for a claim that had not been determined by a court of competent jurisdiction (there had been protracted, unresolved litigation among the parties prior to and during the bankruptcy cases, which had served as the basis for abatement). The court granted the motion to dismiss, finding that resolution of the claim did not turn on bankruptcy law, and there were no considerations of plan compliance or with completion of the reorganization (which had long since concluded and the case closed). Thus, the court lacked subject matter jurisdiction.

<u>PROCEDURE</u>

Boyd v. Akard, 2012 U.S. Dist. LEXIS 4753 (W.D. Tex. 2012).
JUDGE: Xavier Rodriguez, United States District Judge.

Debtor-Petitioner, who filed under Chapter 7, filed a Writ of Mandamus, asking the court to vacate the bankruptcy court's order granting a temporary injunction against him as the trustee of two of his family's spendthrift trusts, prohibiting any transfer, disposition, or encumbrance of any money on deposit in a bank account. Trustee, who filed against Debtor, claimed that some assets within the family trusts were self-settled, meaning that the Debtor placed them within the trusts himself. Debtor argued that, because the trust is a spendthrift trust, it is not property of the bankruptcy estate. However, Trustee noted that Debtor was spending the money in the trust and wanted an injunction to preserve assets until a ruling was made. Petitioner's request for writ of mandamus was denied. The mandamus remedy is an extraordinary one, granted only in the clearest and most compelling cases. A party seeking such relief must satisfy three requirements before the court will issue a writ of mandamus: (1) the petitioner must have "no other adequate means" to obtain the relief requested; (2) the petitioner must show a "clear and indisputable" right to the relief requested; and (3) the court, in its discretion, "must be satisfied that the writ is appropriate under the circumstances." Petitioner failed the first requirement, because he could have appealed the injunction instead of seeking a mandamus remedy. The district court noted that, in the Fifth Circuit, mandamus relief is not appropriate where the petition has an adequate remedy through a regular or interlocutory appeal, and that mandamus relief may be available to obtain appellate review of bankruptcy orders that are not otherwise appealable. Thus, even if Boyd was correct that the bankruptcy court erred, it would have been wholly improper to utilize the extraordinary remedy of mandamus to bypass available appellate remedies. That the petitioner failed to file a notice of appeal timely and therefore an appeal was no longer available to him did not justify the use of mandamus. The district court denied the petition for writ of mandamus.

Special Value Continuation Partners, L.P. v. Jones, 2011 WL 5593058 (Bankr. S.D. Tex. 2011)
JUDGE: Marvin Isgur, United States Bankruptcy Judge.

Adversary proceeding was related to a bankruptcy case in Delaware. The lawsuit was originally filed in Texas state court, after the filing of the Delaware bankruptcy, against former officers and directors of the debtor. The defendants, as former officers and directors, had filed proofs of claim in the bankruptcy case seeking contribution, reimbursement, and indemnity, so the outcome of the adversary proceeding would affect the bankruptcy case. The defendants therefore removed the state court lawsuit to the bankruptcy court in the Southern District of Texas. The plaintiffs filed a motion to abstain and/or remand the proceeding to state court. The defendants then filed a motion to transfer the proceeding to the Delaware bankruptcy court.

The court first decided the motion to transfer. Because the proceeding was not core, transfer under 28 U.S.C. § 1412 was inapplicable. The court also found that transfer under 28 U.S.C. § 1404 was inappropriate. The defendants did not prove that the Delaware bankruptcy court was a more convenient venue under the private and public interest factors. The defendants argued that it should be presumed that the home bankruptcy court could more easily, expeditiously, and inexpensively try a “related to” proceeding. The court held, however, that after Stern v. Marshall, 131 S.Ct. 2594 (2011), the bankruptcy judge’s lack of constitutional authority to decide the case negated such a presumption. Other private interest factors were neutral or weighed slightly in favor of transfer. Public interest factors did not favor transfer, and Texas had a stronger local interest in the lawsuit. Therefore, only two of the § 1404 factors weighed in favor of transfer, and the others were neutral or weighed against. Because the defendants did not show that the Delaware bankruptcy court was clearly more convenient, the court denied the motion to transfer.

The court granted the motion to abstain and remand. Although mandatory abstention did not apply because the lawsuit was filed after the bankruptcy case, the discretional abstention factors weighed towards abstention and remand. In addition to noting that the case involved state law issues, a factor strongly in favor of abstention and remand, the court noted that under Stern, the bankruptcy judge’s lack of authority to enter a final judgment in the proceeding negated any detrimental effect of abstention and remand to the efficient administration of the estate.

PROPERTY OF THE ESTATE

In re Hoff, 644 F.3d 244 (5th Cir. 2011).
JUDGES: Smith, Wiener, and Owen, Circuit Judges.

Hoff's grandmother set up a trust for him, in which he could withdraw a designated percentage of the trust's remaining assets upon reaching certain ages, 30, 35, and 40. Additionally, Hoff could only make withdrawals from the trust after attaining the designated ages if the "Settlor" had died before he attained that age. While the term Settlor was never defined in the trust documents, Hoff's grandmother was consistently referred to as "Settlor." Between the time Hoff turned 30 and 35, his grandmother died. Hoff then filed for Chapter 7 bankruptcy after he turned 37, having never made any withdrawals from the trust. The bankruptcy trustee claimed that, because Hoff had a right to withdraw funds after he turned 35, then that portion of the trust was property of the bankruptcy estate. Hoff claimed that his mother, who made inter vivos contributions to the trust was a settlor who was still living and, therefore, he did not have a right to withdraw from the trust as of the petition date. The Fifth Circuit held that:

1. the grandmother was the only settlor of the trust and that the mother was not a settlor. This finding was supported by the fact that the Trust identified and referred to only the grandmother as settlor, the statement in trust agreement that “Settlor or any other person, trust, or entity may add property of any character to this Trust” clearly contemplated that others (such as the mother) may contribute to the trust, while never referring to those other contributors as “Settlors,” and the Texas Property Code provision in effect as of the petition date that defined settlor to be the person who created the trust (here, the grandmother.

2. age references in the trust instrument did not modify beneficiary's right to withdraw, which had no temporal limitations once beneficiary reached requisite age, but only defined the value of trust corpus that beneficiary could withdraw; and,

3. Hoff's bankruptcy trustee was entitled to withdraw, for the benefit of Hoff's bankruptcy estate, trust principal with a current value equal to the value of one-half of the principal that remained in trust on Hoff's 35th birthday.

In re ASARCO, L.L.C., 650 F.3d 593 (5th Cir. 2011).
JUDGES: Smith and Stewart, Circuit Judges.

The Fifth Circuit affirmed district court’s order affirming bankruptcy court order approving, over parent company’s objection, motion by the debtor for authorization to reimburse the due diligence expenses of certain qualified bidders that participated in attempted auction of a judgment obtained by debtor against the parent company in a fraudulent transfer action.

As a preliminary matter, the Fifth Circuit rejected the parent company’s argument it lacked appellate jurisdiction due to the district court’s own lack of jurisdiction over the reimbursement order, which the parent company contended was not a final, appealable order of the bankruptcy court. The Fifth Circuit reaffirmed that its approach to determining whether an order is appealable in a bankruptcy case is flexible and viewed in a practical, less technical light and found that reimbursement order at issue constituted a final disposition of a discrete dispute within the larger case.

Turning to the merits of the appeal, the parent company argued that the bankruptcy court should have considered the debtor’s motion under § 503(b), which applies to administrative expenses, and not under § 363(b), the business judgment standard. The parent company further argued that even assuming § 363(b) was the correct standard to apply, the bankruptcy court erred in finding that the debtor’s motion satisfied the business judgment standard.

The Fifth Circuit concluded that the business judgment standard is the better fit for assessing the debtor’s reimbursement motion. Section 363 addresses the debtor’s use of the estate property, and in its motion the debtor sought authorization to make discretionary use of the estate’s funds. Section 503, in contrast, generally applies to third parties that have already incurred expenses in connection to the debtor’s estate. In this case, the bankruptcy court issued the reimbursement order before any potential qualified bidders, including the intervenors, had incurred due diligence and work fees. In this context, the Fifth Circuit held that application of the business judgment standard was appropriate.

As to whether the bankruptcy court properly found that the reimbursement request satisfied the business judgment standard, the Fifth Circuit answered in the affirmative, finding no clear error in the bankruptcy court's conclusion that the debtor had demonstrated a compelling and sound business justification for the reimbursement authority. The district court had noted that there was no evidence in the record of self-dealing or manipulation among the parties who negotiated the reimbursement procedures; the reimbursement order facilitated, not hindered, the auction process; and the approved maximum available size of the reimbursement fee was reasonable in comparison to the size of the judgment.

On this record, the Fifth Circuit agreed with the district court that the bankruptcy court did not err in issuing the reimbursement order under the business judgment standard in § 363(b).

Alvertis Isbell v. DM Records, Inc., 2012 U.S. Dist. LEXIS 13525 (E.D. Tex. 2012).
JUDGE: Richard A. Schell, United States District Judge.

Alvertis Isbell d/b/a Alvert Music ("Isbell") sought a declaratory judgment that he was the rightful owner of two musical compositions: ("Subject Compositions") and damages against the defendant, DM Records, Inc. ("DM"), for alleged infringement upon his rights. Bellmark was a record company, owning sound recordings, while Alvert Music is a music publishing company, which owns musical compositions and not sound recordings, both of which were run by Alvertis Isbell. In 1997, DM secured licenses from both companies to exploit both the musical compositions and sound recordings at issue. In April of that year, Bellmark filed a Chapter 11 bankruptcy petition, which was later converted into a Chapter 7 petition. In October of 1999, DM purchased the assets of Bellmark from the bankruptcy estate, including all of Bellmark's rights in the Subject Compositions. In response to Isbell's allegations, DM filed a motion for summary judgment, arguing that (i) Isbell's lawsuit was barred by res judicata and Bankruptcy Code § 363(m), (ii) Isbell did not properly acquire ownership of the Subject Compositions under nonbankruptcy law, (iii) Isbell should be equitably stopped from or he waived his rights to assert ownership, and (iv) even if Isbell owned the rights to the Subject Compositions, DM had purchased from the Bellmark estate an implicit license to exploit the Subject Compositions. Isbell filed a cross motion for summary judgment seeking a judgment that he owned the copyrights to the Subject Compositions and that DM had infringed upon those rights. The court denied summary judgment on the issue of ownership of the subject composition copyrights because there were genuine issues of material fact regarding ownership of the subject composition copyrights under nonbankruptcy law and DM's theory that Bellmark was an alter ego of Isbell such that their commingled assets, including the rights to the Subject Compositions, were transferred in the bankruptcy sale. The court also denied summary judgment on the issue of infringement given that ownership was an essential element of proof and the court had already denied summary judgment on that issue. DM argued that the sale order precluded the action by Isbell under theories of res judicata and pursuant to Bankruptcy Code § 363(m); however, the court rejected these arguments because both assumed the bankruptcy estate owned the Subject Compositions, a fact not yet established. The court also found that there were genuine issues of fact as to at least one the elements of equitable estoppel/waiver – the intent of Isbell – summary judgment was not appropriate on these issues either. Finally, the court found that the undisputed facts did not satisfy the criteria for an implied license and so denied DM's summary judgment on this theory as well.

<u>RECHARACTERIZATION OF DEBT</u>

In re Lothian Oil Inc., 650 F.3d 539, 541 (5th Cir. 2011).
JUDGES: Jones, Chief Judge, and Higginbotham and Southwick, Circuit Judges.

> The Fifth Circuit in this case that equitable subordination and recharacterization "are directed at different conduct and have different remedies." One – equitable subordination – is remedial and aimed at righting inequitable conduct of a claim holder, while the other – recharacterization – has little to do with inequitable conduct and more to do with whether a "claim" should be properly characterized as equity under state law. Here, the bankruptcy court had disallowed the claim of a non-insider creditor and recharacterized the claim as equity. The district court reversed the bankruptcy court's recharacterization of the claim, "declin[ing] to extend the concept of debt recharacterization to a non-insider creditor."
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> The Fifth Circuit reversed the district court and affirmed the bankruptcy court's recharacterization of the claim to equity. In doing so, the Fifth Circuit looked to § 502(b)(1), which provides for the allowance of a claim, unless, among other reasons, it should be disallowed because it is unenforceable under any agreement or "applicable law." The court noted that under the Supreme Court case of *Butner v. United States*, 440 U.S. 48, 54, 99 S.Ct. 914, 918, 59 L.Ed.2d 136 (1979), "applicable law" is *state* law. If under state law, the "claim" is unenforceable because state law would classify it as equity rather than debt, the bankruptcy court must disallow the claim as a claim, but allow it, or recharacterize it, as equity in the debtor. The court rejected the district court's conclusion that a debt may only be recharacterized as equity if that debt was held by an insider, stating, "Unless state law makes insider status relevant to characterizing equity versus debt, that status is irrelevant in federal bankruptcy proceedings." The court ultimately concluded that "[b]ecause Texas law would not have recognized Grossman's claims as asserting a debt interest, the bankruptcy court correctly disallowed them as debt and recharacterized the claims as equity interests."
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> The Fifth Circuit declined to follow other courts that have relied on their equitable powers under Bankruptcy Code § 105(a) to recharacterize debt as equity, given that recharacterization was required in the instant case under state law and § 502(b)(1). Recharacterization, unlike equitable subordination, is not so much an equitable remedy to address inequitable conduct as it is a characterization (or recharacterization) of debt as equity when, under state law, the debt was equity all along and simply misnamed or mischaracterized by the holder of the equity.
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> Equitable subordination under Bankruptcy Code § 510(c)(1), on the other hand, is an equitable remedy that permits a bankruptcy court to subordinate a claim to a claim or an equity interest to an equity interest: "after notice and a hearing, the court *may* – (1) under principles of equitable subordination, subordinate for purposes of distribution all or part of an allowed claim to all or part of another allowed claim or all or part of an allowed interest to all or part of another allowed interest." (emphasis added) Under the plain language of § 510(c), a bankruptcy court cannot subordinate a claim to equity, but only to another claim or claims.
>
> Whereas a bankruptcy court *must* disallow a claim, as a claim, under Bankruptcy Code § 502(b)(1) if, under state law, the claim would be characterized as equity, it is within the court's discretion to subordinate a claim under Bankruptcy Code § 510(c).
> The Fifth Circuit applies a three-pronged test for equitable subordination:
>
> 1. the claimant must have engaged in inequitable conduct;

2. the misconduct must have resulted in injury to the creditors of the bankrupt or conferred an unfair advantage on the claimant; and,

3. equitable subordination of the claim must not be inconsistent with the provisions of the Bankruptcy Code.

Wooley v. Faulkner (In re SI Restructuring, Inc.), 532 F.3d 355, 360-61 (5th Cir. 2008). Further, equitable subordination is remedial, not penal, in nature: a claim may be subordinated to another claim only to the extent necessary to offset the harm that the debtor or its creditors has suffered as a result of the inequitable conduct of the claimant. *Id.* at 361 (citing *Benjamin v. Diamond (In re Mobile Steel Co.)*, 563 F.2d 692, 701 (5th Cir. 1977)). If there is no harm, then equitable subordination is not permitted. *Id.* As a practical matter, the Fifth Circuit has permitted equitable subordination in only three circumstances: "(1) when a fiduciary of the debtor misuses his position to the disadvantage of other creditors; (2) when a third party controls the debtor to the disadvantage of other creditors; and (3) when a third party actually defrauds other creditors." *Official Committee of Unsecured Creditors v. Cajun Electric Power Cooperative, Inc. (In re Cajun Electric Power Cooperative, Inc.)*, 119 F.3d 349, 357 (5th Cir. 1997).

Equitable Subordination	**Recharacterization**
Bankruptcy Code § 510(c)	Bankruptcy Code § 502(b)(1); state law
Claim to Claim or Equity to Equity	Claim to Equity
Permissive if applicable	Mandatory if applicable
Equitable and Remedial in Nature (subordinating a claim to another claim or an equity interest to other equity interests because of harm caused by inequitable conduct)	Not Equitable in Nature (properly identifying the nature of an interest under state law regardless of harm caused or whether inequitable conduct exists)

REPRESENTATION AND EMPLOYMENT

In re Duke Investments, Ltd., 454 B.R. 414 (Bankr. S.D. Tex. 2011).
JUDGE: Jeff Bohm, United States Bankruptcy Judge.

Debtor moved to disqualify attorney who had prepared proof of claim on creditor's behalf and attorney's firm from representing creditor in adversary proceeding challenging the propriety of default interest included in proof of claim, on ground that attorney would have to be called as witness. The bankruptcy court held that: (1) attorney was not a "necessary witness," as required for his disqualification under the Model Rules or under Louisiana law; (2) lack of evidence that attorney's testimony would substantially conflict with that of other employees of creditor who assisted attorney in preparing proof of claim, or would be substantially adverse to creditor's interests, prevented grant of disqualification motion over objection of creditor; and (3) even assuming that attorney had to be disqualified from representing creditor, that disqualification would not extend to attorney's entire firm.

In re ASARCO L.L.C., 457 B.R. 575 (S.D. Tex. 2011).
JUDGE: Andrew S. Hanen, United States District Judge.

In 2005, Asarco filed for bankruptcy and shortly afterwards filed an application to retain Lehman Brothers as its financial advisor pursuant to a Letter of Engagement and Bankruptcy Code § 328. Asarco agreed to pay Lehman $100,000 a month for twenty four months and $75,000 a month thereafter. Asarco also agreed to pay Lehman a $4 million transaction fee, against which one hundred percent of the monthly fees for the first twenty four months would be credited, and thereafter fifty percent of the monthly fee. Barclays Capital (BarCap), through a sale in Lehman's bankruptcy case, became the assignee under the ASARCO contract, which it renegotiated with Asarco. Under the new agreement, BarCap would be paid $225,000 a month and a $5 million transaction fee upon the sale of substantially all of Asarco's assets or restructuring, no matter the value of the services provided. Asarco won a judgment, which granted them stock in a successful copper mine. Asarco then entered an agreement with BarCap to auction the judgment. This agreement provided that BarCap would be paid $6 million upon completion of the sale, although the bankruptcy court never approved the auction agreement.

ASARCO's plan was confirmed, pursuant to which its former parent reacquired ASARCO. In connection with its final fee application, BarCap applied for over $9 million in discretionary fees consisting of: (1) $1,202,500 for "unanticipated services" performed by Lehman; (2) a $2 million general "success fee"; and (3) a $6 million success fee in connection with the successful auction of the judgment. The Bankruptcy court awarded $975,000 for the unanticipated services performed by Lehman, but denied the other two fees. Both Asarco's parent company and BarCap appealed.

The district court affirmed the bankruptcy court's award of the $975,000 for unanticipated services and its denial of the "discretionary" success fees. The court noted the strict standard in the Fifth Circuit for modifying a fee approved under § 328: once the fee is approved under § 328, the fee may be modified only upon a finding that the original agreement "prove[d] to have been improvident in light of developments not capable of being anticipated at the time of the fixing of such terms and conditions." The Fifth Circuit has also emphasized that this strict standard requires that circumstances actually be "incapable of anticipation, not merely unanticipated," a distinction that is "not insignificant."

The court found that the bankruptcy court's award of $975,000 in additional fees for Lehman's services was proper because: (1) the bankruptcy court applied the correct standard in considering the fee award, and (2) there is ample evidence in the record to support the bankruptcy court's conclusions that the length and complexity of the bankruptcy were incapable of anticipation when Lehman entered into the engagement letter. The court also held that the bankruptcy court correctly considered BarCap's request for the Success Fee under the terms of the BarCap Engagement Letter. The BarCap Engagement Letter, like the Lehman Engagement Letter, was approved under § 328 of the Bankruptcy Code, not § 330. Additionally, the court held that the bankruptcy court considered the relevant factors in the BarCap Engagement Letter when it determined not to award the "success fee." The court agreed with the bankruptcy court that Asarco's successful restructuring was the result of a "coalescence of factors" and not exclusively because of BarCap's services. Lastly, the court found that the judgment auction was covered by the initial BarCap Engagement Letter, that the Supplemental Engagement Letter was never approved and therefore never agreed to, and, despite the fact that the failed auction might have led the parent to propose its plan, the auction itself was not successful. Thus, the $6 million fee enhancement was not warranted.

In re Boyd, 2012 Bankr. LEXIS 600 (Bankr. S.D. Tex. 2012).
JUDGE: Marvin Isgur, United States Bankruptcy Judge.

> American Property Locators, Inc. ("API") was in the business of locating funds and other property for creditors including some in the instant case. API filed a motion for authority to pay funds, which was denied by the court on findings that API had failed to provide sufficient documentation to establish the identity of the proper recipient. API amended its motion to name a second creditor as the recipient. The court denied the motion with prejudice and ordered API and its agent to show cause why they should not be required to submit all future claims and pleadings through counsel. After briefing, the court held that respondents might properly continue to file routine motions to pay unclaimed funds as such filings were administrative acts much like the filing of claims, acts that non-attorneys were authorized to undertake pursuant to Bankruptcy Rule 9010. However, where disposition of an application required consideration of non-routine or complex issues and/or a hearing, API would be required to appear through counsel. The court stated that it, not the filer, determines when the representation of counsel is necessary. Accordingly, it found that API is prohibited from filing a brief or appearing at any hearing, unless through an attorney.

RES JUDICATA

Weaver v. Tex. Capital Bank, N.A., 660 F.3d 900 (5th Cir. 2011).
JUDGES: Smith, Benavides, and Haynes, Circuit Judges.

> Dewey Weaver ("Weaver") and Walter Dootson personally guaranteed loans from Texas Capital Bank, N.A. ("Texas Capital") to SL Management that were secured by eleven tracts of land in Texas (the "Collateral"). SL Management filed a petition for relief under Chapter 11. Under SL Management's confirmed plan, the debtor proposed to sell the Collateral to satisfy the outstanding loans. If a sale could not be completed, the plan proposed the Collateral would be surrendered to Texas Capital, and this would fully satisfy the debt. If the value of the land was less than the value of the claim, then Weaver would pay the difference. The sale did not go through and SL Management turned the property over to Texas Capital. During the bankruptcy, Texas Capital filed a state court action against Weaver to enforce the guaranty agreements. Weaver did not appear or respond and the state court entered a default judgment against him. After Texas Capital filed a collection action against him, Weaver filed an action to have the court declare the debt was fully satisfied by the surrender of SL Management's property to Texas Capital. The district court ruled in Weaver's favor and Texas Capital appealed. The Fifth Circuit held that *res judicata* applied and barred Weaver's request for declaratory judgment, reversing the lower court. The declaratory judgment action was brought on the exact same guarantees at issue in the Texas state court action. Because this action and the Texas action arose from the same transaction, the current claim (that the claim was paid and satisfied) needed to be raised as an affirmative defense in that earlier suit and could not now be brought as a separate claim for relief.

In re Noram Res., Inc., 2011 WL 6936361 (Bankr. S.D. Tex. 2011)
JUDGE: Marvin Isgur, United States Bankruptcy Judge

> The Chapter 7 Trustee sued the debtor's major secured lender and a former director of the debtor for fraud, breach of fiduciary duty, civil conspiracy, and other causes of action. Prior to bankruptcy, the debtor had issued a Debenture in favor of the secured lender and had granted a

security interest in virtually all of the debtor's assets. The Trustee alleged that the defendants conspired to induce the debtor to breach the terms of the Debenture in order to acquire the assets.

Earlier in the bankruptcy case, the Trustee had filed a motion to sell substantially all of the debtor's assets to the secured lender. The court issued an order granting the motion to sell. The defendants moved to dismiss the Trustee's claims, arguing that they were barred by res judicata as a collateral attack on the sale order.

The court dismissed all claims against the secured lender that were based on alleged breaches before the sale order. The sale order constituted a final judgment on the merits for res judicata purposes, even though the litigation of the sale order was not adversarial as between the Trustee and the secured lender. The court found that claims for breach of fiduciary duty, conspiracy, and fraud were part of the "same transaction" that was litigated with respect to the sale order. The court noted that the validity and status of the secured lender's claim were directly at issue in the sale order, and many of the Trustee's claims were based on the same issues.

The court did not dismiss the claims that were based on post-sale conduct, nor the claims against the former director. The claims that were based on post-sale conduct were not part of the same nucleus of operative facts at issue in the approval of the sale order. Moreover, the former director was not in privity with the secured lender for res judicata purposes, and therefore claims against the former director were not barred.

STANDING

In re Capco Energy, Inc., 2012 Bankr. LEXIS 348 (Bankr. S.D. Tex. 2012).
JUDGE: Marvin Isgur, United States Bankruptcy Judge.

Plaintiff, a Chapter 11 Trustee, filed an adversary proceeding against defendants, a buyer and guarantors, seeking to collect under a promissory note and for breach of contract. Defendants asserted counterclaims for breach and rescission of the purchase and sale agreement and cancellation of the note and guaranties. The trustee filed a motion to dismiss the counterclaims for cancellation of a note and certain guaranties under Fed. R. Civ. P. 12(b)(1), claiming the court did not have subject matter jurisdiction, arguing that the defendants did not have standing to assert the counterclaims for cancellation. The court agreed with the Trustee that the defendants did not have constitutional standing to sue for cancellation of a note and the other party's guaranty. The court noted that they would not have standing "if they have not asserted that they would be concretely and particularly injured if the Note and the guaranties are enforceable." Here, the guarantors were not injured by the enforcement of the other party's guaranty, and the guaranties explicitly provided that the guarantors' liability would not be affected by any change in terms that might be extended to the buyer or another guarantor by the debtor. Further, the language of the guaranties did not make the guarantors actual parties to the note (and, therefore, also did not have statutory standing under Texas law). Accordingly, the court dismissed those counterclaims based upon lack of subject matter jurisdiction.

<u>TRUSTEE AS LIEN CREDITOR</u>

In re Villarreal, 2011 Bankr. LEXIS 5160 (Bankr. S.D. Tex. 2011).
JUDGE: Marvin Isgur, United States Bankruptcy Judge.

> A tax foreclosure sale of the debtors' homestead was conducted prior to the petition date. The highest bidder delivered the purchase price to the deputy sheriff conducting the sale, which was deposited into the registry of the state court. The debtors filed for bankruptcy after the buyer delivered the purchase price but before a tax deed was prepared, delivered, or filed of record. The court held that the debtors could use § 544(a)(3), which provides that a trustee may avoid the transfer of property of the debtor that is voidable by "a bona fide purchaser of real property . . . from the debtor, against whom applicable law permits such transfer to be perfected, that obtains the status of a bona fide purchaser and has perfected such transfer at the time of the commencement of the case, whether or not such a purchaser exists," to avoid the sale of their homestead. The court concluded that a hypothetical purchaser would not have been charged with knowledge of the tax sale by constructive notice. Under Texas law, constructive notice was notice given by properly recorded instruments and charged to a person as a matter of law, regardless of that person's actual knowledge, and the parties agreed that no tax deed was filed, prepared, or recorded prior to the bankruptcy filing. Nor would a hypothetical purchaser be charged with knowledge of the tax sale by inquiry notice based on the ongoing tax lawsuit involving the homestead because a hypothetical purchaser would not have constructive knowledge that would trigger inquiry notice of all ongoing legal proceedings just because they were matters of public record. As noted by the Fifth Circuit, "the common law notion of constructive notice of ongoing proceedings" has been superseded in Texas by the lis pendens statutes. The court went on to find that "a reasonably diligent inquiry would not have uncovered the fact that the property had been sold at the tax foreclosure sale." Thus, the court held that the tax sale should be avoided.

<u>MISCELLANEOUS</u>

In re Moose Oil & Gas Co., 645 F.3d 689 (5th Cir. 2011) (Privity of Contract).
JUDGES: Garwood, Smith, and Clement, Circuit Judges.

> The Fifth Circuit reversed the district court, affirming the judgment of the bankruptcy court, which awarded a money judgment against the appellant. Because there was no privity of contract or estate between the appellant and appellee, there was no applicable theory or bases of recovery for the appellee against the appellant. The Fifth Circuit remanded to the district court, with directions to remand to the bankruptcy court, with directions to the bankruptcy court to render judgment that the appellee take nothing.

Evans v. Sterling Chem., Inc., 660 F.3d 862 (5th Cir. 2011) (Pension Plans).
JUDGES: Jolly, DeMoss, and Prado, Circuit Judges.

> Plaintiffs, who had been employed by acquired company before its acquisition by defendant, and who thereafter continued to be employed by defendant–company until retirement, brought action under ERISA, challenging three decisions to raise their benefit plan premiums. The United States District Court for the Southern District of Texas granted judgment for defendant. Retirees appealed. The Fifth Circuit held that: (1) section of asset purchase agreement (APA) pertaining to employee retirement benefits plan constituted a valid amendment to acquiring company's benefits plan and (2) section of APA pertaining to employee retirement benefits plan was assumed by

acquiring company in bankruptcy as part of its assumption of benefits plans, despite rejection of the APA itself.

In re Gharbi, 2012 U.S. Dist. LEXIS 3695 (W.D. Tex. 2012) (Waiver of Filing Fees).
JUDGE: Lee Yeakel, United States District Judge.

Pro se appellants filed three requests for waiver of appellate filing fee with the bankruptcy court, each of which was denied (the first request was summarily denied, while the second and third requests were denied with the court stating that there was nothing in the Bankruptcy Code or Rules that allow an appeal to proceed *in forma pauperis* and that appellant had previously shown himself to be a vexatious litigant). The district court overturned the denials on appeal, holding that (1) the bankruptcy court abused its discretion in denying appellants' requests and (2) the lower court misstated the law when it asserted that there was no basis for waiver of the filing fee. The district court opined that any court of the United States may authorize the prosecution of an appeal without prepayment of fees if the litigant submits an affidavit demonstrating an inability to pay. Because neither the court nor the appellee addressed the statements made in appellants' declarations, the district court reversed and appellant was permitted to proceed without paying the filing fee.

In re Royce Homes LP, 2012 U.S. Dist. LEXIS 5981 (S.D. Tex. 2012) (Discovery Orders).
JUDGE: Lee H. Rosenthal, United States District Judge.

The bankruptcy court ordered production of documents sought under Rule 2004 by Chapter 7 trustee that the owner of a Chapter 7 debtor ("Owner") claimed were privileged. Owner appealed the order, and the trustee moved to dismiss the appeal for lack of jurisdiction. The district court dismissed the appeal, finding that: (1) the challenged order was not a final order that may be appealed as of right under 28 U.S.C. § 158(a)(1), (2) the challenged order was not an appealable order under the collateral order doctrine because appellant could not show that the discovery order compelling production of allegedly privileged documents, as a categorical group, was entitled to membership in the narrow and selective class of collaterally appealable orders, and (3) there otherwise was no basis to grant leave to appeal.