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Bankruptcy

Honorable Harlin D. Hale
Northern District of Texas, judge_harlin_hale@txnb.uscourts.gov

Amber M. Carson
Gray Reed, acarson@grayreed.com

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*Honorable Harlin D. Hale**
*Amber M. Carson***

I. INTRODUCTION

During the Survey period, federal courts at all levels were busy rendering important bankruptcy decisions. These cases arise in both the consumer and business context. The authors have selected decisions on legal topics that should be of interest to both consumer and business bankruptcy lawyers. This Survey is not intended to be an exhaustive coverage of all bankruptcy decisions since last year's survey. However, we hope the reader will appreciate how courts are approaching some hard issues and perhaps spot a trend or two as cases wind their way on appeal.

II. STRUCTURED DISMISSALS

A. Permitting Structured Dismissals Over the Objection of Creditors in Violation of the Absolute Priority Rule: *In re Jevic Holding Corp.*

One case now pending in the U.S. Supreme Court at the time of this Survey could impact both business and consumer bankruptcy cases. In *In re Jevic Holding Corp.*, the case serving as the basis for the appeal to our nation's highest court, the U.S. Court of Appeals for the Third Circuit examined whether a Chapter 11 case could "be resolved in a 'structured dismissal' that deviates from the Bankruptcy Code's priority system" under 11 U.S.C. § 507.[1] The case involved a declining trucking company (the Debtor), that was acquired by the CIT group (CIT), a subsidiary of equity firm Sun Capital Partners (Sun).[2] After the Debtor filed for bankruptcy protection, two lawsuits were filed in the U.S. Bankruptcy Court for the District of Delaware. The first was filed by a group of the Debtor's terminated truck drivers (the Drivers) "alleging violations of federal and

* The Honorable Harlin D. Hale is a bankruptcy judge for the Northern District of Texas and an adjunct professor of Creditors' Rights at the SMU Dedman School of Law.
** Amber M. Carson graduated from SMU Dedman School of Law in 2012 and is serving a one-year term as law clerk to the Honorable Harlin D. Hale.
Contributing law students and externs to the U.S. Bankruptcy Court for the Northern District of Texas include Chance Hiner, Jennifer Little, Trevor Spears, Evan Atkinson, Aubrey Edkins, Courtney Capshaw, and Daley Epstein from SMU Dedman School of Law; and Melinda Chaney from UNT Dallas School of Law.

1. Official Comm. of Unsecured Creditors v. CIT Grp./Bus. Credit Inc. (*In re* Jevic Holding Corp.), 787 F.3d 173, 175 (3d Cir. 2015), *rev'd sub nom.*, Czyzewski v. Jevic Holding Corp., 137 S. Ct. 973 (2017).
2. *Id.*

state Worker Adjustment and Retraining Notification (WARN) Acts."[3] The second lawsuit was brought by the Official Committee of Unsecured Creditors (the Committee), alleging a fraudulent conveyance action against CIT and Sun in regards to CIT's acquisition of the Debtor by leveraged buyout.[4]

Ultimately, the Committee, CIT, and Sun reached a structured settlement agreement that contemplated (1) a mutual release and dismissal of the fraudulent conveyance action; (2) a payment by CIT to cover a portion of the administrated expenses of the bankruptcy case; (3) a transfer of Sun's first priority lien on the only remaining cash in the estate to a trust to pay tax and administrative claims, as well as unsecured creditors on a pro rata basis; and (4) a dismissal of the Debtor's Chapter 11 bankruptcy case.[5] However, the settlement agreement did not include a recovery to the Drivers on their uncontested WARN Act claims against the Debtor, which the Drivers estimated to be worth approximately $12.5 million.[6]

The Drivers and the U.S. Trustee (the UST) objected to the proposed settlement, arguing that the agreement violated the priority scheme under Section 507 of the Bankruptcy Code.[7] The UST further argued that the Bankruptcy Code does not permit structured dismissals.[8]

The bankruptcy court noted that while the Bankruptcy Code does not explicitly permit structured dismissals, an increasing number of bankruptcy courts allow them when circumstances warrant such a result.[9] The bankruptcy court found that "dire" circumstances existed in the present case and that without the proposed settlement, it was improbable that any constituents besides secured creditors would receive a distribution from the estate.[10] Additionally, the bankruptcy court held that unlike Chapter 11 plans, settlements are not required to comport with the absolute priority rule.[11] The bankruptcy court then applied the test of *In re Martin*[12] to the settlement and found that the settlement should be approved, and the Debtor's bankruptcy case dismissed.[13]

The Drivers appealed, and the U.S. District Court for the District of Delaware affirmed the bankruptcy court's approval of the settlement and

3. *Id.* at 176.
4. *Id.*
5. *Id.* at 177.
6. *Id.*
7. 11 U.S.C. § 507(a)(4) (2012); *In re Jevic*, 787 F.3d at 178.
8. *In re Jevic*, 787 F.3d at 178. The Drivers also alleged a breach of fiduciary duty by the Committee, which will not be discussed for purposes of this summary. *Id.*
9. *Id.* In fact, one of the authors of this survey has approved two. *See In re* Olympic 1401 Elm Assocs., LLC, No. 16-30130-hdh, 2016 WL 4530602, at *1 (Bankr. N.D. Tex. Aug. 29, 2016); *In re* Buffet Partners, L.P., No. 14-30699-HDH-11, 2014 WL 3735804, at *1 (Bankr. N.D. Tex. July 28, 2014).
10. *In re Jevic*, 787 F.3d at 178.
11. *Id.*
12. 91 F.3d 389, 393 (3d Cir. 1996).
13. *In re Jevic*, 787 F.3d at 178–79.

dismissal of the Chapter 11 case.[14] The Drivers then filed an appeal in the U.S. Court of Appeals for the Third Circuit.[15] The only issue on appeal was whether the bankruptcy court had discretion to approve a structured dismissal over the objection of creditors when doing so would result in a violation of the statutory priority scheme.[16]

In holding that the bankruptcy court was permitted to approve a structured dismissal in this "rare" instance, the Third Circuit preliminarily found that structured dismissals are allowable under the Bankruptcy Code so long as there was not an attempt to "evade the procedural protections and safeguards of the plan confirmation or conversion processes."[17] The Third Circuit admitted that settlements must be "fair and equitable"[18] but pointed out that neither Congress nor the Supreme Court has found that the absolute priority rule applies to settlements as well.[19]

The Third Circuit rejected the Fifth Circuit's holding in *Matter of AWECO, Inc.*,[20] which strictly applied the "fair and equitable" standard—and in turn the absolute priority rule—to settlements under the Bankruptcy Code.[21] Instead, the Third Circuit agreed with the Second Circuit's rationale in *In re Iridium Operating LLC*, which found that even a settlement that violates the absolute priority rule may "be approved when the remaining factors weigh heavily in favor of approving a settlement."[22] The Third Circuit emphasized the importance of fair dealing in settlements and that in these cases there must be "specific and credible" reasons to excuse the nonconformity with the Code's priority scheme.[23]

While the Third Circuit admitted the decision was a "close call," it ultimately held that, in this rare instance, the bankruptcy court was justified in approving a structured dismissal because it was the "least bad alternative."[24] The Third Circuit affirmed the district court, and the Supreme Court granted certiorari on June 28, 2016; oral argument was held on December 7, 2016.[25]

Allowing the parties to depart from the statutory priorities by agreement raises concerns. *In re Jevic Holding Corp.* presents hard facts and,

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14. *Id.* at 179.
15. *Id.*
16. *Id.* at 180.
17. *Id.* at 182. The Third Circuit did not opine as to whether a structured dismissal would be permitted in a case where it is conceivable that a plan will be confirmed or conversion might benefit the estate. *Id.* at 181–82.
18. *See id.* at 182 (quoting Protective Comm. for Indep. Stockholders of TMT Trailer Ferry, Inc. v. Anderson, 390 U.S. 414, 424 (1968)).
19. *Id.* at 183.
20. 725 F.2d 293, 295–96 (5th Cir. 1984).
21. *In re Jevic*, 787 F.3d at 183–84.
22. *Id.* at 183 (quoting Motorola, Inc. v. Official Comm. of Unsecured Creditors (*In re* Iridium Operating LLC), 478 F.3d 452, 464 (2d Cir. 2007)).
23. *Id.* at 184 (citing *In re Iridium Operating LLC*, 478 F.3d at 466).
24. *Id.* at 184–85.
25. *Id.* at 186; *see also* Czyzewski v. Jevic Holding Corp., 136 S.Ct. 2541 (2016); Transcript of Oral Argument, Czyewski v. Jevic Holding Corp., 137 S. Ct. 973 (2017) (No. 15-649).

as the saying goes, those cases often make bad law. To the authors, this case appears incongruent with the rights of creditors in a bankruptcy proceeding, although limiting the holding to these facts certainly helps. Whether the Supreme Court agrees remains to be seen.[26]

B. Structured Dismissals in Involuntary Bankruptcy Cases: *In re Positron Corporation*

Bankruptcy courts in the U.S. Court of Appeals for the Fifth Circuit continue to consider the use of structured dismissals as an exit for Chapter 11 of the Bankruptcy Code. In *In re Positron Corp.*,[27] the U.S. Bankruptcy Court for the Northern District of Texas considered whether it could approve a structured dismissal in a pending involuntary Chapter 11 case when a non-petitioning creditor opposed the settlement. After the filing of a bankruptcy proceeding against the Putative Debtor, the Putative Debtor and certain of its creditors sought a structured dismissal of the bankruptcy case.[28] The structured dismissal contemplated the refiling of a bankruptcy petition by the Putative Debtor if the structured dismissal was not granted or if the Putative Debtor materially breached the terms of the agreement.[29] One unsecured creditor opposed the settlement agreement, arguing that it was an improper *sub rosa* plan and violated the Bankruptcy Code's priority scheme under § 1129(b).[30]

The bankruptcy court noted that in the typical bankruptcy case, barring an objection or something "untoward" in the proposed dismissal, it should be approved notwithstanding the lack of explicit authorization for structured dismissals in the Bankruptcy Code.[31] However, the bankruptcy court emphasized that in the context of an involuntary bankruptcy proceeding, the Bankruptcy Code only permits two options: granting an order for relief or dismissal of the proceeding.[32] Thus, although the bankruptcy judge found merit to the proposed structured dismissal, he found that he had no authority to approve it.[33]

The bottom line may be that structured dismissals are allowed outside pending involuntary proceedings, but only in limited circumstances. As mentioned in this Survey, the U.S. Supreme Court has before it a structured dismissal case that should provide plenty of additional guidance on the subject.[34]

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26. The Supreme Court issued an opinion reversing and remanding the Third Circuit's decision in *In re Jevic Holding Corp.* outside of the Survey period. *See* Czyzewski v. Jevic Holding Corp., 137 S. Ct. 973, 987 (2017).
27. 556 B.R. 291, 291–92 (Bankr. N.D. Tex. 2016).
28. *Id.* at 291.
29. *Id.* at 293.
30. *Id.* at 291–92, 295; *see* 11 U.S.C. § 1129(b) (2012).
31. *In re Positron*, 556 B.R. at 294.
32. *Id.* at 295.
33. *Id.* at 295–96.
34. *See* Czyzewski v. Jevic Holding Corp., 137 S. Ct. 973 (2017).

III. THE EXEMPT CHARACTER OF PROCEEDS

A. Loss of Exempt Character in IRA Proceeds: *In re Hawk*

Cases involving the proceeds of exempt property continue to create issues for the bankruptcy courts. There are plenty of homestead cases, some of which are discussed in this Survey. The new issue seems to be the treatment of funds withdrawn from retirement accounts. Debtors with such accounts—and their lawyers—should beware of the harsh results of some recent cases.

In *In re Hawk*, the U.S. District Court for the Southern District of Texas evaluated the scope of a debtor's claimed exemption of his interest in an individual retirement account (IRA), finding that, under Texas law, Chapter 7 debtors who withdraw funds from exempt IRAs post-petition must roll over those funds into another exempt IRA account within sixty days.[35] If they fail to do so, the funds become nonexempt property of the estate.[36]

The case involved a Chapter 7 debtor (the Debtor) who claimed an exemption under Texas law for two IRA accounts from his bankruptcy estate under 11 U.S.C. § 522. After the petition date, the Debtor withdrew funds from one account but did not roll them over into a new exempt IRA. Upon learning of these funds, the Chapter 7 Trustee (the Trustee) filed a motion for turnover. The Trustee argued that since the Debtor failed to reinvest in another exempt IRA within sixty days, under Section 42.0021 of the Texas Property Code,[37] the funds automatically reverted to the bankruptcy estate.[38]

The Trustee relied on the decision by the U.S. Court of Appeals for the Fifth Circuit in *In re Frost* regarding exempt homestead proceeds and argued that it should apply to the IRA proceeds by analogy.[39] In *In re Frost*, the Fifth Circuit held that under Texas property law, homestead proceeds must be reinvested in another exempt homestead within six months in order to maintain their exempt status.[40] The Debtor in the instant case disagreed, arguing that the funds he had withdrawn did not lose their exempt status merely because he did not reinvest them since the funds "were withdrawn after the deadline for objections to exemptions" and were fixed in character as of the date of the bankruptcy filing.[41] The bankruptcy court ruled in favor of the Trustee, and the district court affirmed.[42]

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35. Hawk v. Engelhart (*In re* Hawk), 556 B.R. 788, 799–800 (S.D. Tex. 2016), *appeal docketed*, No. 16-20641 (5th Cir. Sept. 26, 2016).
36. *Id.* at 800.
37. Tex. Prop. Code Ann. § 42.0021 (West 2014).
38. *In re Hawk*, 556 B.R. at 793.
39. *Id.* at 793–94 (citing Viegelahn v. Frost (*In re* Frost), 744 F.3d 384, 385 (5th Cir. 2014)).
40. *Id.* at 793 (citing *In re Frost*, 744 F.3d at 385).
41. *Id.* at 794.
42. *Id.* at 801.

The Fifth Circuit has not directly ruled on this issue, and bankruptcy courts are split regarding the permanency of exemptions after the date they are allowed.[43] The district court in the instant case emphasized that under § 522, the Debtor had a choice as to whether to proceed under state or federal law.[44] In choosing to proceed under Texas law, he was bound by its rules. The district court agreed with the bankruptcy court's rationale in finding that the "Texas Proceeds Rule" under Section 41.001(c) of the Texas Property Code,[45] requiring property owners selling their exempt homestead to reinvest the proceeds within six months or lose the exemption, applies by analogy to the facts of this case under Section 42.0021.[46] In reaching its conclusion, the district court cited favorably the logic in *In re Frost*, which stated that an "essential element of the exemption must continue in effect" and that the status quo of exempt assets must be maintained throughout the pendency of the bankruptcy case.[47] Since the funds were removed from the IRA account during the pendency of the bankruptcy case and were not reinvested within the sixty-day period, under Texas law they lost their exemption status and automatically became property of the estate.[48]

This holding certainly presents practical problems to older debtors who rely upon their retirement funds for their living expenses. The authors hope that the Fifth Circuit will soon weigh in to provide clear guidance to lower courts.

B. Another View on IRA Proceeds: *In re Moore*

Not all courts during the Survey period held that distributions of proceeds of retirement funds go into the estate and to the trustee. Judge Rhoades of the U.S. Bankruptcy Court for the Eastern District of Texas carefully considered Texas and bankruptcy law to come to a well-reasoned conclusion. In *In re Moore*, the bankruptcy court decided the scope of a debtor's claimed exemption of her interest in IRA distributions.[49] The Chapter 7 debtor (the Debtor) claimed an exemption under Texas law for a disclosed interest in an IRA.[50] Post-petition, the Debtor withdrew funds from the exempted account and did not reinvest them in another exempt IRA.[51] The Chapter 7 Trustee (the Trustee) objected to the claimed exemption, arguing that the IRA funds were only conditionally exempt and lost their exempt character when the funds were not rolled

43. *Id.* at 800.
44. *Id.* at 799 (citing Camp v. Ingalls (*In re* Camp), 631 F.3d 757, 759 (5th Cir. 2011); *In re* Jarboe, 365 B.R. 717, 720 (Bankr. S.D. Tex. 2007)).
45. Tex. Prop. Code Ann. § 41.001(c) (West 2014).
46. *Id.* at 788 n.3, 800.
47. *Id.* at 800 (quoting Viegelahn v. Frost (*In re Frost*), 744 F.3d 384, 387 (5th Cir. 2014)).
48. *Id.* at 800–01.
49. *In re* Moore, No. 15-42046, 2016 WL 3704723, at *1 (Bankr. E.D. Tex. July 6, 2016).
50. *Id.*
51. *Id.*

over into another exempt account.[52]

Similar to the argument made by the trustee in *In re Hawk*,[53] the Trustee in this case argued that the holding of the U.S. Court of Appeals for the Fifth Circuit in the *In re Frost* case—that a debtor's failure to reinvest homestead proceeds into a new homestead within six months automatically resulted in the proceeds becoming property of the estate—should control by analogy.[54] The Trustee sought to extend the Fifth Circuit's holding in *In re Frost* under Section 41.001(c) of the Texas Property Code to the IRA exemption statute under Section 42.0021(c) of the same code.[55]

Upon review, the bankruptcy court overruled the Trustee's objection, holding that the IRA statute is "fundamentally different" than the homestead statute under Texas law.[56] Rather than merely exempting the individual retirement account itself, Texas law exempts the account holder's *rights* to the assets in the account and her right to receive the payments from the account.[57] Retirement funds do not lose their exemption after withdrawal, and Texas law explicitly prohibits turnover of "proceeds of, or the disbursement of, property exempt under" the IRA exemption statute.[58]

Furthermore, the bankruptcy court noted that there is no "IRA proceeds" rule analogous to the homestead proceeds rule and that it would be contrary to the policy behind the exemption to hold that the IRA exemption can be extinguished if the funds are not deposited into another exempt retirement account.[59] The bankruptcy court also applied the "snapshot rule" and found that the Debtor's interest in the funds in her IRA and her right to receive distributions from it were exempt on the petition date, and her subsequent action did not change their exemption status.[60] Thus, the bankruptcy court overruled the Trustee's objection to the exemption and held that the Debtor's IRA distributions remained exempt.[61]

Lawyers are thus faced with the *In re Hawk* case versus the *In re Moore* decision. The authors hope that the Fifth Circuit will provide judges and practitioners some guidance on this issue.

52. *Id.*
53. Hawk v. Engelhart (*In re* Hawk), 556 B.R. 788, 793–94 (S.D. Tex. 2016), *appeal docketed*, No. 16-20641 (5th Cir. Sept. 26, 2016).
54. *In re Moore*, 2016 WL 3704723 at *1; *see* Viegelahn v. Frost (*In re Frost*), 744 F.3d 384, 385 (5th Cir. 2014).
55. *In re Moore*, 2016 WL 3704723, at *1, *2.
56. *Id.* at *3.
57. *Id.*
58. *Id.* at *4 (quoting Tex. Civ. Prac. & Rem. Code Ann. § 31.002(f) (West 2015)).
59. *Id.* at *5.
60. *Id.* at *5, *6.
61. *Id.* at *6.

C. The Exempt Character of Homestead Proceeds: *In re Montemayor*

As most practitioners know, Texas has a well-established tradition of protecting a debtor's homestead.[62] In fact, protecting a debtor's homestead is such an essential part of Texas law that it is rooted in the state constitution.[63] However, issues sometimes arise surrounding the question of whether the debtor's homestead should receive the liberal protections afforded by the law. In *In re Montemayor*, the U.S. Bankruptcy Court for the Southern District of Texas faced the unenviable task of wading into Texas homestead laws and relevant case law to determine if a debtor (the Debtor) was still entitled to his homestead exemption when he had not reinvested the proceeds from a sale of an exempted homestead into his new homestead.[64] The bankruptcy judge did a thorough job in a well-reasoned opinion on the topic.

The Debtor filed a voluntary Chapter 7 petition on January 27, 2014.[65] In his schedules, the Debtor claimed his Texas state exemptions and properly exempted his half-interest in his homestead.[66] "[N]either the [Chapter 7] Trustee [(the Trustee)] [n]or any party in interest filed an objection to the Debtor's claimed homestead exemption."[67]

Four months later, the Debtor sought the bankruptcy court's permission to sell his homestead, which the bankruptcy court granted.[68] The proceeds of the sale extinguished the outstanding liens on the homestead, and the remaining monies were distributed to the Debtor equivalent to his half interest in the property.[69] The Debtor then immediately used a portion of the funds to purchase a lot and to prepare the land for construction of a new homestead.[70] However, some of the proceeds of the sale were not reinvested in the new homestead and were instead deposited into the Debtor's bank account.[71] The Trustee sought turnover of the homestead proceeds that had not been reinvested in the new homestead within six months after the sale.[72]

Relying on the holding of the U.S. Court of Appeals for the Fifth Circuit in the *In re Frost*[73] case, the Trustee argued that the Debtor's failure to reinvest the remaining proceeds in the new homestead within six

62. *See, e.g.*, Romo v. Montemayor (*In re* Montemayor), 547 B.R. 684, 695 (Bankr. S.D. Tex. 2016).
63. *See* Tex. Const. art. XVI, § 50.
64. *In re Montemayor*, 547 B.R. at 686.
65. *Id.* at 686–87.
66. *Id.* at 687.
67. *Id.*
68. *Id.*
69. *Id.*
70. *Id.*
71. *Id.* at 688.
72. *Id.*; *see* Tex. Prop. Code Ann. § 41.001(c) (West 2014) ("The homestead claimant's proceeds of a sale of a homestead are not subject to seizure for a creditor's claim for six months after the date of sale.").
73. Viegelahn v. Frost (*In re* Frost), 744 F.3d 384, 385 (5th Cir. 2014).

months of the homestead sale caused them to become non-exempt.[74] The bankruptcy court distinguished the Fifth Circuit's holding in *In re Frost*, emphasizing that at the time the debtor in *In re Frost* sold his homestead, it was property of the estate even though it was fully exempted.[75] Furthermore, the bankruptcy court found that the proceeds from the homestead in *In re Frost*, pursuant to the Chapter 13 plan, became non-exempt property of the estate when the exemption lapsed.[76]

Unlike in *In re Frost*—a Chapter 13 case where the homestead proceeds were exempted but remained property of the estate without revesting in the debtor until the temporal exemption expired—in the instant case, the bankruptcy court found that the Debtor's homestead exemption became "final" when the Trustee failed to object to the exemption.[77] The bankruptcy court emphasized the fact that the Debtor was a Chapter 7 debtor rather than a Chapter 13 debtor like the debtor in *In re Frost*.[78] The bankruptcy court concluded that, due to this distinction, when the homestead exemption became "final," the exemption and its proceeds were no longer property of the estate.[79]

Accordingly, the Debtor was entitled to the remaining proceeds from the sale; however, the bankruptcy court noted the potential threat of claims by post-petition creditors to the monies.[80] Furthermore, the bankruptcy court *sua sponte* granted the Debtor summary judgment on the new homestead's exempt status.[81]

The bankruptcy court's opinion in *In re Montemayor* walks through much of the case law related to the exemption of homestead proceeds, which lays the foundation for the court's conclusion and allows it to reach a logical result. For a practitioner, the benefits are twofold. First, if a Chapter 7 client wishes to sell his homestead post-petition, this is a case to keep in the arsenal. Second, the opinion's discussion of the relevant case law is an excellent primer on the issue of exempt homestead proceeds.

IV. FRAUDULENT TRANSFERS

A. Beneficiaries of Fraudulent Transfers: *Janvey v. Libyan Investment Authority*

The Allen Stanford Ponzi scheme seems to be a set of facts that keeps on giving, at least in terms of case law. During the most recent Survey period, the U.S. Court of Appeals for the Fifth Circuit weighed in several times on the reach of fraudulent transfer law.

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74. *In re Montemayor*, 547 B.R. at 689.
75. *Id.* at 708; *see In re Frost*, 744 F.3d at 389.
76. *In re Montemayor*, 547 B.R. at 712.
77. *Id.* at 713.
78. *Id.*
79. *Id.*
80. *Id.* at 713–14.
81. *Id.* at 716.

In *Janvey v. Libyan Investment Authority*, a corporate parent was not an "entity for whose benefit" an allegedly fraudulent transfer was made merely due to the corporate parent's status as sole shareholder of an initial transferee.[82] Stanford devised a Ponzi scheme that he carried out through a group of related entities by selling certificates of deposits (CDs) to investors.[83] Instead of investing the funds, however, Stanford used newly acquired funds to redeem earlier investors' matured CDs.[84]

A court-appointed receiver sought to recover the proceeds of some of the CDs that had been transferred to the Libyan Foreign Investment Company (LFICO), under the Texas Uniform Fraudulent Transfer Act (TUFTA).[85] The receiver sought the funds not only from LFICO, but also from LFICO's sole shareholder, the Libyan Investment Authority (LIA), arguing that LIA was the person "for whose benefit the transfer was made."[86] In response, LIA argued that it was not a beneficiary of the transfer merely because it was the shareholder of the initial transferee.[87]

In agreeing with LIA, the Fifth Circuit favorably cited a decision of the U.S. Bankruptcy Court for the Northern District of Illinois, which held that shareholders are not beneficiaries of transfers "unless they actually received distributions of the transferred property . . . or a showing can be made to pierce the corporate veil."[88] The Fifth Circuit distinguished two cases relied upon by the receiver—*Esse v. Empire Energy III, Ltd.*[89] and *Citizens National Bank of Texas v. NXS Construction, Inc.*[90]—in which the shareholders were involved with the transfer, benefitted from the transfer, or participated in the wrongdoing.[91]

The Fifth Circuit found that LIA neither received an "independent benefit" from the transfer nor held the status of an alter ego of LFICO, and thus it was not a beneficiary of the transfer for purposes of TUFTA.[92]

This case is a good reminder that shareholders of the corporations they own are separate under the law absent a special set of facts not proven in this case.

B. "Value" Under TUFTA: *Janvey v. Golf Channel, Inc.*

In another Stanford-related decision, the U.S. Court of Appeals for the Fifth Circuit, with the help of the Texas Supreme Court, clarified a requirement under Texas's fraudulent transfer law. In *Janvey v. Golf Channel, Inc.*, the Fifth Circuit affirmed a lower court's decision to deny a

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82. Janvey v. Libyan Inv. Auth., 840 F.3d 248, 265 n.78, 266 (5th Cir. 2016).
83. *Id.* at 254.
84. *Id.*
85. *Id.* at 265.
86. *Id.*; *see* Tex. Bus. & Com. Code Ann. § 24.009(b)(1) (West 2015).
87. *Janvey*, 840 F.3d at 266.
88. *Id.* (quoting Schechter v. 5841 Bldg. Corp. (*In re* Hansen), 341 B.R. 638, 646 (Bankr. N.D. Ill. 2006)).
89. 333 S.W.3d 166, 181 (Tex. App.—Houston [1st Dist.] 2010, pet. denied).
90. 387 S.W.3d 74 (Tex. App.—Houston [14th Dist.] 2012, no pet.).
91. *Janvey*, 840 F.3d at 266.
92. *Id.* at 265–66.

claw-back request under TUFTA after receiving guidance from the Texas Supreme Court.[93] The court-appointed receiver for Stanford International Bank, Ltd. (Stanford) sought to recover $5.9 million in fraudulent transfers paid by Stanford to The Golf Channel, Inc. (Golf Channel) in exchange for "advertising services aimed at recruiting additional investors into Stanford's multi-billion dollar Ponzi scheme" under Section 24.005(a)(1) of TUFTA.[94] The U.S. District Court for the Northern District of Texas granted Golf Channel's motion for summary judgment upon finding that it established the affirmative defense of receiving the payments "in good faith and for a reasonably equivalent value."[95] The Fifth Circuit initially reversed, reasoning that "the [$5.9 million in] payments to Golf Channel were not for 'value' because [the] advertising services could only have depleted the value of the Stanford estate and thus did not benefit Stanford's creditors."[96] However, the Fifth Circuit ultimately vacated its order and certified a question to the Texas Supreme Court regarding the definition of "value" under TUFTA.[97]

The supreme court concluded that:

> TUFTA's "reasonably equivalent value" requirement can be satisfied with evidence that the transferee (1) fully performed under a lawful, arm's-length contract for fair market value, (2) provided consideration that had objective value at the time of the transaction, and (3) made the exchange in the ordinary course of the transferee's business.[98]

The existence of a Ponzi scheme does not change the "value" inquiry under TUFTA so long as "the services would have been available to another buyer at market rates" in the absence of the scheme.[99] The Fifth Circuit clarified that consideration can have "objective value" even if it does not benefit the estate or "generate[ ] an asset . . . that could be levied to satisfy . . . creditors."[100] Because Golf Channel's television airtime would have been available to other buyers absent Stanford's purchase, the Fifth Circuit determined that the "advertising services had objective value . . . regardless of Stanford's financial solvency at the time" of the transaction.[101] Accordingly, the Fifth Circuit affirmed the district court's grant of summary judgment for Golf Channel.[102]

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93. Janvey v. Golf Channel, Inc. (*Golf Channel IV*), 834 F.3d 570, 573 (5th Cir. 2016).

94. Tex. Bus. & Com. Code Ann. § 24.005(a)(1) (West 2015); *Golf Channel IV*, 834 F.3d at 571.

95. *Golf Channel IV*, 834 F.3d at 571.

96. *Id.* at 571–72 (citing Janvey v. Golf Channel, Inc. (*Golf Channel I*), 780 F.3d 641, 646 (5th Cir.), *vacated and superseded on reh'g*, (*Golf Channel II*), 792 F.3d 539 (5th Cir. 2015)).

97. *Id.* at 572; *see Golf Channel II*, 792 F.3d at 547 (5th Cir. 2015), *certifying question to* (*Golf Channel III*), 487 S.W.3d 560 (Tex. 2016).

98. *Golf Channel III*, 487 S.W.3d at 564.

99. *Golf Channel IV*, 834 F.3d at 572 (quoting *Golf Channel III*, 487 S.W.3d at 570).

100. *Id.* (quoting *Golf Channel III*, 487 S.W.3d at 577).

101. *Id.* (citing *Golf Channel III*, 487 S.W.3d at 581–82).

102. *Id.* at 573.

This second holding by the Fifth Circuit, after guidance from the supreme court, seems correct to the authors. A contrary result would have perhaps exposed every honest vendor of the Stanford entities to fraudulent transfer liability, a result that seems contrary to the purpose of fraudulent transfer law and practicality.

C. Reasonably Equivalent Value: *In re Worldwide Diamond Ventures, L.P.*

Bankruptcy cases are not always limited to dull fact patterns about mortgages, notes, and defaults. In *In re Worldwide Diamond Ventures*, a Chapter 7 trustee (the Trustee) was entitled to avoidance and recovery of a transfer of a 6.32-carat pink diamond because the Debtor had not provided reasonably equivalent value in exchange for it.[103] The Trustee brought an adversary proceeding against Sharpshooter II, Inc. (Sharpshooter) to recover funds paid to Sharpshooter by the Debtor for the diamond (the Pink Diamond) under 11 U.S.C. §§ 544 and 550, on the grounds that the transaction was a constructive fraudulent transfer under TUFTA.[104]

The U.S. Bankruptcy Court for the Northern District of Texas had previously granted partial summary judgment to the Trustee on the insolvency element of TUFTA and on Sharpshooter's affirmative defense of statute of limitations.[105] The only remaining issue before the bankruptcy court was whether the Debtor had received "reasonably equivalent value" in exchange for the Pink Diamond.[106]

The undisputed facts show that the Pink Diamond was purchased and sold five times over a six-year period beginning in 2007.[107] The sales price for each of those transactions was $218,000, $250,000, $295,000, $600,000 (the transaction at issue in this case), and $190,000 respectively.[108] It appears that the Debtor was willing to pay more than double what the previous purchaser had paid because Sharpshooter showed the Debtor "two grossly inflated appraisals."[109]

In granting the Trustee's motion, the bankruptcy court cited a bankruptcy court decision out of the Southern District of Texas, later affirmed

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103. Milbank v. Sharpshooter II, Inc. (*In re* Worldwide Diamond Ventures, LP), 559 B.R. 143, 144–45, 151 (Bankr. N.D. Tex. 2016).

104. *Id.* at 145. TUFTA provides that:

> A transfer made or obligation incurred by a debtor is fraudulent as to a creditor whose claim arose before the transfer was made or the obligation was incurred if the debtor made the transfer or incurred the obligation without receiving a reasonably equivalent value in exchange for the transfer or obligation and the debtor was insolvent at that time or the debtor became insolvent as a result of the transfer or obligation.

Tex. Bus. & Com. Code Ann. § 24.006(a) (West 2015).

105. *In re Worldwide Diamond Ventures*, 559 B.R. at 147.

106. *Id.*

107. *Id.* at 148.

108. *Id.*

109. *Id.* at 149. One of the appraisals valued the ring at $1,400,000 while the second valued it at $1,011,200.

by the U.S. Court of Appeals for the Fifth Circuit, finding that when determining whether reasonably equivalent value was given, "[t]he salient issue is whether the estate lost value."[110] After purchasing the Pink Diamond at a price that was double the amount of the last purchase price, the Debtor subsequently sold it for an amount lower than one-third of its purchase price.[111] The bankruptcy court found that there was no question of material fact that the estate lost value when the Debtor paid $600,000 for the Pink Diamond.[112]

After concluding that the Trustee was entitled to avoid and recover the transfer to Sharpshooter, the bankruptcy court then determined the value the estate had lost.[113] The bankruptcy court determined that the actual value of the Pink Diamond was $210,000—the highest bid received at a Sotheby's auction from 2015.[114] This sales price was used by the bankruptcy court because it was received after significant marketing efforts and was the only value that "was truly fair and arms-length."[115]

The bankruptcy court granted summary judgment in favor of the Trustee for $390,000, the difference between the amount paid for the Pink Diamond by the Debtor ($600,000) and the actual value of the Pink Diamond ($210,000).[116]

Although bankruptcy courts do not see many pink diamond cases, they are often required to make value determinations. This case is a good illustration of a solid, practical approach to value in the context of a fraudulent transfer lawsuit.

V. DISMISSAL UNDER SECTION 707(A) FOR CAUSE: *IN RE KRUEGER*

May a bankruptcy court dismiss an individual Chapter 7 liquidation for bad faith? In a case with somewhat startling facts, the U.S. Court of Appeals for the Fifth Circuit answered with an empathetic "Yes!"[117] In *In re Krueger*, the Fifth Circuit examined the circumstances in which a Chapter 7 case can be dismissed under § 707(a) for cause due to a debtor's bad faith.[118] The Debtor was engaged in state court litigation against his former business partner.[119] The Debtor filed his Chapter 7 bankruptcy petition one day prior to a show cause hearing ordered by the state court for violation of a temporary restraining order and temporary injunction.[120]

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110. *Id.* at 150 (quoting Smith v. Suarez (*In re* IFS Fin. Corp.), 417 B.R. 419, 442 (Bankr. S.D. Tex. 2009), *aff'd*, 669 F.3d 255 (5th Cir. 2012)).
111. *Id.* at 150.
112. *Id.* at 151.
113. *Id.*
114. *Id.*
115. *Id.*
116. *Id.*
117. Krueger v. Torres (*In re* Krueger), 812 F.3d 365, 367 (5th Cir.), *cert. denied*, 137 S. Ct. 314 (2016).
118. 11 U.S.C. § 707(a) (2012); *In re Krueger*, 812 F.3d at 370.
119. *In re Krueger*, 812 F.3d at 367.
120. *Id.*

The Debtor's former business partner responded by filing a motion to dismiss the Debtor's bankruptcy case for cause under 11 U.S.C. § 707(a).[121] "[T]he bankruptcy court granted the motion to dismiss for cause . . . and imposed a two-year refiling bar on [the Debtor]."[122] The Debtor "unsuccessfully sought reconsideration and appeal to the district court," and then appealed to the Fifth Circuit.[123]

The Fifth Circuit described the appeal as an "exercise in chutzpah" (usually not a good sign) and affirmed the bankruptcy court's dismissal.[124] The Debtor argued that his case could only be dismissed under § 707(a) for cause for actions that are not covered by more specific Bankruptcy Code provisions, that the "for cause" requirement was "technical and procedural in nature," and that the absence of an "explicit good faith requirement in Chapter 7" meant that his case could not be dismissed for bad faith.[125] The Fifth Circuit dismissed each of these arguments in turn.[126]

The Fifth Circuit pointed out that Congress kept the phrase "for cause" purposefully broad and that there is no textual qualification for the language.[127] Additionally, it noted that more specific provisions in the Code do not cover the same actions or remedies and apply at different stages of the case than § 707(a).[128] It held that a debtor's bad faith can be cause for dismissal under § 707(a) and that in determining whether the debtor had acted in bad faith, the court has wide discretion and can consider the debtor's actions before, during, and after filing a bankruptcy petition.[129] The Fifth Circuit emphasized that the force of the automatic stay was meant to aid the "honest but unfortunate debtor" and that it "ha[d] no place being deployed against honest but unfortunate creditors who stand in the path of a dishonest bankrupt."[130]

The evidence showed that the Debtor "filed bankruptcy for illegitimate purposes, misled the court and other parties, and engaged in bare-knuckle litigation practices, including lying under oath and threatening witnesses."[131] The Fifth Circuit explained:

> Under a flexible, totality of the circumstances approach, . . . [Debtor] filed chapter 7 because of a criminal contempt proceeding pending against him, because his state court litigation had taken a turn for the worse, and to provide him the cover to retake control of [the business]. These "non-economic motives" are "unworthy of bankruptcy protection." Once his chapter 7 case commenced, [Debtor] engaged

121. *Id.* at 368.
122. *Id.*
123. *Id.* at 368–69.
124. *Id.* at 366–67.
125. *Id.* at 372–73.
126. *Id.*
127. *Id.* at 372.
128. *Id.* at 372, 373.
129. *Id.* at 370, 372.
130. *Id.* at 373; *see* Grogan v. Garner, 498 U.S. 279, 286–87 (1991).
131. *In re Krueger*, 812 F.3d at 374.

> in conduct designed to manipulate the proceedings to his own ends, including false filings, false testimony, and witness intimidation. His duplicitous behavior is exactly the sort of conduct contemplated by most courts as giving cause for dismissal under § 707(a).[132]

The Fifth Circuit therefore affirmed the judgments of the bankruptcy court and district court in dismissing the Debtor's case for cause under § 707(a).[133]

In re Krueger has strong facts that no doubt led the Fifth Circuit to its conclusion; however, § 707(a)'s language is certainly broad enough to include bad faith, and the case seems to the authors to be decided correctly. The lesson for debtors' counsel would be to reign in the recalcitrant debtor before filing, or avoid bankruptcy court altogether.

VI. DISCHARGE

A. Actual Fraud Under 11 U.S.C. § 523: *Husky International Electronics, Inc. v. Ritz*

During the Survey period, the U.S. Supreme Court handed down only one bankruptcy decision. However, the case's import may be vast. In *Husky International Electronics, Inc. v. Ritz*, the Supreme Court adopted a broad reading of the term "actual fraud" as it is used in 11 U.S.C. § 523(a)(2)(A), the discharge exception for debts obtained by "false pretenses, a false representation, or actual fraud."[134]

The case arose after Chrysalis Manufacturing Corporation (Chrysalis)—a Texas-based company that manufactures circuit boards—purchased component parts from Husky International Electronics (Husky), incurring a debt of nearly $164,000 over the course of four years.[135] During this time, Daniel Lee Ritz, Jr. (Ritz), who served as a director of Chrysalis, transferred large sums of Chrysalis funds to other entities he controlled. When the Chrysalis debt went unpaid, Husky sought to recover the debt from Ritz personally, who filed for Chapter 7 bankruptcy shortly thereafter. Husky initiated an adversary proceeding in Ritz's bankruptcy case, arguing that the Chrysalis debt could not be discharged because Ritz's fraudulent conveyances constituted "actual fraud" under § 523(a)(2)(A).[136] The district court disagreed, and held that the discharge exception did not apply.[137] On appeal, the U.S. Court of Appeals for the Fifth Circuit affirmed, holding that a false representation is a necessary element of "actual fraud" under § 523(a)(2)(A).[138]

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132. *Id.* at 375 (internal citation omitted) (quoting Huckfeldt v. Huckfeldt (*In re* Huckfeldt), 39 F.3d 829, 833 (8th Cir. 1994)).
133. *Id.* at 376.
134. *See* 11 U.S.C. § 523(a)(2)(A) (2012); Husky Int'l Elecs., Inc. v. Ritz, 136 S. Ct. 1581, 1590 (2016).
135. *Ritz*, 136 S. Ct. at 1585.
136. *Id.*
137. *Id.*
138. *Id.* at 1585–86.

The Supreme Court reversed the lower courts, relying upon the legislative history of the Bankruptcy Code to hold that the term "actual fraud" encompasses forms of fraud that can be perpetrated without a false representation, such as fraudulent conveyances.[139] The Code originally barred the discharge of debts obtained by "false pretenses or false representations," but Congress later amended the provision to add "actual fraud."[140] According to the Supreme Court, this change demonstrated that "Congress did not intend 'actual fraud' to mean the same thing as 'a false representation.'"[141]

Furthermore, the Supreme Court noted, common law supports that conclusion, as fraudulent conveyances are "not an inducement-based fraud."[142] Because fraudulent conveyances are often concealed, there are limited opportunities for the debtor to put forth a false representation; as a result, "[a false representation] could hardly be considered a defining feature of this kind of fraud."[143] Accordingly, the Supreme Court reversed the Fifth Circuit and remanded the case for further proceedings.[144]

Justice Thomas wrote a very powerful dissent, which focused on the language of the Bankruptcy Code.[145] How far litigants and courts are willing to stretch the holding, which barred discharge of a debt incurred long before the debtor's fraudulent conduct, will remain to be seen.

B. Discharge Under 11 U.S.C. § 727: *In re Packer*

Most individual debtors file a Chapter 7 petition with the primary intent of obtaining a discharge. However, creditors sometimes seek to except their debts from discharge under 11 U.S.C. § 523 or to block the entire discharge under § 727. During the Survey period, the U.S. Court of Appeals for the Fifth Circuit handed down a brief but important case showing that it is hard to block a discharge.[146] Section 727 has many elements for creditors to meet.[147]

In *In re Packer*, the Fifth Circuit solidified its approach to denying discharge under 11 U.S.C. § 727(a) when it held that the party objecting to the discharge failed to show the requisite fraudulent behavior that would warrant such a denial.[148] Plaintiff–Appellant Judgment Factors, L.L.C. (Judgment Factors) filed an adversary proceeding to prevent the entry of the Debtor's Chapter 7 discharge pursuant to § 727(a)(2)(A) (improper transfer); (a)(3) (failure to keep records); (a)(4)(A) (false oath); and

139. *Id.* at 1586.
140. *Id.*
141. *Id.*
142. *Id.* at 1587.
143. *Id.*
144. *Id.* at 1590.
145. *See id.* at 1590–91, 1594 (Thomas, J., dissenting).
146. *See* Judgment Factors, L.L.C. v. Packer (*In re* Packer), 816 F.3d 87, 89 (5th Cir. 2016) (per curiam).
147. *See* 11 U.S.C. § 727 (2012).
148. *In re Packer*, 816 F.3d at 89.

(a)(5) (failure to explain loss of assets).[149] The U.S. Bankruptcy Court for the Eastern District of Texas granted the Debtor's motion for summary judgment, and the U.S. District Court for the Eastern District of Texas affirmed.

On appeal, the Fifth Circuit emphasized the requirement that "a 'court shall grant the debtor a discharge, unless' the debtor engaged in specific actions that are statutorily enumerated"—a proclamation that necessitated a meticulous analysis of § 727(a) in light of the Debtor's actions.[150] Strictly interpreting the language in the various sections of § 727(a), and taking into consideration well-established Fifth Circuit precedent, the Fifth Circuit determined that the Debtor's actions did not amount to the fraudulent type of behavior that would merit a denial of discharge, as none of the aforementioned provisions statutorily prohibited his actions.[151] Because Judgment Factors was unable to prove each of the elements required for each of their claims under § 727(a), the Fifth Circuit affirmed the trial court's grant of the Debtor's summary judgment.[152]

In re Packer highlights the expansiveness of broad Chapter 7 discharge and how reluctant courts are to deny discharge under § 727(a). The Fifth Circuit's strict interpretation requires the party objecting to the discharge to put forth evidence that falls specifically under one of the relevant provisions of § 727(a), and simultaneously requires the debtor to have engaged in specific and enumerated actions.

C. Mortgage Payments in Chapter 13 Bankruptcy Proceedings: *In re Kessler*

Sometimes, debtors in Chapter 13 plans fall behind in their direct mortgage payments on their homes and yet remain current on their payments to the Chapter 13 trustee under the plan. In a very important consumer bankruptcy case, the U.S. Court of Appeals for the Fifth Circuit has now held that such debtors have not completed their plan obligations and are not entitled to a discharge at the end of the case.[153]

In *In re Kessler*, the Fifth Circuit held that post-petition payments made directly to the Debtors' mortgagor had to be paid before the Debtors could receive discharge under the Debtors' Chapter 13 plan.[154] The Chapter 13 plan provided for both direct post-petition payments on the mortgage to the mortgagee and, importantly, payments to the trustee to cure pre-petition mortgage arrears.[155] "Despite their failure to make the

149. *Id.* at 90.
150. *See id.* at 91 (quoting 11 U.S.C. § 727(a)).
151. *See id.* at 93–95. The Court also briefly touched on the alter ego and reverse veil piercing theories proposed by Judgment Factors, but summarily dismissed them as claims belonging to the estate, rather than to a creditor. *See id.* at 92.
152. *Id.* at 95.
153. Kessler v. Wilson (*In re* Kessler), 655 F. App'x 242, 244 (5th Cir. 2016) (per curiam).
154. *Id.*
155. *Id.* at 243.

[direct] post-petition mortgage payments, the [Debtors] moved for discharge" in accordance with 11 U.S.C. § 1328(a), arguing that "[b]ecause post-petition mortgage payments are . . . nondischargeable under § 1322(b)(5), . . . [their] direct payments [fell] outside of their plan and [could not] be required for discharge under § 1328(a)."[156]

On appeal, the Fifth Circuit was left to decide whether "payments on the post-petition mortgage debt were provided for 'under the plan,' and thus [whether] nonpayment barred discharge."[157] Interpreting past precedent, the Fifth Circuit affirmatively held that "post-petition payments of § 1322(b)(5) debts fall under the plan when pre-petition defaults are also provided for in the plan."[158] Because the Debtors' Chapter 13 plan provided for curing pre-petition mortgage arrears and for maintenance of post-petition payments, the Debtors' post-petition payments were payments "under the plan."[159] Given the § 1328(a) requirement that discharge shall only be granted when *all* payments *under the plan* are paid, the Fifth Circuit held that denial of discharge was appropriate.[160]

The facts of *In re Kessler* are not uncommon, as Chapter 13 debtors often run into problems after the plan is confirmed. It is now clear that direct payments made under a mortgage must also be paid, along with all payments made to the Chapter 13 trustee pursuant to the plan, for a debtor to receive a discharge at the end of the plan period.

D. Surrender Under a Chapter 13 "Cure-and-Maintain" Plan: *In re Dennett*

Debtors who fail to pay their direct mortgage payments continue to have limited options. In *In re Dennett*, a bankruptcy judge in the U.S. Bankruptcy Court for the Northern District of Texas *sua sponte* addressed the ability of debtors to surrender their home and receive a discharge notwithstanding their failure to make all direct mortgage payments under their Chapter 13 plan.[161]

The case involved Chapter 13 debtors (the Debtors) who sought to cure a default on a mortgage owed to Nationstar Mortgage, LLC (Nationstar). The Debtors' "cure-and-maintain" plan provided for the cure of their prepetition mortgage arrears and ongoing direct mortgage payments to Nationstar.[162] The Debtors sought a discharge at the expiration of their plan term, but had missed thirty-three of the required direct payments

156. *Id.* at 243–244; *see* 11 U.S.C. §§ 1322(b)(5),1328(a) (2012).
157. *In re Kessler*, 655 F. App'x at 243.
158. *Id.* at 244 (citing Foster v. Heitkamp (*In re* Foster), 670 F.2d 478, 489, 493 (5th Cir. 1982).
159. *Id.* (citing *In re Foster*, 670 F.2d at 488–89).
160. *Id.* (citing 11 U.S.C. § 1328(a)). The Debtors also argued that the mortgagee "waived its right to challenge discharge when it did not respond or object to [the] discharge motion." *Id.* This argument was rejected quickly; the Fifth Circuit said there is nothing in the Bankruptcy Code or prior precedent that would require a trustee or creditor to "object in order for a court to deny discharge." *Id.* at 245 (citing 11 U.S.C. § 1328).
161. *In re* Dennett, 548 B.R. 733, 734 (Bankr. N.D. Tex. 2016).
162. *Id.* at 735.

under the plan.[163] In order to make up for the missed payments, the Debtors proposed to modify their plan and "surrender . . . their home in full satisfaction of the claim held by Nationstar."[164]

It is clear after *In re Kessler* that a debtor is unable to receive a discharge if he fails to make all payments under his plan and that direct payments under a "cure-and-maintain" plan are considered "payments under the plan."[165] In *In re Ramos*, a recent opinion out of the U.S. Bankruptcy Court for the Northern District of Texas, surrender by way of modification was not permitted to remedy a failure to make regular direct mortgage payments under a "cure-and-maintain" plan.[166] However, the bankruptcy judge in the instant case disagreed with the rationale in *In re Ramos* and chose not to categorically deny surrender as a means to correct a default under the plan.[167]

After reviewing various authorities on the subject, the bankruptcy court concluded that surrender can be considered "payment" for purposes of plan modifications under 11 U.S.C. § 1329(a).[168] In this case, the Debtors were not at the end of a five-year plan, the Debtors' home was worth more than the amount owed to Nationstar, and neither the Chapter 13 trustee nor Nationstar objected to the modification.[169] Thus, the bankruptcy court held that the plan could be subject to modification.[170]

The issue of surrender near the end of a Chapter 13 plan is a hot one, most likely waiting for guidance from the U.S. Court of Appeals for the Fifth Circuit.

VII. FEES

A. Reduction of Fees Reviewed Under 11 U.S.C. §§ 328(B) and 330(A): *In re King* (*King I*)

Ruling on proposed fees when creditors are unhappy is an unpleasant job for a bankruptcy judge. Several cases during the Survey period point out problem areas for bankruptcy practitioners.

In *In re King* (*King I*), the U.S. Bankruptcy Court for the Southern District of Texas reduced a law firm's fee request by nearly two-thirds after finding that the firm attempted to charge for services more appropriately requested by the trustee.[171] The ruling sends a message to all Chapter 7 trustees that diligence is required when reviewing the services

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163. *Id.*
164. *Id.*
165. *Id.* (citing *In re* Kessler, No. 09-60247-RLJ-13, 2015 WL 4726794, at *4 (Bankr. N.D. Tex. June 9, 2015), *aff'd sub nom.*, Kessler v. Wilson (*In re* Kessler), 655 F. App'x 242 (5th Cir. 2016)).
166. *Id.* at 736 (citing *In re* Ramos, 540 B.R. 580, 584 (Bankr. N.D. Tex. 2015)).
167. *Id.* at 737.
168. *Id.* at 738.
169. *Id.* at 737.
170. *Id.* at 741–42.
171. *In re* King (*King I*), 546 B.R. 682, 685–86 (Bankr. S.D. Tex. 2016).

their firms bill to the estate.[172] The case arose when a law firm (the Firm) filed its fee application for services related to its representation of a Chapter 7 trustee (the Trustee) in the underlying bankruptcy case.[173] The Trustee was a named partner of the Firm.[174] Shortly thereafter, the largest unsecured creditor in the case, Western Surety Company (Western Surety), filed an objection to the fee application.[175] Western Surety objected because the requested fees were both "excessive" and for services "that are part of the ordinary duties of a trustee."[176]

The bankruptcy court analyzed the Firm's fee application under 11 U.S.C. §§ 328(b) and 330(a). While "[t]he purpose of § 328(b) is to ensure that the trustee's firm is not compensated" for duties that the trustee is required to fulfill under § 704(a), § 330(a) seeks "to ensure that the fees awarded to the trustee's firm are reasonable and only for services that were actually and necessarily rendered."[177] Before conducting its § 328(b) analysis, the bankruptcy court set out perhaps a new standard for determining whether a service performed by a law firm falls within the statutory duties of a trustee. First, any services that do not require legal assistance are "*per se* non-compensable."[178] Conversely, "any legal services that require special expertise are *per se* compensable."[179] Finally, the bankruptcy court accumulated a list of nine categories of services that are "presumptively non-compensable," such as reviewing and evaluating claims, investigating estate property, and selling or disposing of assets.[180] However, the bankruptcy court clarified that the presumption of non-compensability can be overcome by demonstrating that the "services rendered involved 'unique difficulties' beyond the trustee's own ability to handle [the] issues."[181]

The bankruptcy court applied the § 328(b) analysis to the case at hand by reviewing the time entries of three associates at the Firm. After reviewing the description of the services in the time entries, the bankruptcy court concluded that the Firm sought compensation for both non-legal services, which are per se non-compensable, and services that fall within the "presumptively non-compensable" category.[182] Moreover, the Firm failed to meet its burden of establishing that the latter services involved

172. *Id.* at 685.
173. *Id.* at 685–86.
174. *Id.* at 686.
175. *Id.*
176. *Id.*
177. *Id.* at 692–93.
178. *Id.* at 699.
179. *Id.*
180. *See id.* at 699–700. The full list of any per se non-compensable non-legal services includes: (1) "claim review and evaluation"; (2) "claim objection"; (3) "property demand"; (4) "communication with creditors and other parties-in-interest"; (5) "investigation of estate property"; (6) "selling or disposing of assets"; (7) "communication with and supervision of estate professionals"; (8) "review of the debtor's records"; and (9) "review of pleadings." *Id.*
181. *Id.* at 700 (citing *In re* Kusler, 224 B.R. 180, 186 (Bankr. N.D. Okla. 1998)).
182. *Id.* at 701.

"unique difficulties" that would require additional legal assistance.[183] The bankruptcy court ultimately "deduct[ed] the amount of $20,708.50 from the . . . total requested fee amount of $123,282.25[, leaving] a balance of $102,573.75."[184]

Next, the bankruptcy court applied § 330(a) to the services that survived the § 328(b) analysis. Under § 330(a), a court may award "reasonable compensation for actual, necessary services rendered by the trustee" and "reimbursement for actual, necessary expenses."[185] The bankruptcy court applied the "lodestar method," an approach routinely used in the U.S. Court of Appeals for the Fifth Circuit to calculate reasonable attorneys' fees.[186] Under the lodestar method, courts calculate the "compensable hours billed" and the "reasonable hourly rate for the compensable services," and then multiply the figures to determine the amount of compensable fees.[187] In evaluating whether the hours billed by the Firm were compensable, the bankruptcy court first analyzed whether the services were either "reasonable or necessary" with regard to the case.[188] At the outset, the bankruptcy court disallowed 90.5 hours due to either vague or lumped time entries.[189] The bankruptcy court then analyzed whether the remaining services were reasonable and necessary, ultimately disallowing 44.8 hours for failing to meet the standard.[190] Finally, the bankruptcy court disallowed 0.5 hours for excessive time.[191] Thus, in the first step of the lodestar method, the bankruptcy court deducted $52,047.00 from the surviving $102,573.75, leaving a balance of $50,526.75 in compensable hours billed.[192]

In the second step of the lodestar method, the bankruptcy court considered whether the Firm's hourly rate was reasonable "by evaluating the prevailing market rate."[193] The bankruptcy court concluded that the Firm's rates were reasonable based on comparable rates in the Houston area.[194] However, the bankruptcy court adjusted the requested fees downward another $826.50 after concluding that assembling exhibit booklets should be billed at a paralegal billing rate rather than an associate billing rate.[195]

Finally, the bankruptcy court considered whether the amount of fees should be reduced based on the twelve factors articulated in *Johnson v.*

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183. *Id.*
184. *Id.* at 709.
185. 11 U.S.C. § 330(a) (2012).
186. *King I*, 546 B.R. at 711.
187. *Id.* (citing *In re* Cahill, 428 F.3d 536, 540 (5th Cir. 2005) (per curiam)).
188. *Id.*
189. *See id.* at 712–20.
190. *Id.* at 720–27.
191. *Id.* at 726–27.
192. *Id.* at 727–28.
193. *Id.* at 728.
194. *Id.*
195. *Id.* at 729.

Georgia Highway Express, Inc. or "other equitable factors."[196] Although application of the *Johnson* factors did not result in an adjustment of the fee, the bankruptcy court adjusted the fee downward another $7,559.50 based on three equitable factors: (1) "[t]he Trustee's [f]ailure to [p]roperly [s]upervise his own Firm"; (2) "[t]he Trustee's [m]isrepresentation in the Applications to Employ"; and (3) the Trustee's failure to "[o]btain [a]pproval of the $4,000.00 [s]ettlement that he [e]ffectuated with the Debtor[.]"[197] As a result, the bankruptcy court ultimately approved fees in the amount of $42,140.75, representing an aggregate reduction of $81,141.50 from the initially requested amount of $123,282.25.[198]

The bankruptcy court concluded by stating that in all cases in which a Chapter 7 trustee hires her own law firm to represent her, fee applications proposed by the firm will require a hearing, even if the applications are unopposed.[199] At these hearings, testimony by the trustee regarding the "unique difficulties" requiring the law firm's engagement will be mandatory, and the U.S. Trustee will be required to attend.[200] The bankruptcy court cautioned that § 327(a)—the Bankruptcy Code provision that allows a trustee to retain his own firm for representation—does not operate as a "license for the trustee and his firm to milk the estate for all it is worth."[201]

By any measure, a reduction of a requested fee by two-thirds is substantial. However, *King I* lays out clear guidelines, at least to trustees in the Southern District who hire their own firms, to avoid charging extra for duties that are more properly expected of the trustee than counsel.

B. May I Have Another?: *In re King* (*King II*)

Part two of a court's ruling can sometimes be even harder than the first. Seven months after the first memorandum opinion (the First Opinion) was issued in *King I*, the U.S. Bankruptcy Court for the Southern District of Texas in Houston ruled regarding the fee application submitted by the Chapter 7 trustee (the Trustee).[202] The Trustee had hired his own law firm (the Firm) to represent him in his capacity as trustee.[203] The First Opinion found that "the Trustee had violated his fiduciary duty to the estate 'by allowing his firm to seek illegitimate fees from the estate.'"[204] In a footnote in the First Opinion, the bankruptcy court expressed concern over "the Trustee's failure to properly monitor the Law

196. *Id.* at 711, 729–34 (citing Johnson v. Ga. Highway Express, Inc., 488 F.2d 714, 718 (5th Cir. 1974), *abrogated on other grounds by* Blanchard v. Bergeron, 489 U.S. 87 (1989)).
197. *See id.* at 730–34.
198. *Id.* at 736.
199. *Id.*
200. *Id.* at 737.
201. *Id.*
202. *In re* King (*King II*), 559 B.R. 158, 159 (Bankr. S.D. Tex. 2016).
203. *Id.*
204. *Id.* at 159 (quoting *King I*, 546 B.R. at 685).

Firm's billing" and notified the Trustee that it "would hold a hearing on his eventual application [for] statutory trustee fee[s]" due to this lack of oversight.[205]

Although the Trustee's application requested compensation for $28,461.93—the maximum amount available under 11 U.S.C. § 326(a)—the bankruptcy court ultimately awarded only $5,692.39.[206] Rehashing some of the problems discussed in the First Opinion, the bankruptcy court first determined that awarding the maximum amount available under § 326(a) would be inequitable and disproportionate due to "numerous glaring problems" with the Trustee's administration of the case.[207] First, the Trustee breached his fiduciary duty to creditors "by allowing his Firm to seek illegitimate fees from the estate[,]" which was the subject of the First Opinion.[208] Furthermore, "the Trustee violated Rule 9019 by unilaterally settling a portion of his objection to the Debtor's exemptions," thus robbing the estate's creditors of the opportunity to object to the settlement.[209] The bankruptcy court also found that the Trustee made two misrepresentations to the court upon seeking approval to retain the Firm: that claims would be reviewed and assessed without the incurrence of legal fees and that he would ensure that hiring the Firm would be in the best interest of the estate.[210] Finally, the Trustee violated Rule 2016(a) by failing to submit documentation describing the services rendered or the time expended rendering such services, despite the Rule's requirement that a "detailed statement" of such matters be provided.[211]

Next, the bankruptcy court considered three of the factors listed in § 330(a)(3) to reach its conclusion that a "substantial reduction" of the fee was warranted.[212] The first two factors required the court to consider "the time spent by the Trustee providing services related to the administration of the estate" and "the effective hourly rate for these services given the [requested] fee of $28,461.93."[213] After reviewing the time entries, the bankruptcy court found that the Trustee spent approximately 8.5 hours working on the case, which resulted in an effective hourly rate of $3,011.85.[214] Given that this rate was "more than double the highest paid hourly rate for an attorney . . . in Houston[,]" the bankruptcy court determined that the "application of [the first two] factors . . . justifie[d] a substantial reduction in the amount of the fee requested by the Trustee."[215] The third factor required the bankruptcy court to consider "the Trustee's

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205. *Id.* (citing *King I*, 546 B.R. at 689 n.3).
206. *Id.*
207. *Id.* at 168.
208. *Id.* at 165 (citing *King I*, 546 B.R. at 685).
209. *Id.*
210. *Id.* at 165–66.
211. *Id.* at 166–67 (citing FED. R. BANKR. P. 2016(a)).
212. *Id.* at 169, 171.
213. *Id.* at 169.
214. *Id.* at 170.
215. *Id.* at 170–71.

board-certification, skill, and experience in the bankruptcy field."[216] Because of the Trustee's substantial experience in bankruptcy law and board certification in business bankruptcy law, the bankruptcy court determined that the Trustee's poor performance in the administration of the case justified further reduction of the fee.[217]

Finally, the bankruptcy court adopted the "grading" approach used by the court in *In re Phillips*[218] to determine a "reasonable" fee pursuant to § 326(a).[219] Taking all of the Trustee's conduct into consideration, the bankruptcy court concluded that his efforts were "below 'merely good or average' for a trustee of his caliber and his experience," and ultimately lowered the requested fee from $28,461.93 to $5,692.39.[220] The opinion ended on a stern note:

> The message should now be clear: This Court will not automatically award any Chapter 7 trustee the maximum amount allowed by § 326(a), and this is so even if no objections to the fee application are lodged. If the Court, after reviewing a trustee's fee application, chooses not to approve the fee request in chambers, but rather sets a hearing, then the trustee must earn his fee the old fashioned way: Prove it.[221]

The Trustee's fees in this case were cut nearly eighty percent. In a case where the court finds a breach of fiduciary duty and misrepresentation, it is hard to fault the judge for expressing concerns. That said, it is unclear whether other bankruptcy judges in Texas or the U.S. Court of Appeals for the Fifth Circuit will adopt this grading approach. The authors included the *King* cases in this Survey as a word of warning to trustees and their counsel.

C. Violation of Duties: *In re Chapter 13 Plan Administration in the Brownsville, Corpus Christi & McAllen Divisions*

Trustees and bankruptcy judges hold two different roles in the bankruptcy process, so when a bankruptcy court publicly admonishes a trustee and the court itself, lawyers should pay very close attention. In *In re Chapter 13 Plan Administration in the Brownsville, Corpus Christi & McAllen Divisions*, the chief bankruptcy judge for the U.S. Bankruptcy Court for the Southern District of Texas issued an opinion taking the local Chapter 13 trustee (the Trustee) to task, while explicitly rebuking the former practices of the court.[222]

216. *Id.* at 169.
217. *Id.* at 171.
218. 392 B.R. 378, 391–92 (Bankr. N.D. Ill. 2008).
219. *King II*, 559 B.R. at 172.
220. *Id.* at 173–74 ("Just like children in school who are lazy, cheat, rely on others to do their work, and are caught in the act, the Trustee here deserves a 'D' . . . .").
221. *Id.* at 176.
222. *In re* Chapter 13 Plan Admin. in the Brownsville, Corpus Christi & McAllen Divs., No. 15-701, 2016 WL 2772099, at *6 (Bankr. S.D. Tex. May 6, 2016).

Here, the Trustee and a former bankruptcy judge for the division had been administering Chapter 13 plans in a manner that was inconsistent with the Uniform Plan and Motion for Valuation of Collateral (Uniform Plan) implemented by the Southern District of Texas.[223] Specifically, the Trustee was conducting Chapter 13 cases where mortgage payments had increased in disparate ways to other locations throughout the District and the Division, under the direction of the former judge.[224] Although the Trustee denied that she had been conducting Chapter 13 cases incorrectly, and the retired bankruptcy judge provided a written affidavit supporting the Trustee, the bankruptcy court was not convinced.[225]

First, the chief judge expressly voiced his concerns involving the previous actions of the bankruptcy court. Addressing the conduct of a bankruptcy judge, the chief judge stated that "[t]he most fundamental tenet of [the Code of Conduct] is the responsibility that judges have to follow the law," and "[l]ocal rules have the force of law so long as they do not conflict with a rule prescribed by the Supreme Court, Congress or the Constitution."[226] Therefore, the chief judge found that the bankruptcy court's previous refusal to follow the Uniform Plan was tantamount to not following the law, which in turn severely undermines confidence in the judicial system and the rule of law.[227]

Next, the chief judge took aim at the UST and his failure to adequately monitor Chapter 13 plans in this instance.[228] He emphasized that the UST has the duty to supervise standing Chapter 13 trustees and take appropriate action when necessary.[229]

Lastly, the chief judge admonished the Trustee and her administration of cases. Beginning with the role of the Trustee in the Chapter 13 process, the chief judge noted, "as a fiduciary and an officer of the Court, a Chapter 13 trustee has the duties of candor, care, loyalty, and impartiality."[230]

The chief judge found that all three parties had violated their various duties.[231] The Trustee and the UST were given the opportunity by the bankruptcy court to craft a remedy for debtors affected by the Trustee's actions but failed to produce a suitable option.[232] Thus, the chief judge crafted his own remedies for debtors who had overpaid or underpaid, including the availability of potential liability for the Trustee.[233] Furthermore, the chief judge ordered a direct review of the Trustee's practices

223. *Id.* at *1–2.
224. *Id.*
225. *Id.* at *1–2, *6.
226. *Id.* at *4 (citing Kinsley v. Lakeview Reg'l Med. Ctr. LLC, 570 F.3d 586, 589 (5th Cir. 2009)).
227. *See id.*
228. *Id.*
229. *Id.*
230. *Id.*
231. *Id.* at *6.
232. *Id.*
233. *Id.*

and competencies by the UST.[234]

Finally, the chief judge ended his ruling with a heartfelt apology on behalf of the bankruptcy court. The force of his remarks may only be felt by reading the statement in full. He closed:

> All citizens deserve equal treatment under the law regardless of race, creed, gender or geographic location. The bankruptcy process in the Southern District of Texas has failed Chapter 13 debtors in the Brownsville, Corpus Christi and McAllen divisions. On behalf of the Bankruptcy Court, the undersigned offers its sincere apology to those debtors and their families that did not receive the justice they deserve. The Court hopes that practitioners in these divisions will share this Order with their clients and convey just how hard it is for the undersigned to publicly recognize the failure of a system that he took an oath to protect. There will be no more secret rules, unspoken practices or disparate treatment of citizens in different divisions. We are one Bankruptcy Court with a single set of written rules. All citizens within the Southern District of Texas will be treated equally and with respect.[235]

By any measure, this case is ugly for all concerned, and whether the possible imposition of personal liability on the Chapter 13 trustee will withstand a challenge of immunity is up in the air. However, this case serves as a stark reminder of the duties of all officers of the court.

VIII. INVOLUNTARY CASES: *IN RE BATES*

Successful involuntary bankruptcy petitions are difficult because 11 U.S.C. § 303 has stiff requirements as to the number of petitioners, the amount of their claims, the validity of the petitioners' debts, and the requirement that the potential debtor be generally not paying its debts.[236] A recent case during the Survey period, *In re Bates*, provides an excellent analysis of the "generally not paying" requirement of 11 U.S.C § 303(h)(1).[237]

In *In re Bates*, an involuntary petition was filed against an individual (the Putative Debtor), who objected to the filing.[238] In considering whether an order for relief could be entered against the Putative Debtor, the U.S. Bankruptcy Court for the Western District of Texas examined 11 U.S.C. § 303(h)(1), which states:

> (h) . . . the court shall order relief against the debtor in an involuntary case under the chapter under which the petition was filed, only if—(1) the debtor is generally not paying such debtor's debts as such debts become due unless such debts are the subject of a bona fide dispute as to liability or amount . . . .[239]

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234. *Id.* at *7.
235. *Id.*
236. *See* 11 U.S.C. § 303(b), (h) (2012).
237. *In re* Bates, 545 B.R. 183, 186 (Bankr. W.D. Tex. 2016).
238. *Id.* at 185.
239. 11 U.S.C. § 303(h)(1); *In re Bates*, 545 B.R. at 186.

The bankruptcy court applied the four-factor "generally not paying" test from the *In re Norris* case to determine that the Putative Debtor was "generally not paying" his debts as they became due.[240] The *In re Norris* test includes the following factors: (1) "[t]he number of unpaid claims not subject to a bona fide dispute"; (2) "[t]he amount of such claims"; (3) "[t]he materiality of the non-payments"; and (4) "[t]he [Putative Debtor's] overall conduct in his financial affairs."[241] The bankruptcy court found that the "Putative Debtor was generally paying on thirteen [ ] debts as they became due and was not paying five [ ] creditors whose debts were currently due" that amounted to a substantial percentage of the Putative Debtor's liability.[242]

In applying the first prong, the bankruptcy court found that " a final judgment that has not been stayed is not subject to a bona fide dispute"[243] and that small recurring monthly payments to creditors could not be considered when applying the "generally not paying" test.[244] "The Bankruptcy Code does not define the term 'bona fide dispute,'" but the objective standard adopted by the U.S. Court of Appeals for the Fifth Circuit prevents a petitioning creditor from using involuntary bankruptcy if the debtor has a "basis for either a factual or a legal dispute as to the validity of the debt."[245]

After an examination of the second prong of the "generally not paying" test, the bankruptcy court found that, as of the petition date, the Putative Debtor was not paying on debts amounting to over $130,000 and was paying on debts in an amount just over $18,000.[246]

In applying the last two prongs of the test, the bankruptcy court further found that the Putative Debtor was only paying the debts he wanted to pay, instead of paying all debts equally, and that the Putative Debtor engaged in financial misconduct.[247] Thus, after considering all four factors of the "generally not paying" test, the bankruptcy court concluded that the Putative Debtor was generally not paying his debts as such debts become due pursuant to 11 U.S.C. § 303(h)(1), and an order for relief was entered accordingly.[248]

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240. *In re Bates*, 545 B.R. at 186 (citing *In re* Norris, 183 B.R. 437, 455–57 (Bankr. W.D. La. 1995)). The *In re Norris* test was adopted by a bankruptcy court in the Northern District of Texas in the *In re Moss* case. *Id.* (citing *In re* Moss, 249 B.R. 411, 422 (Bankr. N.D. Tex. 2000)).

241. *Id.* at 187–92.

242. *Id.* at 189–90.

243. *Id.* at 187 (citing Norris v. Johnson (*In re* Norris), No. 96-30146, 1997 WL 256808, at *5 (5th Cir. Apr. 11, 1997) (per curiam)).

244. *Id.* at 188 (citing *In re* Smith, 415 B.R. 222, 232 (Bankr. N.D. Tex. 2009)).

245. *Id.* at 187 (citing Subway Equip. Leasing Corp. v. Sims (*In re* Sims), 994 F.2d 210, 221 (5th Cir. 1993)).

246. *Id.* at 189–90.

247. *Id.* at 192.

248. *Id.* at 193. When determining that an order or relief should be entered, a court must also find that the petitioning creditors have not acted in bad faith. The court in this case made such a finding. *Id.* at 192–93.

In re Bates provides good guidance to lawyers contemplating the filing of an involuntary bankruptcy petition.

IX. 11 U.S.C. § 522

A. 11 U.S.C. § 522(q): *In re Wyly*

In 2005, Congress enacted limitations to the previously unlimited homestead exemption provisions of certain states, including Texas.[249] These limits occur upon certain pre-petition actions of a debtor. There are not many Texas cases applying the limits; however, in this Survey period, the following case was a doozy.

Although bankruptcy law requires a balancing of federal and state law, it is important to remember that at the end of the day the Code wins. In the case of *In re Wyly*,[250] debtor Sam Wyly was reminded of that when he argued that his unlimited homestead exemption provided by Texas law was not subject to the Code's cap in 11 U.S.C. § 522(q) for the violation of federal securities laws. While the case featured other issues, § 522 of the Code will be the focus here.

Following entry of a judgment against Wyly for securities fraud in the amount of $123 million, Wyly filed for Chapter 11 protection in the U.S. Bankruptcy Court for the Northern District of Texas.[251] In his schedules, Wyly elected Texas exemptions that provided him with an unlimited homestead exemption for his house, valued at approximately $12.1 million.[252] The Securities and Exchange Commission (SEC) moved for summary judgment, arguing that 11 U.S.C. § 522(q)(1) capped Wyly's homestead exemption at $155,675, and Wyly made a cross motion for summary judgment, arguing that the provision was not applicable due to the nature of the case.[253]

First, the bankruptcy court found that the uncontroverted evidence at trial established that the property at issue qualified as Wyly's homestead.[254] It then recognized that, unquestionably, "a debtor's unlimited Texas homestead exemption may be limited in bankruptcy by the application of 11 U.S.C. § 522(q)."[255] The bankruptcy court next turned to

249. *See* 11 U.S.C. § 522(q) (2012).
250. *See* 553 B.R. 318, 323–24, 331 (Bankr. N.D. Tex. 2016).
251. *Id.* at 323.
252. *Id.* at 323–24.
253. *Id.* at 320, 334. 11 U.S.C. § 522(q) provides in relevant part:

> (q)(1) As a result of electing . . . to exempt property under State or local law, a debtor may not exempt any amount of an interest in [homestead property] . . . which exceeds in the aggregate $160,375 if . . . (B) the debtor owes a debt arising from—(i) any violation of the Federal securities laws (as defined in section 3(a)(47) of the Securities Exchange Act of 1934), any State securities laws, or any regulation or order issued under Federal securities laws or State securities laws . . . .
>
> (2) Paragraph (1) shall not apply to the extent the amount of an interest in [the homestead] property . . . is reasonably necessary for the support of the debtor and any dependent of the debtor.

254. *In re Wyly*, 553 B.R. at 331.
255. *Id.*

whether the judgment against Wyly qualified as a "debt arising from a violation of Federal securities laws."[256] In finding that it did so qualify, the bankruptcy court examined the definitions of "debt" and "claim" under the Bankruptcy Code.[257]

In its determination, the bankruptcy court held that the judgment fell under the definition of "debt" for purposes of § 522(q), even though it was up for appeal.[258] It further noted that Wyly had merely appealed the damages calculation from the lower court, choosing not to appeal the finding that he had committed fraud.[259] Thus, the bankruptcy court reasoned that even if the amount Wyly was required to disgorge was reduced to a single dollar, it would be enough to trigger the application of § 522(q)(1).[260] Furthermore, the bankruptcy court held that because the SEC agreed not to sell the homestead or to remove Wyly from the homestead until the conclusion of the appeals process, capping Wyly's homestead exemption did not prejudice him.[261]

Simply put, the bankruptcy court found that the plain meaning of § 522(q)(1) meant what it said, despite unknown outcomes in the appellate process.[262] Thus, the savings clause in § 522(q)(2), the application of which was to be argued at a later date, was left as Wyly's only chance to save a greater amount of the equity in his homestead.[263]

B. 11 U.S.C. § 522(o) and § 522(p): *In re Colliau*

The 2005 amendments did not just add a cap to homestead exemptions for debtors who had engaged in securities fraud; Congress also imposed limits upon general state law homestead exemptions in 11 U.S.C. § 522, subsections (o) and (p).[264] Under § 522(o), the exemption may be limited by a debtor's fraudulent pre-petition payments towards his homestead.[265] Under § 522(p), a recently acquired homestead may be subject to a dollar cap.[266] During the Survey period, the U.S. Bankruptcy Court for the Western District of Texas issued an order that addresses both of these sections.[267]

In re Colliau focused on the interaction between § 522, subsections (o) and (p), and whether these two subsections should be read "in conjunction or independently[,]" as well as on the snapshot rule and its application with respect to waiting for appreciation of property.[268] The case

256. *Id.* at 332.
257. *Id.*
258. *Id.*
259. *Id.*
260. *Id.* at 333.
261. *Id.*
262. *See id.*
263. *See id.* at 335.
264. *See* 11 U.S.C. § 522(o), (p).
265. *See id.* § 522(o).
266. *See id.* § 522(p).
267. *In re* Colliau, 552 B.R. 158, 161 (Bankr. W.D. Tex. 2016).
268. *Id.* at 159, 161.

involved homestead property that was purchased within 1,215 days of bankruptcy and therefore subject to the § 522(p) cap of $311,350.[269]

In an oral ruling, the bankruptcy court employed § 522(o) and § 522(p) in conjunction to reduce the exemption cap in § 522(p).[270] The bankruptcy court found, under § 522(o), that improvements in the amount of $11,156 "on the eve of bankruptcy" must be deducted from the Debtors' interest in the homestead because they were made "with the intent to hinder, delay, or defraud creditors."[271] Thus, the bankruptcy court deducted the cost of the improvements from the $311,350[272] cap in § 522(p), reducing the cap to $300,000.[273] The bankruptcy court further found that $16,000 was required for maintenance of the home and deducted that amount from the Debtors' $316,000 equity interest in the home, leaving their total interest in the homestead at $300,000.[274] The bankruptcy court concluded that the Debtors' interest did not exceed the reduced § 522(p) cap.[275]

A creditor of the Debtors and the Chapter 7 Trustee objected, arguing that § 522(p) and § 522(o) should be read independently and that the cost of the improvements should be deducted from the equity the Debtors owned in the property.[276] After a second review of the case, the bankruptcy court agreed and amended its ruling.[277]

The bankruptcy court noted that leaving the estate without an interest in the property or the amount of the improvements, even though the improvements fell under § 522(o), was contrary to the policy and intent of § 522(o) and § 522(p).[278] The bankruptcy court reviewed the meaning of "interest" in § 522(o) and determined that the Debtors' interest in the property was essentially the amount of equity in the property.[279] Thus, the bankruptcy court reduced the Debtors' equity in the property, instead

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269. *Id.* at 159–60. 11 U.S.C. § 522(p)(1) states:

> [A]s a result of electing . . . to exempt property under State or local law, a debtor may not exempt any amount of interest that was acquired by the debtor during the 1215-day period preceding the date of the filing of the petition that exceeds in the aggregate $160,375 in value in . . . (D) real or personal property that the debtor or dependent of the debtor claims as a homestead.

270. *In re Colliau*, 552 B.R. at 160–61.

271. *Id.* at 160; *see also* 11 U.S.C. § 522(o). Section 522(o) provides in part:

> [T]he value of an interest in . . . real or personal property that the debtor . . . claims as a homestead[ ] shall be reduced to the extent that such value is attributable to any portion of any property that the debtor disposed of in the 10-year period ending on the date of the filing of the petition with the intent to hinder, delay, or defraud a creditor and that the debtor could not exempt . . . .

272. Since this case involved two joint debtors, the value listed in § 522(p)(1) is doubled. *In re Colliau*, 552 B.R. at 161 n.7.

273. *Id.* at 160.

274. *Id.*

275. *Id.*

276. *Id.*

277. *Id.* at 160–61.

278. *Id.* at 161.

279. *Id.* (citing *In re* Presto, 376 B.R. 554, 600 (Bankr. S.D. Tex. 2007)).

of the § 522(p) cap, by the amount of the improvements, without considering the costs of maintaining the estate.[280]

Relying on *In re Cipolla*[281] to determine that § 105(a) gave it general authority to impose an equitable lien, the bankruptcy court then allowed the estate to realize the amount of the improvements, plus any additional equity above the § 522(p) cap, by placing such a lien on the house.[282] Without addressing the Texas proceeds rule, the bankruptcy court gave the Debtors ninety days to satisfy the lien and avoid a forced sale.[283]

The Chapter 7 Trustee argued that the estate should be able to realize any value of the homestead above the § 522(p) cap, if and when the home appreciated above the cap amount.[284] The bankruptcy court disagreed, explaining that the snapshot rule, which directs that the exemption status of an asset is fixed as of the petition date, precludes such a holding.[285] The bankruptcy court distinguished the U.S. Supreme Court's opinion in *Schwab v. Reilly*, finding that since the homestead was valued below the § 522(p) cap on the petition date, the bankruptcy estate had no interest in the homestead property, even if the value of the property later appreciated.[286] Therefore, the homestead property was exempt and thus removed from the estate, and if the property later appreciated above the cap, the benefit would go to the Debtors rather than the bankruptcy estate.[287]

This is a good case to read to understand § 522(o) and § 522(p), and how they may interact. *In re Colliau* also contributes to the governing case law regarding Texas homesteads in Chapter 7 cases. To the authors, some cases appear to be contrary to most practitioners' early understanding of the laws. *In re Colliau* appears to be correct and helps clear some of the fog.

X. RECLASSIFICATION OF A DEFICIENCY CLAIM: *IN RE RODGERS*

In *In re Rodgers*, a former Texas attorney, now serving as a judge for the U.S. Bankruptcy Court for the Northern District of Alabama, weighed in on whether surrender can result in reclassification of a deficiency claim.[288] The bankruptcy court held that a Chapter 13 debtor can

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280. *Id.*

281. In *In re Cipolla*, Judge Gargotta used § 105(a) to grant an equitable lien to the estate to secure the interest in the property and allow the trustee to sell for failure to compensate the estate within six months. *Id.* at 162 (citing *In re* Cipolla, No. 09-11199, ECF 26 (Bankr. W.D. Tex. 2010), *vacated and remanded on other grounds*, 476 F. App'x 301 (5th Cir. 2012)).

282. *Id.*

283. *Id.*

284. *Id.* at 163.

285. *Id.* at 163, 164 (citing Brown v. Sommer (*In re* Brown), 807 F.3d 701, 708–10 (5th Cir. 2015)).

286. *Id.* at 163–64 (citing Schwab v. Reilly, 560 U.S. 770, 775–76, 782 (2010)).

287. *Id.* at 164.

288. *In re* Rodgers, No. 14-83452-CRJ-13, 2016 Bankr. LEXIS 3880, at *1–2 (Bankr. N.D. Ala. Nov. 2, 2016).

"surrender collateral and . . . reclassify [any] remaining deficiency as an unsecured claim" provided the modification is proposed in good faith and meets the requirements of 11 U.S.C. § 1329.[289] When the Debtors' Chapter 13 plan (the Plan) was confirmed, both Debtors were employed.[290] Following confirmation of the Plan, one of the Debtors lost her job, resulting in an inability of the Debtors' to meet the payment requirements of the Plan.[291] The Debtors then filed a Motion to Modify, seeking to surrender their vehicle in order to reduce their Plan payments and reclassify the deficiency balance as unsecured.[292]

In reaching a decision, the bankruptcy court recognized that there is a circuit split regarding whether a Chapter 13 debtor may be permitted to surrender collateral post-confirmation and have the deficiency treated as an unsecured claim.[293] The bankruptcy court rejected the minority view adopted by the U.S. Court of Appeals for the Sixth Circuit in *Chrysler Financial Corporation v. Nolan* because, in holding that a "post-confirmation surrender and reclassification is per se impermissible," the Sixth Circuit "has read several artificial restrictions into § 1329 that are not grounded in the plain text of the statute."[294] Rather, the bankruptcy court opted for a broad interpretation of § 1329 that takes "Congress's intent . . . to facilitate successful completion of chapter 13 plans" into account.[295] The bankruptcy court based this decision on two recent holdings from other bankruptcy courts: *In re Scarver* from the U.S. Bankruptcy Court for the Middle District of Alabama and *In re Anderson* from the U.S. Bankruptcy Court for the Northern District of Mississippi.[296]

The bankruptcy court ultimately adopted the reasoning of *In re Scarver*.[297] In that case, the debtor's Plan included a $4,900 secured auto loan.[298] Shortly after confirmation, the vehicle was totaled in an accident and the debtor's insurance company paid only $2,802, leaving a balance of $2,098.[299] The *In re Scarver* court determined that a post-confirmation plan modification resulting in the surrender of collateral and the remaining deficiency balance being treated as an unsecured claim is permissible, provided the modification meets the requirements of § 1329 and is made in good faith.[300] Courts have traditionally considered five non-exclusive

289. *Id.* at *4 (citing *In re* Scarver, 555 B.R. 822 (Bankr. M.D. Ala. 2016)).
290. *Id.* at *5–6.
291. *Id.* at *7.
292. *Id.* at *8.
293. *Id.* at *10 (citing *In re Scarver*, 555 B.R. at 828).
294. *Id.* at *10, *12 (first citing Chrysler Fin. Corp. v. Nolan (*In re* Nolan), 232 F.3d 528, 535 (6th Cir. 2000); and then citing *In re Scarver*, 555 B.R. at 834).
295. *Id.* at *15–16 (quoting *In re* Anderson, 545 B.R. 174, 181 (Bankr. N.D. Miss. 2015)).
296. *See id.* at *14–15; *see also In re Scarver*, 555 B.R. at 833; *In re Anderson*, 545 B.R. at 181.
297. *In re Rodgers*, 2016 Bankr. LEXIS 3880, at *4, *16.
298. *Id.* at *14 (citing *In re Scarver*, 555 B.R. at 825).
299. *Id.*
300. *Id.* at *13.

factors to determine good faith when a debtor seeks to surrender a vehicle:

> (1) the extent of any post-confirmation depreciation in the collateral securing the affected creditor's claim, and whether the depreciation is the fault of the debtor;
> (2) whether the debtor failed to maintain insurance as required by a loan agreement or an adequate protection order;
> (3) the proposed treatment of the creditor's deficiency claim (if any such claim exists);
> (4) whether the debtor is current on plan payments; and
> (5) the length of time between plan confirmation and the filing of the proposed modification.[301]

The *In re Scarver* court found that the necessary good faith requirement was satisfied because there was no evidence that the decline in the vehicle's value was due to any fault of the debtor.[302] As stated above, the bankruptcy court in *In re Rodgers* adopted the *In re Scarver* court's reasoning, holding that surrender and reclassification of a deficiency claim may be allowed where the court finds good faith.[303]

In re Rodgers is a good case to keep in mind when calamity strikes after plan confirmation. Options remain available for the good faith debtor.

XI. CONCLUSION

Although the U.S. Supreme Court was rather quiet on bankruptcy during the Survey period, it did hand down one very significant decision that may have great effect in the dischargeability realm.[304] The Supreme Court also set up two important cases, one in the consumer area[305] and the other a business case that may go well beyond Chapter 11,[306] for coverage next year. The U.S. Court of Appeals for the Fifth Circuit continues to resolve differences in the bankruptcy courts in the circuit. Moreover, the bankruptcy courts have tackled tough issues that have a real impact, particularly in the consumer bankruptcy area. Overall, 2016 provided a fulsome Survey period for the courts.

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301. *Id.* at *13–14 (quoting *In re Scarver*, 555 B.R. at 838).
302. *Id.* at *14.
303. *Id.* at *4, *16.
304. *See supra* Part VI, Section A.
305. Midland Funding, LLC v. Johnson, 137 S. Ct. 326 (2016) (mem.). As this case is really more of a consumer law case than a bankruptcy case, the authors did not include it in this Survey. Depending on the scope of the ruling, the authors reserve the right to include it next time. The U.S. Supreme Court reversed the Eleventh Circuit's judgment outside of this Survey period in *Midland Funding, LLC v. Johnson*, 137 S. Ct. 1407 (2017)).
306. *See supra* Part II, Section A and text accompanying note 26; *see also* Czyzewski v. Jevic Holding Corp. 137 S. Ct. 973 (2017).