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Bankruptcy

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I. INTRODUCTION

The Survey period covers some cases that should be of interest to both consumer and business bankruptcy lawyers. The authors chose issues that seem to reoccur, including how to get out of bankruptcy by agreement, what happens to the proceeds of exempt property in a bankruptcy case, and what the standard is for dischargeability actions. Hopefully, these and other topics covered below will aid you in your practice.

II. STRUCTURED DISMISSALS

A. In the Land of Structured Dismissals, the Code's Priority Scheme is Still King: The Supreme Court Resolves the Circuit Split in *Czyzewski v. Jevic Holding Corp.*

On March 22, 2017, in a highly-anticipated decision, the U.S. Supreme Court handed down a 6–2 decision[1] in *Czyzewski v. Jevic Holding Corp.*,[2] resolving the circuit split regarding so called "structured dismissals" that do not follow the Bankruptcy Code's priority scheme. The majority held that a deviation from the Code's priority rules is not permitted in structured dismissals over the objection of affected parties.[3] This narrow hold-

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Contributing practitioners, law students, and externs to the U.S. Bankruptcy Court for the Northern District of Texas include Jennifer Little from Bracewell Houston; Amber Carson from Gray Reed & McGraw Dallas; Daley Epstein, Alexa Naumovich, and Elijah Stone from SMU Dedman School of Law; Tom de la Torre from the University of Texas School of Law; and Dylan Ross from Notre Dame Law School.

1. Justice Thomas, joined by Justice Alito, dissented, arguing that the original question presented was "[w]hether a bankruptcy court may authorize the distribution of settlement proceeds in a manner that violates the statutory priority scheme," but that once certiorari was granted, petitioners "switch[ed]" the question to "[w]hether a Chapter 11 case may be terminated by a 'structured dismissal' that distributes estate property in violation of the Bankruptcy Code's priority scheme." Justice Thomas was disinclined to answer the newly presented question because the parties had briefed only the first question, the justices would benefit from more guidance on the new question from other courts, and he didn't want to encourage similar "bait-and-switch tactics." Czyzewski v. Jevic Holding Corp., 137 S. Ct. 973, 987–88 (2017) (Thomas, J., dissenting) (citations omitted) (first and third alterations in original).
2. *Id.* at 978 (majority opinion).
3. *Id.* at 983.

ing will necessarily require practitioners to secure the agreement of all parties when proposing a structured dismissal that does not strictly comply with ordinary priority rules and will be a strong weapon in the arsenal of creditors who feel they are not getting their due in such a structured dismissal.

Jevic stems from the bankruptcy cases of three affiliated debtors: Jevic Holding Corp., Jevic Transportation, Inc., and Creek Road Properties, LLC (collectively, Jevic). After Jevic filed their voluntary petitions under Chapter 11 of the Bankruptcy Code, their secured creditors were sued by the unsecured creditors' committee under fraudulent conveyance law. Jevic, the committee, and Jevic's senior secured creditors reached a settlement agreement that contemplated, *inter alia*, a settlement of the fraudulent conveyance lawsuit, payment of administrative claims in full, payment to unsecured creditors on a pro rata basis, and the dismissal of Jevic's bankruptcy cases. The problem, however, is that the settlement did not provide for a distribution to a group of truck drivers who had obtained a judgment against Jevic for violations of federal and state Worker Adjustment and Retraining Notification (WARN) Acts. Under a Chapter 11 plan or in a Chapter 7 liquidation, part of the truck drivers' judgment would have been a priority wage claim entitled to payment ahead of general unsecured creditors.

Over the objection of the truck drivers and the United States Trustee, the U.S. Bankruptcy Court for the District of Delaware. and the U. S. District Court for the District of Delaware (on appeal) permitted the structured dismissal because, essentially, it was the better of two bad options.[4] The bankruptcy court noted that the estates were administratively insolvent and, that without the proposed settlement, it was unlikely that any constituents outside of Jevic's secured creditors would receive a distribution.

The U.S. Court of Appeals for the Third Circuit agreed with the lower courts.[5] Preliminarily, it determined that structured dismissals are permissible under the Bankruptcy Code so long as there is not an attempt to "evade the procedural protections and safeguards of the plan confirmation or conversion processes."[6] The Third Circuit rejected the U.S. Court of Appeals for the Fifth Circuit's strict application of the absolute priority rule to settlements,[7] and instead adopted the U.S. Court of Appeals for the Second Circuit's more flexible approach.[8] This approach holds that the absolute priority rule does not apply to settlements but the policy behind the rule does. The Second Circuit emphasized that if a settlement (and, in turn, a settlement that incorporates a structured dismissal) devi-

4. *Id.* at 982.
5. *In re* Jevic Holding Corp., 787 F.3d 173, 184–85 (3d Cir. 2015), *as amended* (Aug. 18, 2015), *rev'd and remanded sub nom.* Czyzewski v. Jevic Holding Corp., 137 S. Ct. 973 (2017).
6. *Id.*at 182.
7. Matter of AWECO, Inc., 725 F.2d 293, 295–96 (5th Cir. 1984).
8. *In re* Iridium Operating, LLC, 478 F.3d 452, 464 (2d Cir. 2007).

ates from the priority scheme of § 507, the parties must have "specific and credible grounds to justify [the] deviation."[9] The Third Circuit acknowledged that such a justification would be rare.[10] While the Third Circuit admitted the decision was a "close call," ultimately, it held that under these facts, the bankruptcy court was justified in approving the structured dismissal because it was the "least bad alternative."[11]

The Supreme Court recognized two issues in this case. First, did the truck driver petitioners have standing to challenge the structured dismissal? Article III standing requires a plaintiff to have sustained an injury that could be alleviated through a favorable judicial decision. Second, can a bankruptcy case be terminated by a structured dismissal that does not comply with the Code's priority rules? The majority opinion held, first, that the truck drivers did have standing because overturning the structured dismissal could possibly redress their injury, and second, that a bankruptcy court could not approve a structured dismissal that was inconsistent with the Code's priority scheme without the consent of affected parties.[12]

The respondents argued that the truck driver petitioners lacked standing to challenge the structured dismissal because they did not suffer an injury that could be redressed. Whether or not the structured dismissal was granted, they argued, the truck drivers were unlikely to recover on their judgment—the estate simply did not have enough funds to provide them a recovery.

The Supreme Court disagreed for two reasons. First, the Supreme Court found that a settlement respecting the priority rules was now possible.[13] After the structured dismissal was negotiated, the WARN lawsuit against one of Jevic's secured creditors had concluded. Thus, the secured creditor may now be amenable to some sort of distribution to the truck drivers.[14]

Second, the fraudulent conveyance action against Jevic's secured creditors could have value to the estate in a Chapter 7 liquidation.[15] Alternatively, if Jevic's case were dismissed, the truck drivers could pursue the fraudulent conveyance action themselves, which could result in a recovery to them. In sum, because the truck drivers were deprived of a recovery in the settlement and could possibly recover a portion of their judgment if the structured dismissal was overturned, the Supreme Court

9. *Jevic*, 787 F.3d at 184 (internal quotation marks omitted).

10. *Id.* at 185–86 ("[W]e believe the Code permits a structured dismissal, even one that deviates from the § 507 priorities, when a bankruptcy judge makes sound findings of fact that the traditional routes out of Chapter 11 are unavailable and the settlement is the best feasible way of serving the interests of the estate and its creditors. . . . [T]his result is likely to be justified only rarely . . . .").

11. *Id.* at 184–85.

12. Czyzewski v. Jevic Holding Corp., 137 S. Ct. 973, 983–87 (2017).

13. *Id.* at 983.

14. *Id.*

15. *Id.*

found that they had standing to challenge the structured dismissal.[16]

In coming to its ultimate conclusion, the Supreme Court continued its recent practice of leaning strongly towards the plain meaning of statutory construction when interpreting the Bankruptcy Code. Citing Justice Scalia's oft-quoted tenet that "Congress . . . does not, one might say, hide elephants in mouseholes,"[17] the Supreme Court concluded that § 349(b)'s allowance of a deviation from a return to the prepetition status quo after a dismissal "for cause"[18] simply does not contemplate a final disposition of a bankruptcy case that violates the Code's priority scheme.[19] Had Congress intended to allow such a result, the Supreme Court reasoned, Congress would have made such an intent clear.[20]

The Supreme Court cited two examples to illustrate that even when structured dismissals have been allowed under the authority granted to bankruptcy judges under § 349(b) or § 105(a), courts have not suggested that Congress intended structured dismissals to act as a backdoor around the Code's priority scheme. In *In re Buffet Partners, L.P.* out of the U.S. Bankruptcy Court for the Northern District of Texas, none of the affected parties objected to the proposed structured dismissal.[21] In *Iridium Operating*, out of the Second Circuit, the settlement did not contemplate a dismissal of the bankruptcy case and merely provided for a distribution of settlement proceeds to a litigation trust that would pursue claims on behalf of the estate.[22]

As a relief to many practitioners, the Supreme Court distinguished—and arguably acknowledged—first-day wage orders and critical-vendor orders.[23] Unlike structured dismissals, wage orders and critical-vendor orders do not result in a final disposition of a bankruptcy case. Furthermore, they allow the debtor to continue operating as a going concern and to preserve value for the estate, provide the debtor a higher likelihood of completing a successful reorganization, and leave even "disfavored" creditors in better positions.[24]

Even though the Third Circuit held that an acceptable departure from the priority scheme in structured dismissals would be "rare," the Supreme

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16. *Id.*
17. Whitman v. Am. Trucking Ass'ns, 531 U.S. 457, 468 (2001).
18. When a bankruptcy case is dismissed, 11 U.S.C. § 349(b) allows a court "for cause" to modify *inter alia* the reinstatement of an avoided transfer or a voided lien; allow orders, judgments, and/or transfers to stand; and to modify the revesting of property of the estate back into the debtor. 11 U.S.C. § 349(b) (West 1994).
19. *Jevic*, 137 S. Ct. at 984.
20. *Id.* "The importance of the priority system leads us to expect more than simple statutory silence if, and when, Congress were to intend a major departure. . . . [W]e would expect to see some affirmative indication of intent if Congress actually meant to make structured dismissals a backdoor means to achieve the exact kind of nonconsensual priority-violating final distributions that the Code prohibits in Chapter 7 liquidations and Chapter 11 plans." *Id.*
21. *In re* Buffet Partners, L.P., No. 14-30699-HDH-11, 2014 WL 3735804, at *4 (Bankr. N.D. Tex. July 28, 2014).
22. *In re* Iridium Operating, LLC, 478 F.3d 452, 465–66 (2d. Cir. 2007).
23. *Jevic*, 137 S. Ct. at 985–86.
24. *Id.*

Court refused to allow even a limited concession to the priority rules.[25] The Court expressed doubt that any such exception could be sufficiently defined and contained, and regardless, noted that the Code did not permit such an exception.[26]

Practitioners will likely be glad about this limited holding. It dissipates the fear they held that the Supreme Court would determine the broader issue, whether structured dismissals in general are a permissible means of resolving a Chapter 11 case.[27] The Supreme Court was careful not to express an opinion as to the legality of structured dismissals in general. This narrower holding will allow the continuation of the increasingly common practice of allowing structured dismissals and should do little to disturb non-case-dispositive orders in connection with an ongoing bankruptcy case.

III. EXEMPTIONS

A. Once Exempt Always Exempt: The Fifth Circuit Solidifies the Finality of IRA Proceeds Exemptions in Chapter 7—*In re Hawk*

In *In re Hawk*, a panel for the U.S. Court of Appeals for the Fifth Circuit, now infamously, reversed course from their previous ruling, affirmatively holding that debtors' funds withdrawn from an exempt individual retirement account (IRA) after filing for Chapter 7 bankruptcy remain exempt property for the life of the case and beyond, no matter how or if they are reinvested.[28] The Fifth Circuit initially affirmed the lower court's decision to compel turnover of proceeds from Chapter 7 debtors' post-petition liquidation of an exempt IRA. Its reasoning, largely based on *In re Frost*, was that the proceeds lost their exempt status when not timely reinvested into another exempt IRA within sixty days.[29] That opinion was handed down on July 19. But only seven weeks later, after granting a petition for panel rehearing, the Fifth Circuit reversed. The court found that under Texas law, Chapter 7 debtors' withdrawn funds from an exempt IRA post-petition remain exempt, even when they fail to reinvest those funds into another exempt IRA within sixty days.[30]

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25. *Id.* at 986–87.
26. *Id.* at 987 ("We cannot 'alter the balance struck by the statute'. . . not even in 'rare cases'" (citations omitted)).
27. Others, however, may feel as though this case is another in a line of cases from our nation's highest court leaving bankruptcy practitioners and judges "rowing upstream with an ever-shorter paddle" by reducing options in detriment to the practicalities associated with real-world bankruptcy cases. Donna Higgins, *Jevic Likely to Bring More Certainty, but Less Autonomy for Judges*, 63 No. 23 Bankr. Ct. Decisions Wkly. News & Comments 2, 4 (Apr. 13, 2017).
28. Hawk v. Engelhart (*In re* Hawk), 871 F.3d 287, 293–96 (5th Cir. 2017).
29. *In re* Hawk, 864 F.3d 364 (5th Cir. 2017), *vacated and superseded on reh'g* by *id.* at 287.
30. *In re Hawk*, 871 F.3d at 296.

This case involved Chapter 7 debtors (the Debtors) who under Texas Property Code Section 42.0021, claimed an exemption for funds held within an IRA. This act excluded these funds from the bankruptcy estate pursuant to 11 U.S.C. § 522.[31] No party in interest objected to the IRA exemption in the thirty-day period following the meeting of creditors.[32]

The Debtors, post-petition and after the objection period had passed, decided to liquidate the IRA. They did not, however, roll the liquidated funds into a new exempt IRA. Upon learning of the funds and the actions taken by the Debtors, the Chapter 7 trustee (the Trustee) filed a motion for turnover pursuant to 11 U.S.C. § 542.[33] The bankruptcy court ordered the turnover, reasoning that the Debtors failed to reinvest the funds in another exempt IRA within sixty days, and thus, under Section 42.0021 of the Texas Property Code,[34] the funds lost their exempt status.[35] The district court affirmed the bankruptcy court's decision.[36]

Reviewing this case for a second time, the Fifth Circuit retreated from their previous position and affirmed the "snapshot rule" by analyzing case law concerning Texas homesteads.[37] The exempt status of IRA proceeds was a case of first impression, but parallels could be drawn with Texas homestead proceeds.[38] The Fifth Circuit looked to the application of the "snapshot rule" regarding homestead exemptions as applied in *In re Frost*.[39] In *In re Frost*, the post-petition proceeds from the sale of a homestead lost their exempt status when a Chapter 13 debtor failed to reinvest those proceeds in another homestead within six months.[40] The Debtors in the present case argued *In re Frost* did not apply because the proceeds were fixed in character as of the date of the bankruptcy filing and would remain excluded from a Chapter 7 bankruptcy estate because the interest was after-acquired property.[41] The Fifth Circuit agreed.[42]

The Fifth Circuit's analysis hinged on two specifics. First, "the Trustee did not object to the IRA exemption until well after the time for objections had passed."[43] The Fifth Circuit found support in 11 U.S.C. § 522(l) and the Supreme Court's strict interpretation of § 522(l) in determining the character of an exemption once the objection period has passed.[44]

31. *Id.* at 289.
32. *Id.*
33. *Id.* at 289–90.
34. Tex. Prop. Code. Ann. § 42.0021 (West 2014).
35. *In re Hawk*, 871 F.3d at 290.
36. *Id.*
37. *Id.* at 291.
38. *Id.*
39. *Id.* at 292–93 (citing *In re* Frost, 744 F.3d 384, 386–89 (5th Cir. 2014)).
40. *Id.* at 293 (citing *In re Frost*, 744 F.3d at 385).
41. *Id.* at 294.
42. *Id.*
43. *Id.*
44. *Id.*; 11 U.S.C. § 522(l) (West 2016) ("Unless a party in interest objects, the property claimed as exempt on [the schedules] is exempt."); *see* Taylor v. Freeland & Kronz, 503 U.S. 638, 639, 643–44 (1992) (holding that a party in interest in a Chapter 7 case cannot contest the validity of an exemption after the statutory thirty-day period for objections even if the debtor had no colorable basis for claiming the exemption).

Here, the Debtors filed for Chapter 7 bankruptcy and claimed the exemption for the funds held within the IRA account, which no party in interest objected to.[45] Once the thirty-day objection period had passed, the Trustee could not object to the unconditionally exempted funds in the IRA account.[46]

Second, Chapter 7 gives debtors a "'fresh start' by shielding from creditors . . . postpetition earnings and acquisitions."[47] The panel looked at this IRA exemption problem in the specific context of a Chapter 7 bankruptcy to determine if newly withdrawn IRA funds became part of the estate.[48] The Fifth Circuit distinguished *In re Frost* by viewing it solely in the context of a Chapter 13 case.[49] The Fifth Circuit recognized "Chapter 7 cases and Chapter 13 cases are not meant to always yield the same results."[50] Pursuant to a Chapter 13 plan, new property acquired after filing the plan becomes property of the bankruptcy estate under 11 U.S.C. § 1306(a)(1).[51] The Fifth Circuit noted § 1306(a)(1) only applies in Chapter 13 cases and that no similar provision applies in Chapter 7 cases.[52] There were no means for the Trustee to pull the newly acquired property into the Chapter 7 estate once the objection period passed and no objection was made.[53] Accordingly, because the Trustee did not timely object to the claimed exemption, the Debtors were entitled to the liquidated funds from the IRA account.[54]

In re Hawk appears to clear up some confusion, mainly regarding the crossover between Chapter 7 and Chapter 13 principles. In the Fifth Circuit, it is now established that the holding in *In re Frost* is limited to Chapter 13 cases. Chapter 7 and Chapter 13 may not be as analogous as previously believed. Chapter 13 bankruptcy provides a tool to allow some post-petition property into the estate—§ 1306(a)(1). Because Chapter 7 trustees do not have this same tool, debtors can now rely on the finality stemming from the lack of objections to exemptions in a Chapter 7. As after-acquired property, once the time for objection has passed, funds withdrawn from an exempt IRA account in a Chapter 7 case are, and forever will be, unconditionally exempt.

B. Anti-Extraterritoriality Reduced to *Ash*: *Sheehan* Protects Debtors Who Change States Within Applicable 730-Day Window

The provisions of the Bankruptcy Code governing extraterritorial ex-

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45. *In re Hawk*, 871 F.3d at 295.
46. *Id.* at 296.
47. *Id.* at 294, 296 (quoting Harris v. Viegelann, 135 S. Ct. 1829, 1835 (2015)).
48. *Id.* at 294–96.
49. *Id.* at 294.
50. *Id.* at 295.
51. *In re Hawk*, 871 F.3d at 295–96.
52. *Id.* at 295.
53. *Id.* at 296.
54. *Id.*

emptions[55] continue to challenge courts across the nation. In *Sheehan v. Ash*,[56] the U.S. District Court for the Northern District of West Virginia examined conflict of law issues familiar to Texas practitioners—may courts allow debtors to apply the exemptions of their former state of domicile to property physically located outside of that state? In answering this question, the *Sheehan* district court conducted a thorough analysis of the issues and ultimately adopted the same legal approach as the U.S. District Court for the Western District of Texas's seminal case *In re Fernandez*.[57] The district court affirmed the bankruptcy court's state-specific interpretation of § 522(b), ruling that Louisiana exemption laws could apply to the debtors' personal property in West Virginia.[58]

Joint debtors (the Debtors) lived in Louisiana from 2011 to March 2015. They subsequently moved to West Virginia, where they filed for bankruptcy in July 2015. The Debtors owned a house on two acres in Louisiana worth $65,000. They also owned personal property in both Louisiana and West Virginia worth $20,771.

Whether the Louisiana exemptions reached the personal property located in West Virginia was the central issue on appeal. The Chapter 7 trustee (the Trustee) objected to the notion that a bankruptcy court must apply out-of-state exemption laws to personal property within its physical jurisdiction, specifically Louisiana exemption laws to personal property physically in West Virginia.

The district court prefaced its analysis with an overview of statutory interpretation. Section 522(b)(3)(A) directs debtors to exempt property that "is exempt"[59] under the law of the former state of domicile, but it fails to inform as to the scope of those exemptions. Acknowledging the statute leaves "critical questions unanswered,"[60] the district court evalu-

55. 11 U.S.C. § 522(b) (West 2016). "Extraterritorial exemptions" reflect a choice-of-law issue regarding whether § 522(b) mandates that a former state of domicile's exemption laws should reach out-of-state property and/or whether courts sitting in one state must apply the exemption laws of another state. The issue typically arises when a debtor moves to a new state within the 730-day period preceding the petition and seeks to compel the court in their current state to apply the exemptions of their former state of domicile.

56. 574 B.R. 585, 587 (N.D.W. Va. 2017), *aff'd*, 889 F.3d 171 (4th Cir. 2018).

57. No. EP-11-CV-123-KC, 2011 WL 3423373, at *11 (W.D. Tex. Aug. 5, 2011).

58. *Sheehan*, 574 B.R. at 597–98.

59. Section 522(b)(3)(A) allows debtors to exempt property:

> that is exempt under Federal law . . . or State or local law that is applicable on the date of the filing of the petition to the place in which the debtor's domicile has been located for the 730 days immediately preceding the date of the filing of the petition or if the debtor's domicile has not been located in a single State for such 730-day period, the place in which the debtor's domicile was located for 180 days immediately preceding the 730-day period or for a longer portion of such 180-day period than in any other place.

11 U.S.C. § 522(b)(3)(A) (West 2016).

60. Such as:

> Should the Court strictly construe the phrase "is exempt" and look to what [Louisiana] courts would allow debtors to exempt in non-bankruptcy actions? Should the Court look to [Louisiana] law to see if [Louisiana] would permit out-of-state property to be exempt in bankruptcy? Or should the Court treat the subsection as a choice of law provision, and simply apply the

ated three methods of interpreting the statute's language: (1) anti-extraterritoriality; (2) preemption; and (3) state-specific.[61]

The Trustee argued for anti-extraterritoriality, which interprets the statute to preclude bankruptcy courts from giving "extraterritorial effect to any state's exemption laws."[62] The Trustee supplemented his argument by analogizing to a "presumption against extraterritoriality" in federal law on an international level,[63] and citing constitutional limits on the states' sovereign power.[64] Rejecting this argument, the district court noted that the argument "fail[ed] to address the concerns articulated so effectively by the district court in *Fernandez*."[65] Anti-extraterritoriality misplaces Congress's intent to involve states in regulating bankruptcy exemptions.[66] Furthermore, a federal statute that directs federal courts to adopt a state's laws for national application does not offend the Constitution.[67] And from a practical standpoint, anti-extraterritoriality would render the 730-day window pointless because most debtors would end up applying federal exemptions anyway, which Congress would have simply mandated had it intended the federal exemptions to apply.[68]

The preemption interpretation construes § 522(b) as a preemptive choice-of-law provision.[69] In application, a bankruptcy court could apply a state's exemption laws to non-residents and out-of-state property regardless of whether the state intended its exemption laws to have extraterritorial effect.[70] The district court explained this interpretation contravenes Congress' intent to allow states to implement their own bankruptcy schemes with limitations on extraterritoriality. And since neither the bankruptcy court nor the parties advocated for this position, the district court dismissed it.[71]

The state-specific interpretation is the majority approach and the one the district court adopted. It finds a middle ground between the other two

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> categories and amounts of [Louisiana] exemption to Debtor's bankruptcy estate, paying no attention to any potential limitations [Louisiana] law might impose on applying [Louisiana] law outside [Louisiana]? The statute's terse command to determine what "is exempt under . . . State" law provides no clear answer.

Sheehan, 574 B.R. at 591 (quoting *Fernandez*, 2011 WL 3423373, at *6) (alterations in original).

61. *Id.*

62. *Id.*

63. *Id.* at 593 (citing, *e.g.*, 28 U.S.C. § 1350 (West 1948) (the Alien Tort Statute)).

64. "[The Trustee] argued 'that the State of Louisiana lacks the power as a sovereign entity to prescribe exemptions for property which was not within the State of Louisiana on the date of filing and further that the use of such exemptions is prohibited by the Due Process clause of the Fourteenth Amendment.'" *Id.* at 590 (citing Dkt. No. 8-4 at 2).

65. *Id.* at 593 (citing *Fernandez*, 2011 WL 3423373, at *7).

66. *Id.* at 588 ("Congress designed the exemption system . . . to allow states to participate in th[e] regulation of debtor/creditor relations") (citing Hovis v. Wright, 751 F.2d 714, 715–16 (4th Cir. 1985)).

67. *Id.* at 594.

68. *Id.* at 595.

69. *Id.* at 596.

70. *Id.* (citing *Fernandez*, 2011 WL 3423373, at *6).

71. *Id.* at 596–99.

interpretations, allowing debtors to use the exemption laws of a former domicile for out-of-state property to the extent the state does not expressly limit the use of its exemptions to in-state residents or in-state property.[72] Moreover, it requires a determination of "whether [the] jurisdiction intends to apply its exemptions to out-of-state property" rather than whether the jurisdiction has the authority to do so.[73] The district court was "constrained to agree" that the state-specific interpretation represented the plainest meaning of § 522(b)(3)(A), as well as the most liberal interpretation that can feasibly apply to the statute.[74] The state-specific interpretation offends neither congressional intent nor constitutional limitations on state power. The district court likewise embraced the notion that bankruptcy courts should defer to each state's intent regarding its laws while also interpreting state laws according to "general principles governing exemptions."[75]

The Northern District of West Virginia ultimately affirmed the bankruptcy court's order, ruling that the application of Louisiana exemptions to the Debtors' personal property in West Virginia was proper.[76] The district court noted the plain language of the Louisiana exemption statutes and their corresponding case law did not limit the exemption statutes' applicability to in-state property.[77] Thus, six years after-the-fact, *Sheehan* validates the Western District of Texas's approach in *Fernandez*, albeit with lukewarm conviction. Although the Fourth Circuit affirmed the district court in *Sheehan*, the door is still open for divergent analyses in the future. With exemptions varying between states, and Texas's exemptions playing a large role in bankruptcy proceedings, this could be a hot topic in the future.

IV. FRAUDULENT TRANSFERS AND PREFERENCES

A. Fifth Circuit Weighs in Again on Homestead Rights of a Non-Filing Spouse—*Wiggains v. Reed*

On February 14, 2017, the U.S. Court of Appeals for the Fifth Circuit entered its opinion in *Wiggains v. Reed*. It affirmed the bankruptcy court's decision that a partition agreement between a debtor and his spouse was a fraudulent transfer because the debtor had actual intent to hinder and delay creditors.[78] Additionally, the Fifth Circuit found that the debtor's wife was not entitled to a one-half separate property interest in the homestead net proceeds under § 363(j).[79]

72. *Id.* at 595.
73. *Id.*
74. *Id.* The court did not elaborate on its constraint. Most likely, the state-specific interpretation is *at least* the only viable interpretation at this point, if not in fact the intended construction of § 522(b)(3)(A).
75. *Id.* at 596 (quoting *In re* Stephens, 402 B.R. 1, 6 (B.A.P. 10th Cir. 2009)).
76. *Id.* at 592.
77. *Id.* at 596.
78. Wiggains v. Reed (*In re* Wiggains), 848 F.3d 655, 662–63 (5th Cir. 2017).
79. *Id.* at 668.

Jeremy and Tania Wiggains bought an expensive home in a Dallas suburb. The couple invested heavily in the home, making valuable improvements with the intent to eventually sell it for a profit. After signing a sales contract for $3.4 million, the Wiggainses executed and filed a partition agreement (the Partition Agreement). In accordance with Texas matrimonial law, the Partition Agreement re-characterized the home as separate property, with each spouse having "sole and exclusive authority, management, and control of their separate property."[80] One hour after recording the agreement, Mr. Wiggains filed for Chapter 7 bankruptcy.

Mr. Wiggains claimed an exemption for his separate interest in the homestead under Texas law, subject to the $155,675 cap in § 522(p) of the Bankruptcy Code that limits a debtor's homestead exemption to the extent homestead value is attributable to non-exempt property that the debtor, "with the intent to hinder, delay, or defraud a creditor," disposed of within the ten-year period preceding the petition date.[81] This section is deemed the "mansion loophole" and was specifically enacted as part of the Bankruptcy Abuse Prevention and Consumer Protection Act (BAPCPA) in 2005 to address situations, like this, where debtors attempt to use the homestead exemption to perpetrate some sort of bankruptcy abuse. In this light, and hearing objections from certain creditors, the trustee convinced Mr. Wiggains to eventually limit his homestead to $130,675.

The Chapter 7 trustee sold the home for $3.4 million. After payment of all liens, claims, and encumbrances, the home netted $568,668.41 in cash. This was further decreased by disbursement of the homestead exemption claimed by Mr. Wiggains. On May 5, Mrs. Wiggains initiated an adversary proceeding, asserting that the Partition Agreement entitled her to a one-half separate property interest in the net proceeds from the sale, and seeking a declaratory judgment to that effect. The trustee counterclaimed to avoid the petition, seeking a declaration that remaining proceeds from the sale were property of the estate.

The U.S. Bankruptcy Court for the Northern District of Texas, Dallas Division held a day-long trial on these issues.[82] At the trial, Mr. Wiggains testified that upon the advice of counsel, he entered into the Partition Agreement for the purpose of excluding his wife's community property interest in the estate. He understood how homestead laws worked and knew his home was worth more than the statutory cap. The bankruptcy court held that Mr. Wiggains's "sole actual intent in entering the Partition Agreement was to avoid the effect of the limitation placed on his homestead exemption by § 522(p) of the Bankruptcy Code."[83] Likening such intent to "gamesmanship for the purpose of placing reachable assets

80. *Id.* at 658.
81. 11 U.S.C. § 522(o), (p) (West 2016).
82. *In re Wiggains*, 848 F.3d at 659.
83. *Id.* (citing 11 U.S.C. § 522(p)).

outside of creditor's reach,"[84] the bankruptcy court further noted that Mr. Wiggains's "articulated intent to preserve for his family as much as possible is the same as an intent to shield as much money as possible from creditors."[85]

The bankruptcy court deemed the Partition Agreement a fraudulent transfer and determined that Mrs. Wiggains had "no right or interest in the Homestead Net Sale Proceeds by virtue of the Partition Agreement."[86] In reaching this conclusion, the court noted that the principal factor was the execution of the Partition Agreement "in the shadow of an imminent bankruptcy filing,"[87] stating that the act "can only be reasonably interpreted as an act done with intent to hinder [or] delay creditors."[88]

The initial decision did not determine the issue of whether Mrs. Wiggains was entitled to distribution from some of the net sale proceeds under § 363(j), which requires the trustee to distribute proceeds of a sale to a debtor's spouse or a co-owner if such party has an interest in the property due to her separate homestead interest stemming from the Partition Agreement.[89] On April 20, 2015, she filed a motion in the bankruptcy case to have compensation paid under § 363(j). The bankruptcy court held a separate hearing on Mrs. Wiggains's request where she was the only witness. The bankruptcy court held that Mrs. Wiggains failed to meet her burden of showing entitlement under § 363(j) or any other provision of the Bankruptcy Code.[90] On September 22, 2015, Mrs. Wiggains filed an appeal with the district court, and additionally filed a direct appeal to the Fifth Circuit, which agreed to hear her case.

On appeal, Mrs. Wiggains presented two arguments to support the contention that the bankruptcy court clearly erred in finding the Partition Agreement was made with intent to hinder or delay creditors. First, she argued that the bankruptcy court failed to engage in a contextual analysis to determine her husband's intent in executing the Partition Agreement. Second, she argued that the bankruptcy court erroneously discounted her husband's legitimate interest to preserve her homestead interest.[91]

In its analysis, the Fifth Circuit began with the statutory language itself. Under 11 U.S.C. § 548(a)(1)(A),

> a bankruptcy trustee may avoid any pre-petition transfer of assets by a debtor "that was made or incurred on or within 2 years before the date of the filing of the petition" if the debtor made the transfer "with actual intent to hinder, delay, or defraud" any past or future

84. *Id.*
85. *Id.*
86. *Id.*
87. *Id.*
88. *Id.*
89. 11 U.S.C. § 363(j) (West 2010).
90. *In re Wiggains*, 848 F.3d at 660.
91. *Id.*

creditor.[92]

Establishing that intent to "hinder and delay" is sufficient without intent to "defraud," the Fifth Circuit examined three cases offered by Mrs. Wiggains that analyzed the context of a transfer to determine intent. In the first two cases, the bankruptcy courts denied discharge after undergoing a contextual analysis and ultimately finding actual intent.[93] But the Fifth Circuit found the case at hand more closely aligned with the third case, *Albuquerque National Bank v. Zouhar*.[94] In *Zouhar*, "the debtor 'candidly admitted the purpose of' his transfer was 'to shield assets from creditors.'"[95] The bankruptcy court found in *Zouhar* that direct evidence of a debtor's actual intent removed the need for the court to rely on circumstantial evidence or inferences.[96]

Mrs. Wiggains argued that the bankruptcy court erroneously found intent to shield assets from creditors in her husband's express testimony that he was looking to protect his wife's assets. But, applying the principle found in *Zouhar*, the Fifth Circuit found that "[k]eeping [the] property in the hands of his wife is the mirror of keeping [the] property out of the hands of creditors."[97] From a legal standpoint, the Fifth Circuit found there was no difference between entering the Partition Agreement to preserve value for the debtor's spouse and intent to hinder and delay creditors.[98] Emphasizing the importance of deference to the bankruptcy court's findings with regard to the issue of intent, the Fifth Circuit found no clear error.[99]

Mrs. Wiggains's second argument was that the bankruptcy court misapplied case law protecting a non-debtor spouse's separate homestead interest in its denial of a distribution to her. According to Mrs. Wiggains, § 363(j) of the Bankruptcy Code allows her, as a non-debtor spouse, to receive a distribution of the net sale proceeds.

Acknowledging the power of a homestead interest under the Texas Constitution, the Fifth Circuit distinguished the legal interest from the economic interest. Citing prior Texas cases, the Fifth Circuit said that the Texas exemption grants only a possessory interest in real property, not an economic one.[100]

With this established, the Fifth Circuit looked to see, even upon recognizing that Mr. Wiggains had the requisite intent to hinder and delay his creditors, whether it needed to accept that Mrs. Wiggains had her own separate interest requiring a distribution in addition to what was given to

92. *Id.* (quoting 11 U.S.C. § 548(a)(1)(A) (West 2005)).
93. Brooke Credit Corp. v. Lobell (*In re* Lobell), 390 B.R. 206, 219–20 (Bankr. M.D. La. 2008); Bank of Oklahoma, N.A. v. Boudrot (*In re* Boudrot), 287 B.R. 582, 587–88 (Bankr. W.D. Okla. 2002).
94. 10 B.R. 154 (Bankr. D. N.M. 1981).
95. *Id.* at 156.
96. *Id.*
97. *In re Wiggains*, 848 F.3d at 662.
98. *Id.* at 662–63.
99. *Id.* at 663.
100. *Id.* at 664; *see* Heggen v. Pemelton, 836 S.W.2d 145, 148 (Tex. 1992).

her husband. The Fifth Circuit relied on two relatively recent Fifth Circuit decisions in concluding that she did not.

In *Kim v. Dome Entertainment Center, Inc.*,[101] the U.S. Court of Appeals for the Fifth Circuit found for a non-debtor spouse seeking compensation for her separate interest in a homestead that she shared with her husband.[102] But unlike the present case where the purchase of the home happened well after BAPCPA, the Kims' estate was a pre-BAPCPA purchase. In the *Kim* decision, the Fifth Circuit examined a hypothetical proposed by Mrs. Kim, economically equating a homestead estate to a life estate. However, the Fifth Circuit did not fully accept the analogy, stating that the hypothetical "would seem to overvalue homestead rights."[103] Additionally Mrs. Kim proposed a Takings Clause argument, which the court noted would likely be limited to pre-BAPCPA cases, despite not fully briefing the issue.[104]

In *Thaw v. Moser*, the U.S. Court of Appeals for the Fifth Circuit emphasized the "important limitation" that the *Kim* holding put on a Takings Clause argument, finding the timing to be dispositive.[105]

Applying the principle set forth in those cases, the Fifth Circuit found that the Wiggains' Taking Clause argument would fail based on the post-BAPCPA purchase of the homestead.[106] Additionally, the Fifth Circuit agreed with the bankruptcy court's rejection of another Takings Clause-type challenge that might arise if a state's regulatory taking is "so unreasonable or onerous as to compel compensation."[107] The Fifth Circuit reiterated, as it did in *Thaw*, that under the Bankruptcy Code, "the sale of property is not so unreasonable or onerous as to compel compensation."[108]

The Fifth Circuit next addressed whether § 363(j)[109] requires distribution of net proceeds from the sale of a homestead where a non-debtor spouse claims a separate interest. Subsection (h), referenced in subsection (j), applies to "the interest of any co-owner in property in which the debtor had, at the time of the case, an undivided interest as a tenant in common, joint tenant, or tenant by the entirety . . . ."[110] Their home was deemed property of the estate by the bankruptcy court under § 541(a)(2), so subsection (h) did not apply because they no longer had an interest in the home.

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101. 748 F.3d 647 (5th Cir. 2014).
102. *Id.* at 650.
103. *Id.* at 661.
104. *Id.* at 657, 663.
105. Thaw v. Moser, 769 F.3d 366, 369 (5th Cir. 2014).
106. *In re* Wiggains, 848 F.3d 655, 665 (5th Cir. 2017)
107. *Id.* at 666 (quoting Palazzolo v. Rhode Island, 533 U.S. 606, 627 (2001)).
108. *Id.*
109. 11 U.S.C. § 363(j) (West 2010) ("After a sale of property to which subsection (g) or (h) of this section applies, the trustee shall distribute to the debtor's spouse or the co-owners of such property, as the case may be, and to the estate, the proceeds of such sale, less the costs and expenses, not including any compensation of the trustee, of such sale, according to the interests of such spouse or co-owners, and of the estate.").
110. *Id.* § 363(h).

Last, the Fifth Circuit touched on the lower court's finding that "special circumstances" did not exist which could merit an increase in recovery to the non-debtor spouse over the debtor's § 522(p) monetary cap.[111] The Fifth Circuit agreed with the bankruptcy court that there was nothing confiscatory in this case, pointing to the short time the Wiggainses lived in the home, their "active" participation in the sale process, and their failure to object to the sale order.[112]

11 U.S.C. § 548(a)(1)(A) provides that a bankruptcy trustee may avoid any pre-petition transfer of assets by a debtor that was made or incurred on or within two years before the date of the filing of the petition if the debtor made the transfer "with actual intent to hinder, delay, or defraud" any past or future creditor.[113] Although the Code does not explicitly define "intent to hinder, delay, or defraud," courts have found that intent to "hinder and delay" can be found under the statute without intent to defraud.[114] Here, according to the trial court and affirmed on appeal, Mr. Wiggains illustrated actual intent to keep the property in the hands of his wife, which the Fifth Circuit equated with actual intent to keep it out of the hands of creditors, and thus, subjected the property to avoidance under § 548.[115]

B. Conniving Cancellation: The Waiver of a 60-Day Cancellation Notice or Penalty is an Asset Under TUFTA—*Hometown Valley View*

In *Hometown 2006-1 1925 Valley View, L.L.C. v. Prime Income Asset Management, L.L.C.*,[116] the U.S. Court of Appeals for the Fifth Circuit held that contractual payments due during a required sixty-day termination notice period are an asset under the Texas Uniform Fraudulent Transfer Act (TUFTA).[117] The mutual waiver of a contract's termination provision, in an effort to benefit an alter ego and escape payment of damages, is a fraudulent transfer subject to clawback by a trustee.[118]

Prime Income Asset Management, L.L.C. (Prime LLC) was contracted to operate as an advisor to three publicly traded real estate companies.[119] Prime LLC was a wholly-owned subsidiary of Prime Income Management, Inc. (Prime Inc.). Prime Inc. provided all of the services for these contracts on behalf of Prime LLC because Prime LLC had no employees or assets. All three advisory contracts (the Advisory Contracts) for the

111. *In re Wiggains*, 848 F.3d at 667.
112. *Id.* at 668.
113. 11 U.S.C. § 548(a)(1)(A) (West 2005).
114. *Id.*
115. *In re Wiggains*, 848 F.3d at 622–23. The attorney for Wiggains has filed a petition for an en banc rehearing, and the Fifth Circuit ordered Reed to respond. The parties are waiting to hear from the Fifth Circuit, which has not yet ruled on the petition.
116. 847 F.3d 302, 304 (5th Cir. 2017).
117. *Id.* at 304; Tex. Bus. & Com. Code Ann. § 24.002 (West 2015).
118. *Hometown*, 847 F.3d at 304–05, 308.
119. American Realty Investors, Inc.; Transcontinental Realty Investors, Inc.; and Income Opportunity Realty Investors, Inc.

publicly traded real estate companies had a provision that required sixty-day written notice to Prime LLC for cancellation, and failure to provide notice subjected them to an early cancellation penalty.[120]

Independent of the Advisory Contracts, Prime LLC was guarantor on a commercial real estate loan. Hometown 2006-1 1925 Valley View, L.L.C. (Hometown), the plaintiff in the case, was successor-in-interest to this loan. The borrower on the loan had missed payments and demolished part of the property without authorization, so Hometown responsively moved to foreclose on the property. Before foreclosure, Prime LLC transferred its interest in the property to an affiliated company, EQK Bridgeview Plaza, Inc. (EQK), who after the transfer and still before foreclosure, filed for Chapter 11 bankruptcy.[121]

The automatic stay went into effect upon EQK's filing and Hometown could not continue its foreclosure on the property. Hometown petitioned the bankruptcy court to lift the stay to allow the foreclosure to proceed—such relief was granted. Hometown also sued Prime LLC in their capacity as guarantor, ultimately obtaining a judgment for the foreclosure deficiency (over $2 million).

Shortly after Hometown obtained the judgment, Prime LLC and its members in their entirety created a new company called Pillar Income Asset Management, Inc. (Pillar). The three real estate companies who were party to the Advisory Contracts immediately terminated the contracts. Prime LLC did not require sixty-day notice as stipulated nor did it issue any sort of penalty per the terms of the Advisory Contracts. The three real estate companies then entered into new contracts (the New Advisory Contracts) with Pillar on nearly identical terms as they did with Prime LLC.[122]

In an effort to distance itself, Pillar filed a declaratory judgment in Nevada state court seeking a declaration that it was not an alter ego of Prime LLC. Hometown removed the suit to the U.S. District Court for the District of Nevada. Afterward, "[a]sserting that it was unable to collect on its judgment, Hometown filed the instant action against Prime LLC as well as . . . Prime Inc. . . . [and] Pillar . . . asserting claims for fraudulent transfer under the Texas Uniform Fraudulent Transfer Act . . . ."[123] The U.S. District Court for the Northern District of Texas removed the case to Nevada under the first-filed doctrine, and the District of Nevada then returned the case to Texas. Once in the Northern District of Texas, the district court dismissed Hometown's complaint, holding that the Advisory Contracts were not assets under TUFTA.[124] Hometown appealed to the Fifth Circuit.[125]

120. *Hometown*, 847 F.3d at 304–05.
121. *Id.* at 305.
122. *Id.*
123. *Id.* at 305–06.
124. *Id.* at 306.
125. *Id.*

On appeal, Hometown argued that the Advisory Contracts and the subsequent New Advisory Contracts were fraudulent transfers of assets under Texas law and that the district court erred in dismissing its claim under Rule 12(b)(6).[126]

The Fifth Circuit first delved into how broadly definitions are construed under TUFTA, hinting at how encompassing TUFTA can be.[127] Under TUFTA, "asset" is defined as "property of a debtor."[128] "Property" is defined as "anything that may be the subject of ownership."[129]

The Fifth Circuit next analyzed two cases the district court relied on when it decided to dismiss Hometown's claim. The district court used two bankruptcy cases from the U.S. Court of Appeals for the Seventh Circuit as guidance: *In re Commodity Merchants, Inc.*[130] and *In re Wey*.[131]

In *In re Commodity Merchants, Inc.*, the contracts were terminated legally according to the terms and done so in good faith. The Seventh Circuit held that "the contracts were not freely assignable and had no market value in light of the termination provisions, so that their cancellation could not sustain a claim of fraudulent transfer."[132] In *In re Wey*, the Seventh Circuit held that "[w]hen a termination is pursuant to the terms of a contract, there is no transfer."[133]

Similar to the Seventh Circuit cases, the contracts at issue in this case "were not freely terminable."[134] Because they were not freely terminable, Hometown argued that by waiving the termination provision, Prime LLC created an asset in the funds that would have otherwise been transferred either by penalty or during the sixty-day notice period. Prime LLC conversely argued that because those services had not yet been completed, the future compensation Hometown would have acquired had not yet vested.[135]

The Fifth Circuit opined that Prime LLC was misreading its own termination provision as a "superfluity."[136] There was a minimum base pay paid on the fifteenth of every month under the contracts regardless of services provided. "Waiver of the sixty-day notice period effected a transfer of the right to continue performance under the Agreements and receive the payments due thereunder, payments which had ascertainable value and were sufficiently vested [as] 'assets' under TUFTA's broad definition of 'anything that may be the subject of ownership.'"[137]

126. *Id.* at 306–07. Prime LLC and the other defendants also claimed that the Northern District of Texas lacked diversity jurisdiction. The court disagreed. Since this issue does not specifically relate to bankruptcy, it is not analyzed in this Survey.
127. *Id.*
128. *Id.* at 307 (quoting TEX. BUS. & COM. CODE ANN. § 24.002 (West 2015)).
129. *Id.*
130. 538 F.2d 1260 (7th Cir. 1976).
131. 854 F.2d 196 (7th Cir. 1988).
132. *Hometown*, 847 F.3d at 307–08.
133. *Id.* at 308 (quoting *In re Wey*, 854 F.2d at 199).
134. *Id.*
135. *Id.*
136. *Id.*
137. *Id.* at 308–09.

In conclusion, the Fifth Circuit held that the value of the Advisory Contracts stemmed from the minimum payments they would have generated during the sixty-day notice period.[138] It was this value that allowed the cancellation of the Advisory Contracts to be characterized as an asset under TUFTA.[139]

It is now affirmed that "asset" under TUFTA entails potential sums from wrongly terminated contracts. The Fifth Circuit reversed the district court's Rule 12(b)(6) dismissal of the TUFTA claims and remanded for further proceedings.[140] By declaring cancellation of the Advisory Contracts not on stipulated terms an asset, Hometown made a cognizable claim of constructive transfer that withstood Rule 12(b)(6) scrutiny.[141]

It is well known that definitions under TUFTA are broad. This construction ensures protection for victims of fraudulent transfers. Hometown, on remand, has the potential to claw back estate property if it can carry the burden to show a constructive transfer did take place under TUFTA. The breadth of these definitions allow trustees, parties in interest, or courts to have the latitude to weed through questionable antics and, ultimately, protect the bankruptcy system.

C. Timing is Everything: the Fifth Circuit Dissects What is Actually Meant by "Transfer" in *In re Jackson*

In *In re Jackson*, the U.S. Court of Appeals for the Fifth Circuit determined that a debtor does not have a property right that a creditor can garnish or a debtor can transfer until wages are actually earned.[142] Consequently, the Fifth Circuit held that a creditor's interest in wages under a garnishment order does not begin at the time of service of the order to a debtor's employer, but instead, only begins when a debtor first acquires the right to be paid.[143] Despite a garnishment order being served outside the ninety-day preference window, wages subject to a garnishment order that are earned during the ninety-day preference period can be voided under § 547 of the Bankruptcy Code.[144]

Tower Credit, Inc. (Tower Credit), obtained a garnishment order against Mr. Jackson (Debtor) for a money judgment in Louisiana state court. The order was effective on January 19, 2012, when Tower Credit served Debtor's employer. Between January 19 and November 17, the Debtor's paychecks were garnished without any problems. On November 17, 2012, the Debtor filed for Chapter 7 bankruptcy.[145]

The trustee in the Debtor's Chapter 7 bankruptcy case initiated an adversary action against Tower Credit. The action sought to void the gar-

138. *Id.*
139. *Id.* at 309.
140. *Id.*
141. *Id.*
142. Tower Credit, Inc. v. Schott (*In re* Jackson), 850 F.3d 816, 821 (5th Cir. 2017).
143. *Id.* at 820.
144. *Id.* at 817–18; 11 U.S.C. § 547(b) (West 2016).
145. *In re Jackson*, 850 F.3d at 817.

nishments collected by Tower Credit prior to November 17, stating they were preferential transfers under § 547(b)(4)(A) because they were made within the ninety-day clawback window contemplated by the statute. Tower Credit objected, arguing that the interest in the wages was transferred when Tower Credit served the Debtor's employer on January 19, so the transfer was effectively outside of the ninety-day preference period.[146]

The U.S. Bankruptcy Court for the Middle District of Louisiana granted summary judgement for the trustee. The district court affirmed and Tower Credit appealed to the Fifth Circuit.[147] On appeal, Tower Credit argued that the future payments owed to it under the garnishment order were transferred at the time the garnishment order was served on the Debtor's employer—January 19—and could not be voided under § 547(b) because such date existed outside the ninety-day preference period.[148] The Fifth Circuit was left to dissect the technicalities of what constitutes a transfer.

In *Barnhill v. Johnson*,[149] the U.S. Supreme Court held that "[w]hat constitutes a transfer and when it is complete is a matter of federal law."[150] State law only controls in the absence of federal law. Federal law exists and, therefore, the Fifth Circuit determined that § 547(e) controls if and when the interest in the Debtor's wages was transferred to Tower Credit.[151]

The Fifth Circuit then dove into § 547(e), which says a transfer is generally made at the time it is "perfected."[152] Section 547(e)(3) goes on to state that "a transfer is not made until the debtor has acquired rights in the property transferred."[153]

The Fifth Circuit held that Tower Credit was technically right in contesting that its interest was "perfected" because, upon serving the garnishment order, no party could acquire a judicial lien superior to Tower Credit's interest.[154] However, Tower Credit missed the big picture by neglecting the language of § 547(e)(3) that requires a debtor to have rights in the property to effectuate a transfer.[155]

Citing authority from the U.S. Supreme Court and an interpretation of that authority in a case from the U.S. Court of Appeals for the Sixth Circuit, the Fifth Circuit held that "a debtor cannot logically obtain rights

146. *Id.* at 818.
147. *Id.*
148. *Id.*
149. 503 U.S. 393 (1992).
150. *In re Jackson*, 850 F.3d at 818 (quoting *id.* at 397).
151. *Id.*
152. *Id.* "[A] transfer is generally made at the time it is 'perfected,' which, in the context of non-real property, occurs when 'a creditor on a simple contract cannot acquire a judicial lien that is superior to the interest of the transferee.'" *Id.* (quoting 11 U.S.C. §§ 547(e)(2)(B), 547(e)(1)(B) (West 2016)).
153. *Id.* at 819 (citing 11 U.S.C. § 547(e)(3)).
154. *Id.* at 818–19.
155. *Id.* at 819.

in her future wages until she performs the services that entitle her to receive those wages."[156] Here, even though the Debtor was subjected to a wage garnishment order put in place prior to the preference period, he had no right to transfer future wages subject to that order until they were earned. Therefore, since the Debtor had not yet "brought [the] earnings into existence," no property rights existed at the time the garnishment order was served on the Debtor's employer.[157] And because no property rights existed yet, a transfer of interest could not be effectuated on January 19.[158]

The Fifth Circuit ultimately held that Tower Credit only acquired the interest in the Debtor's wages when he earned them, and $1,756.04 of those wages were earned in the ninety-day period preceding bankruptcy.[159] Because the interest in those wages was obtained in the ninety-day preference period and all other elements of § 547(b) of the Bankruptcy Code were met, the trustee could void the garnishment of $1,756.04 as preferential transfers pursuant to § 547(b).[160]

Though the holding seems narrow at first, the Fifth Circuit's ruling encompasses the broader question of what constitutes a transfer. First, the decision emphasizes that federal law, when present and controlling, always dictates what constitutes a transfer. Though transfers deal with property interests—and property issues traditionally get resolved under state law—the Fifth Circuit has maintained authority to apply federal statutes to issues not just with preferential transfers, but generally to all transfers in the bankruptcy context. Given that bankruptcy courts and bankruptcy practitioners often find themselves dealing with state law property issues, it is assuring to know that the Bankruptcy Code is binding authority on the issue of transfers.

Moreover, in parsing out the language of § 547, the Fifth Circuit has declared when a property interest vests. Section 547's general principle—that "a transfer is not made until the debtor has acquired rights in the property transferred"—has broad implications. Tower Credit cited a trio of cases that supported the proposition that transfer of garnished wages occur at the time the garnishment is served on an employer. In ultimately holding the opposite, the Fifth Circuit cited to separate authority, including the Supreme Court and *Collier on Bankruptcy*, that wages cannot be garnished until the debtor first acquires the right to be paid.[161] In following these authorities, the Fifth Circuit has solidified that a transfer cannot be effectuated until such person acquires the right to that property. It seems intuitive, but in the bankruptcy context, timing is often everything.

156. *Id.* (citing Local Loan Co. v. Hunt, 292 U.S. 234, 243 (1934)); *see* Morehead v. State Farm Mut. Auto. Ins. Co. (*In re* Morehead), 249 F.3d 445, 448 (6th Cir. 2001).

157. *In re Jackson*, 850 F.3d at 820.

158. *Id.* at 821.

159. *Id.* at 818.

160. *Id.* at 819–21.

161. *Id.*

It will be interesting to see if *Jackson* is used for its broader holding. In the meantime, *Jackson* affirms that a transfer can only be effectuated when a debtor first acquires rights in the property, and if such transfer occurs within the ninety days prior to bankruptcy, it will be subject to preferential transfer actions under § 547. Texas bankruptcy lawyers seldom deal with wage garnishments because wages are generally exempt personal property in Texas.[162] The authors thought this case noteworthy because of the rich discussion of transfers.

V. DISCHARGE

A. Collective Guilt and Judicial Deference: Fifth Circuit Imparts Intent onto Co-Conspirator in Non-Dischargeability Action and Elaborates on a Court's Ability to Violate the Automatic Stay—*In Re Cowin*

In *In re Cowin*,[163] the U.S. Court of Appeals for the Fifth Circuit held that damages from a debtor's involvement in a larceny scheme is a non-dischargeable debt under § 523(a)(4).[164] The intent and conduct of a debtor's co-conspirators can be imparted onto the debtor for purposes of non-dischargeability under § 523(a)(4). The Fifth Circuit also held that, where both parties agreed to continue adversary proceedings upon dismissal of the underlying bankruptcy case, a bankruptcy court's entry of a final judgement against a debtor from the previously dismissed bankruptcy case does not violate the automatic stay of a new Chapter 7 proceeding because of harmless error.[165]

Charles Cowin (Cowin), along with a number of family members and friends, executed an elaborate larceny scheme that deprived mortgage owners of excess foreclosure sale proceeds. This deception was accomplished through manipulation of the Texas Tax Code and Texas property laws. "Under Texas law, after a foreclosure sale, tax-transfer liens take priority, junior liens are extinguished, and any excess funds are paid to the junior lienholders in seniority order."[166] The scheme worked as follows: (1) a purchaser would buy a foreclosed property with a first-lien mortgage; (2) the purchaser would enter into a tax-transfer loan agreement with one of Cowin's companies to cover the property taxes; (3) the purchaser would default on the tax loan; (4) Cowin, through his company, would order the trustee of the tax-transfer deed to foreclose on the property for failure to pay the loan; and (5) without telling the trustee about the previous mortgage holder, Cowin would auction off the home to pay the tax loan, take his fee of $1,000, and return any excess proceeds to the

162. Tex. Prop. Code § 42.001(b)(1).
163. 864 F.3d 344, 349–50 (5th Cir. 2017).
164. 11 U.S.C.A. § 523(a)(4) reads: "for fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny." 11 U.S.C. § 523(a)(4) (West 2016).
165. *In re Cowin*, 864 F.3d at 353.
166. *Id.* at 347; *see* Tex. Tax. Code §§ 32.06(b), (j) (West 2013).

purchaser, thus skipping over the junior lienholder.[167]

In early 2010, Bank of America, N.A. (BOA), filed suit against Cowin and his co-conspirators for the excess funds and other damages resulting from the scheme. Cowin subsequently filed for Chapter 11 bankruptcy in the middle of litigation—that bankruptcy case was dismissed. In May of 2010, Cowin then again filed for Chapter 11 bankruptcy. In November, while in that Chapter 11, Countrywide Home Loans Inc. (Countrywide), Deutsche Bank, and several other banks, brought a non-dischargeability action against Cowin (the Countrywide Adversary Proceeding). The U.S. Bankruptcy Court for the Southern District of Texas, Houston Division dismissed the second Chapter 11 case in January of 2012 after finding that Cowin had "abused the [bankruptcy] process by filing two Chapter 11 petitions within the last two years [without filing] a plan and disclosure statement."[168] However, the bankruptcy court, at the parties' request, retained the Countrywide Adversary Proceeding to obtain a final adjudication on the issue of non-dischargeability.[169]

Separate from the Countrywide Adversary Proceeding, BOA's litigation continued. In January 2013, BOA and Cowin entered into a settlement agreement (the BOA Settlement Agreement) while Cowin was not in bankruptcy. Under this agreement, if Cowin entered into bankruptcy again, BOA would be able to immediately seek relief from the automatic stay.[170]

Remember, the bankruptcy court from the second Chapter 11 retained jurisdiction over the Countrywide Adversary Proceeding. Right before the ruling in the Countrywide Adversary Proceeding was made, Cowin filed for his third bankruptcy, this time Chapter 7. The bankruptcy court, the same court that retained his adversary proceeding, lifted the automatic stay from the Chapter 7 to enter the BOA Settlement Agreement. The bankruptcy court did not do the same for Countrywide, and it instead entered a final judgment against Cowin that held the Countrywide debt non-dischargeable.[171]

BOA filed an adversary proceeding in Cowin's new Chapter 7 case. BOA sought to have the debt labelled as non-dischargeable. The bankruptcy court found that the BOA debt was non-dischargeable.[172]

Cowin appealed the Countrywide Adversary Proceeding judgment to the U.S. District Court for the Southern District of Texas. After the district court affirmed on September 29, 2015, Cowin appealed the case to the Fifth Circuit. Cowin then appealed the BOA decision directly to the Fifth Circuit. Both the appeals were consolidated.[173]

167. *In re Cowin*, 864 F.3d at 347.
168. *Id.* at 348.
169. *Id.*
170. *Id.*
171. *Id.*
172. *Id.*
173. *Id.*

Cowin's argument on appeal had two components. First, he argued that the debt to Countrywide was dischargeable. Second, he argued that the bankruptcy court violated the automatic stay in his Chapter 7 case by entering the Countrywide Adversary Judgment.[174]

The Fifth Circuit resolved the issue of non-dischargeability by holding that the factual findings of the case did show "Cowin's *individual* intent and conduct" warranted non-dischargeability under §§ 523(a)(4) and 523(a)(6).[175] The Fifth Circuit entertained Cowin's argument that the intent and actions of others cannot be used to satisfy the elements of § 523(a)(4), but ultimately held that the actions and intent of co-conspirators in fact can.[176]

The Fifth Circuit came to this holding by relying on instructive case law.[177] In *In Re M.M. Winkler & Assocs.*,[178] the U.S. Court of Appeals for the Fifth Circuit held that the actions and intent of other members in a partnership are enough to satisfy the elements of non-dischargeability for an individual partner under § 523(a)(2)(A).[179] Using the plain meaning of the statute, the Fifth Circuit found that that there were no additional qualifications to this section.[180] The section does not explicitly limit dischargeability to the individual actions of a debtor, but instead speaks more generally about how the debt was incurred. The same rationale—plain meaning—was applied to § 523(a)(4) in Cowin's case: "a debtor cannot discharge a debt that arises from larceny so long as the debtor is liable to the creditor for the larceny."[181] Even based on the actions and intent of his co-conspirators, Cowin was still liable for the larceny and the resulting debt was therefore non-dischargeable under § 523(a)(4).[182]

For the issue of the automatic stay, the Fifth Circuit again looked to instructive precedent for guidance. In *Campbell v. Countrywide Home Loans, Inc.*,[183] the U.S. Court of Appeals for the Fifth Circuit held that there was one exception to the automatic stay preventing action against a debtor—"an automatic stay has no effect on actions that are expressly allowed under the Bankruptcy Code."[184] The ruling in *Campbell* was extremely narrow and only pertained to creditors filing proofs of claims, so the Fifth Circuit did not feel comfortable applying it more broadly to this case.[185]

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174. *Id.*
175. *Id.* at 350.
176. *Id.* at 349–50.
177. *Id.* at 350.
178. 239 F.3d 746, 752 (5th Cir. 2001).
179. *In re Cowin*, 864 F.3d at 350; *see* 11 U.S.C.S. § 523(a)(2)(A) (West 2016) ("for money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained by. . . false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor's or an insider's financial condition.").
180. *In re Cowin*, 864 F.3d at 351.
181. *Id.*
182. *Id.*
183. 545 F.3d 348, 356 (5th Cir. 2008).
184. *Id.*
185. *In re Cowin*, 864 F.3d at 352.

The Fifth Circuit instead looked at the harmless error doctrine to, in effect, reach the same result. The Fifth Circuit essentially applied the narrow holding of *Campbell* without explicitly expanding its previous ruling by holding that, "even assuming error in entering the Countrywide Adversary Proceeding because of the automatic stay, such error would be harmless."[186] The Fifth Circuit found that a violation of the automatic stay was harmless for three specific reasons: (1) the bankruptcy court could have lifted the automatic stay unilaterally at any time; (2) if the automatic stay was lifted then the outcome would be the exact same; and (3) Cowin was not prejudiced by the failure to lift the automatic stay since he was a willing participant in the adversary proceeding.[187] The Fifth Circuit found that the filing of a Chapter 7 proceeding by Cowin was a last-ditch effort to avoid the unfavorable ruling in the Countrywide Adversary Proceeding.[188] A halt on that judgment would only have resulted in re-litigation of the same issue, and such litigation would further, and unnecessarily, deplete estate resources.[189] Based on these harmless error principles, the Fifth Circuit held that the bankruptcy court did not violate the automatic stay by entering a judgment against Cowin.[190]

This case broadens the scope of non-dischargeable debts under § 523(a)(4). Using guidance from previous cases, the Fifth Circuit seems to have expanded what can be used to satisfy the elements of non-dischargeability. On one hand, it is reassuring to know that a debtor, who would otherwise be able to avoid penalties or damages, can no longer use the system as a loophole by disclaiming personal wrongdoing. On the other hand, there is some fear that this could unintentionally expand onto the hypothetical innocent partner or unknowing individual who believes his only way to move forward from an unfortunate situation is to discharge the debt in bankruptcy.

Further, the harmless error test established by the Fifth Circuit seems to be an extremely easy test to satisfy. By essentially expanding *Campbell*, any action authorized by the Bankruptcy Code cannot violate the automatic stay. It does not seem to be much of a test at all, as the scope of actions that could be taken by a court in the name of the Bankruptcy Code appears broad. Perhaps, however, that was the intention, especially when the test is applicable in situations geared towards preventing "duplicitous litigation" and abuse of the bankruptcy system.[191]

This case added to the litany of Fifth Circuit cases that find non-dischargeability in situations where the debtor is not the central actor.

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186. *Id.* at 352–53.
187. *Id.* at 353–54.
188. *Id.*
189. *Id.* at 354.
190. *Id.*
191. *Id.*

B. The Exception to the Exception: A Fifth Circuit Clarification on What Actions Satisfy Non-Dischargeability—*In re Haler*

In *In re Haler*,[192] the U.S. Court of Appeals for the Fifth Circuit elaborated on an exception to an exception, holding a fraudulent debt, typically non-dischargeable, was nevertheless dischargeable under the exception of § 523(a)(2).[193] The debt was incurred as a result of an oral general representation of the debtor's financial condition and, therefore, the debt was subject to dischargeability.[194]

In 2006, Randall Haler (Haler) was the Executive Vice President and limited partner at McKinney Aerospace, L.P. (McKinney). McKinney entered into multiple contracts with Boyington Capital Group, L.L.C. (Boyington) to repair and refurbish its business jet. Boyington initially paid McKinney $337,275, but contributed another $60,000 after the two companies agreed to a change order. On the same day of the change order agreement, Boyington cancelled the contract and requested all unused funds to be returned. McKinney acknowledged it needed to return the excess funds but the company never did.[195]

Boyington sued Haler and McKinney in Texas state court for fraud in July of 2006.[196] At the trial, Boyington's witness stated "that Haler had expressed to Boyington that McKinney was in 'very fine legally [sic] financial shape' and had 'plenty of cash to operate [the] business during the term that [it was] working on' the jet."[197] The jury found Haler liable for fraud and awarded Boyington $258,021.73 in damages. The state court issued the final judgment on December 6, 2011.[198]

After the entry of the jury verdict but before the final judgment was issued, in June of 2010, Haler filed for Chapter 7 bankruptcy. In September of 2010, Boyington initiated an adversary proceeding to get the recent jury award declared as non-dischargeable debt under §§ 523(a)(2), (a)(4), and (a)(6) of the Bankruptcy Code. Boyington, after final judgment was rendered and the appeal process exhausted, sought summary judgement based on collateral estoppel stemming from the finding of fraud by the state court. The U.S. Bankruptcy Court for the Eastern District of Texas, Sherman Division found in favor of Boyington and ruled that the debt was non-dischargeable under § 523(a)(2)(A).[199] The district court affirmed the summary judgment.[200]

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192. 708 F. App'x 836, 838 (5th Cir. 2017) (per curiam).
193. *Id.* at 841; 11 U.S.C.S. § 523 (West 2016).
194. *In re Haler*, 708 F. App'x at 839.
195. *Id.* at 838.
196. Shortly after being sued, McKinney closed and began a self-directed liquidation. *Id.*
197. *Id.* at 838.
198. *Id.* Haler did appeal the verdict, but the Dallas Court of Appeals affirmed with a minor modification to attorney's fees. The state court issued an amended, non-appealable judgement in June of 2015.
199. *Id.*
200. *Id.*

On appeal, Haler argued that the bankruptcy and district courts erred in their application of § 523(a)(2)(A) to the debt because his statements "were [oral] 'statement[s] respecting . . . financial condition' under § 523(a)(2)(A) and thus dischargeable under this subsection."[201]

The Fifth Circuit analyzed §§ 523(a)(2)(A) and (a)(2)(B)(i)–(iv). The Fifth Circuit held that these sections "generally render debt obtained by false pretenses, false representations, or actual fraud non-dischargeable."[202] However, the Bankruptcy Code contains an exception: "if the debt is obtained by a false *oral* statement respecting *financial condition*, then it is dischargeable."[203]

At the outset, the Fifth Circuit noted that the statements were made orally. To further qualify the statements as an exception to an exception, the Fifth Circuit went into what "statement respecting . . . financial condition" entails and if Haler's statements qualified as such. The Fifth Circuit looked at past precedent in *In re Bandi*,[204] which held that "statements respecting financial condition are 'those that purport to present a picture of the debtor's overall financial health.'"[205] The overall financial health of a company is a general representation and it need not be a report or reflection of a specific asset.[206] Haler never made any false claims about specific assets but instead gave a general representation about McKinney to Boyington, which purported to fall under the applicable definition. The Fifth Circuit differentiated between this case and *In re Bandi*. In that case, the debtor made false statements about real property that the debtor did not actually own—false statement toward specific assets that did not constitute statements respecting financial condition.[207] Here, the oral statements were general in nature and did constitute statements respecting financial condition.[208]

The Fifth Circuit further emphasized that the statements of financial condition need not be formal, such as a presentation of the balance sheet or other financial statements. "The information regarding 'overall net worth or overall income flow' contained within such a statement—not the formality of the statement—is what is important."[209]

In light of this reasoning, the Fifth Circuit found Haler's debt to be dischargeable.[210] One, the statements were oral.[211] Two, they were general in nature and met the definition of "statement respecting . . . financial condition."[212] Haler's statements therefore fit within the exception

201. *Id.*
202. *Id.* at 839–40.
203. *Id.*
204. 683 F.3d 671 (5th Cir. 2012).
205. *In re Haler*, 708 F. App'x at 840 (quoting *id.* at 677).
206. *Id.*
207. *Id.*
208. *Id.* at 840–41.
209. *Id.* at 841 (quoting *In re Bandi*, 683 F.3d at 677 n.29).
210. *Id.*
211. *Id.* at 840.
212. *Id.* at 840–41.

outlined in § 523(a)(2)(A).[213]

This will be an interesting one to keep an eye on. The U.S. Supreme Court has recently granted certiorari in *Lamar Archer & Cofrin LLP v. Appling*, an U.S. Court of Appeals for the Eleventh Circuit case dealing with the meaning of "respecting the debtor's . . . financial condition" in the context of non-dischargeability under § 523(a)(2)(A) and (B).[214] The Eleventh Circuit recognized the circuit split on the issue; it rejected the Fifth, Eighth, and Tenth Circuit's holdings that deem a statement concerning a single asset to not be a statement concerning the debtor's financial condition, and instead, held that a statement concerning a single asset may qualify as a statement respecting the debtor's financial condition—making such statement outside the purview of non-dischargeability actions.

The Fifth Circuit's reaffirmation of the exception in § 523(a)(2)(A), and its insight into the scope of the exception, still holds until the Supreme Court chimes in. The Fifth Circuit has certified the need for the statements to be oral—the exception does not extend to statements in writing. Additionally, the Fifth Circuit solidified the general nature of "statement[s] respecting . . . financial condition."[215] So as it stands, general oral statements are the only type afforded the exception to the exception, and oral statements concerning a single asset—because they do not qualify as statements respecting the debtor's financial condition—are still subject to non-dischargeability under § 523 of the Bankruptcy Code.

It is also interesting to note the procedural posture of this case. Haler was found guilty of fraud in state court, yet this same fraud was dischargeable in bankruptcy. *Res judicata* effect as to state court judgments carries weight in bankruptcy court, but these judgments must be viewed in the light of the applicable standard under the Bankruptcy Code and its provisions. While Haler's actions constituted fraud in state court, it did not amount to such a gross degree in bankruptcy court to render that debt non-dischargeable.

VI. FAIR DEBT COLLECTION PRACTICES ACT

A. Proofs of Claim on a Time-Barred Debt Permitted Under the Fair Debt Collection Practices Act—*Midland Funding, LLC v. Johnson*

On May 15, 2017, in *Midland Funding, LLC v. Johnson*,[216] the U.S. Supreme Court settled a contentious circuit split on whether filing a proof of claim on a time-barred debt in a Chapter 13 bankruptcy violated the Fair Debt Collection Practices Act (FDCPA).[217] The FDCPA provisions

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213. *Id.* at 841.

214. Lamar Archer & Cofrin LLP v. Appling, 848 F.3d 953, 958, 960 (11th Cir. 2017) *cert. granted sub nom.* Lamar, Archer & Cofrin, LLP v. Appling, 138 S. Ct. 734 (2018).

215. *In re Haler*, 708 F. App'x at 839.

216. 137 S. Ct. 1407 (2017).

217. 15 U.S.C. § 1692a–1692p (West 1977).

at issue prohibit debt collectors from making representations or using means that are "false," "deceptive," "misleading," "unfair," or "unconscionable."[218] The majority opinion, penned by Justice Breyer, found the conduct to be permissible, although it was met by a scathing dissent.

In this case, the debt collector filed a proof of claim in the debtor's Chapter 13 bankruptcy that appeared on its face to be barred by the applicable statute of limitations.[219] The U.S. Bankruptcy Court for the Southern District of Alabama, Southern Division disallowed the claim following the debtor's objection, but the debtor filed suit against the debt collector for violating the FDCPA. The U.S. District Court for the Southern District of Alabama, Southern Division dismissed the action, but the U.S. Court of Appeals for the Eleventh Circuit reversed, reaffirming its prior decision finding the debt collector's conduct to be prohibited.[220] The Supreme Court granted certiorari and reversed the Eleventh Circuit.

The Supreme Court began its analysis on the "reasonably clear" question of whether filing a proof of claim for a time-barred debt was a "false, deceptive, or misleading" representation under § 1692e.[221] To put it simply, the Supreme Court found no violation because a time-barred debt was nevertheless a "claim" for bankruptcy purposes. While the Bankruptcy Code (the Code) defines "claim" as a "right to payment,"[222] state law tells us whether a right to payment exists after the expiration of a statute of limitations. In Alabama (the relevant state law in this case), like most states, the right to payment survives the expiration of the statute of limitations.[223] Because the time-barred debt remained a right to payment under state law, it was not false, deceptive, or misleading to assert it as a claim in bankruptcy.[224]

The debtor, along with the United States as *amicus curiae*, argued that the Code's definition of "claim" really means an "enforceable claim."[225] The Supreme Court found this argument unpersuasive because the claims allowance provisions of the Code specifically provide that an unenforceable claim should be disallowed upon objection.[226] Importantly, the Supreme Court noted "[the Code] does not say that an 'unenforceable' claim is not a 'claim.'"[227] The Supreme Court went on to explain that "[t]he law has long treated unenforceability of a claim (due to the expira-

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218. 15 U.S.C. §§ 1692e (West 1996), 1692f (West 1977).
219. *Johnson*, 137 S. Ct. at 1411. The date of the last charge on the account was more than ten years before the bankruptcy was filed, and the applicable Alabama statute of limitations was six years. *Id.*
220. Johnson v. Midland Funding, LLC, 823 F.3d 1334, 1335 (11th Cir. 2016) (reaffirming Crawford v. LVNV Funding, LLC, 758 F.3d 1254, 1262 (11th Cir. 2014)).
221. *Johnson*, 137 S. Ct. at 1411.
222. 11. U.S.C. § 101(5)(A) (West 2012).
223. *Johnson*, 137 S. Ct. at 1411. The Supreme Court noted that in Mississippi and Wisconsin, the expiration of the limitations period extinguishes both the remedy and the right, suggesting a different outcome in those jurisdictions. *Id.* at 1412.
224. *Id.*
225. *Id.*
226. *Id.* (citing 11 U.S.C. § 502(b)(1) (West 2005)).
227. *Id.*

tion of the limitations period) as an affirmative defense," which the debtor must raise *after* a claim is asserted, and there is "nothing misleading or deceptive in the filing of a proof of claim that, in effect, follows [a] similar system."[228]

As a final thought on whether a statement is misleading under § 1692e, the Supreme Court said that consideration must be made as to the "legal sophistication of [the statement's] audience."[229] In a Chapter 13 bankruptcy, the audience includes a trustee with a statutory duty to object to improper claims.[230] While a sophisticated trustee is not likely to be misled by a proof of claim for a time-barred debt, the Supreme Court, in a parenthetical, said it would not address the appropriate standard in ordinary litigation.[231]

The Supreme Court then addressed the "closer question" of whether filing a proof of claim on a time-barred debt constituted "unfair or unconscionable" means of collection under § 1692f.[232] The debtor relied on strong precedent that found an FDCPA violation for filing a civil lawsuit on time-barred debt.[233] The primary concerns underlying civil suits on time-barred debt include that the debtor may acquiesce and unwittingly pay the stale debt; that few consumer debtors would be aware that timeliness is an affirmative defense; that the debtor may forget details or lose documentation; or that the debtor may pay the debt merely to avoid court.[234] The Supreme Court remained unmoved by this precedent, however, opining that these concerns "have significantly diminished force in the context of a Chapter 13 bankruptcy."[235]

The Supreme Court made two counterpoints in response to this existing precedent. First, unlike a civil suit on debt, the debtor in a Chapter 13 bankruptcy initiates the proceeding, alleviating the concern that a debtor may pay the stale debt to avoid court.[236] The Supreme Court's second counterpoint reiterated the role of the trustee in a Chapter 13 bankruptcy as a gatekeeper of claims, "mak[ing] it considerably more likely that an effort to collect upon a stale claim in bankruptcy will be met

228. *Id.*

229. *Id.* at 1413 (citing Bates v. State Bar of Ariz., 433 U.S. 350, 383 n.37 (1977)).

230. *Id.* (citing 11 U.S.C. §§ 704(a)(5) (West 2010), 1302(b)(1) (West 2010)).

231. *Id.* In ordinary FDCPA litigation, the "least sophisticated consumer" standard is almost universally applied, which asks whether an unsophisticated consumer would be misled by the statement at issue. *See* Jeter v. Credit Bureau, Inc., 760 F.2d 1168, 1175 (11th Cir. 1985) ("[T]he FDCPA's purpose of protecting consumers is best served by a definition of 'deceive' that looks to the tendency of language to mislead the least sophisticated recipients of a debt collector's [communication] . . . ."); *see also* Jensen v. Pressler & Pressler, 791 F.3d 413, 420 (3d Cir. 2015) ("[T]he Courts of Appeals have nearly universally embraced *Jeter*'s reasoning and employed the least sophisticated debtor standard . . . .").

232. *Johnson*, 137 S. Ct. at 1413.

233. *Id.* (citing, among other cases, Phillips v. Asset Acceptance, LLC, 736 F.3d 1076, 1079 (7th Cir. 2013); Castro v. Collecto, Inc., 634 F.3d 779, 783 (5th Cir. 2011); Kimber v. Fed. Fin. Corp., 668 F. Supp. 1480, 1487 (M.D. Ala. 1987)).

234. *Id.* at 1413.

235. *Id.*

236. *Id.*

with resistance, objection, and disallowance."[237]

The Supreme Court wrapped up its analysis by comparing the purposes and structural features of the FDCPA and the Code, finding that applying the FDCPA to this context would disturb the "delicate balance of a debtor's protections and obligations" created by the Code.[238] For one, it would create a substantive bankruptcy-related remedy the Code itself did not provide.[239] Second, it would permit litigation in ordinary civil courts concerning bankruptcy-related questions.[240] And finally, it would force debt collectors to analyze the merits of a limitations defense when the Advisory Committee on Rules of Bankruptcy Procedure had considered and rejected precisely such a requirement.[241]

The Supreme Court's majority opinion prompted an even longer dissent from Justice Sotomayor, joined by Justices Ginsburg and Kagan. Because the dissent found the conduct at issue to be "unfair or unconscionable" under § 1692f, it did not consider whether the conduct was also "false, deceptive, or misleading" under § 1692e.[242]

The dissent emphasized the sheer magnitude of the debt collection industry ("hundreds of billions of dollars") and how debt collectors have recently turned to the bankruptcy forum to collect time-barred debts after receiving FDCPA violations for pursuing recovery through traditional civil litigation.[243] Justice Sotomayor noted that the problem of filing time-barred claims in bankruptcy "has become so widespread that the Government sued one debt buyer last year 'to address [its] systemic abuse of the bankruptcy process'—including a 'business model' of 'knowingly and strategically' filing thousands of claims for time-barred debt."[244]

The dissent then took issue with the majority's failure to apply to the bankruptcy context the existing FDCPA precedent prohibiting civil suits on stale debt.[245] The dissent found that "[t]he same dynamics are present in bankruptcy proceedings" that exist in the proceedings of civil lawsuits.[246] While the majority heavily relied on the existence and protection of a trustee in bankruptcy, the United States government, as *amicus curiae* (and the entity that oversees Chapter 13 trustees), argued that "trustees 'cannot realistically be expected to identify every time-barred . . . claim filed in every bankruptcy.'"[247] The dissent also pointed out that "[t]he trustees themselves (appearing here as *amici curiae*) agree, describing the practice as 'wasteful' and 'exploit[ative].'"[248]

237. *Id.* at 1414.
238. *Id.* at 1415.
239. *Id.*
240. *Id.*
241. *Id.*
242. *Id.* at 1416 (Sotomayor, J., dissenting).
243. *Id.* at 1416–17.
244. *Id.* at 1418 (internal citations omitted).
245. *Id.*
246. *Id.* at 1419.
247. *Id.* at 1420.
248. *Id.*

In a final adornment, the dissent added that "one should not be able to profit on the inadvertent inattention of others. It is said that the law should not be a trap for the unwary. Today's decision sets just such a trap."[249]

B. Follow-Up to Midland Funding: The Implications of *Henson v. Santander Consumer USA Inc.*

Midland Funding, LLC v. Johnson was decided 5–3 without input from newly confirmed Justice Gorsuch. However, as his first task on the high court, Justice Gorsuch wrote the unanimous opinion in *Henson v. Santander Consumer USA Inc.*,[250] which, although it is not a bankruptcy case, could have a significant impact on the FDCPA and time-barred debt collection in and out of bankruptcy.

In *Henson*, CitiFinancial Auto made an auto loan that subsequently defaulted.[251] Santander purchased the defaulted loan and attempted to collect. The borrowers sued under the FDCPA for conduct related to that collection. The issue was rather simple: whether Santander fell within the FDCPA's definition of a debt collector as an entity that "regularly collects or attempts to collect . . . debts owed or due . . . another."[252] In other words, the U.S. Supreme Court had to decide whether the FDCPA applied to debt buyers collecting on their own purchased accounts. The unanimous Supreme Court gave a resounding "no." In an impressive display of wit flowing from a study of the proper usage of the past participle "owed," the grammarian Supreme Court held that debt purchasers do not trigger the FDCPA's definition at issue.[253]

Henson's holding could prove significant because, just like *Santander*, in *Johnson*, the debt collector was actually a debt buyer collecting on its own account.[254] Justice Sotomayor mentioned the pending *Henson* case in her dissent in *Johnson*, noting that Midland did not dispute that it was a debt collector subject to the FDCPA.[255] Had *Henson* been decided before *Johnson*, there may have been no *Johnson*.

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249. *Id.* at 1421.

250. 137 S. Ct. 1718, 1720 (2017) (per curiam).

251. *Id.* at 1720.

252. *Id.* at 1721 (citing the second part of the statutory definition of 15 U.S.C. § 1692a(6) (West 2011)). It is important to note that the Court limited its analysis to this particular part of the statutory definition. Because the debtor did not make the argument, it did not address the first part of § 1692a(6)'s definition of "debt collector," which includes an entity whose "principal purpose . . . is the collection of any debts." *Id.*

253. *Id.* at 1721–22. For an interesting "plain meaning" analysis of *Henson* and *Johnson* by a leading constitutional law expert, see Erwin Chemerinsky, *Chemerinsky: The Myth of 'Plain Meaning'*, ABA J. (Oct. 31, 2017, 8:00 AM), http://www.abajournal.com/news/article/chemerinsky_plain_meaning_is_a_myth[https://perma.cc/8Y6U-9KUD].

254. Johnson v. Midland Funding, LLC, 823 F.3d 1334, 1335 (11th Cir. 2016) ("Midland purchases accounts with overdue unpaid balances and tries to collect those accounts."), *rev'd*, 137 S. Ct. 1407 (2017).

255. Midland Funding, LLC v. Johnson, 137 S. Ct. 1407, 1416 n.2 (2017) (Sotomayor, J., dissenting).

The *Henson* decision has potential long-range impact because, as it stands, not only have debt buyers been given *carte blanche* to file time-barred claims in bankruptcy, but there may also be an argument that debt buyers are not subject to the FDCPA at all. As Justice Sotomayor put it in *Johnson*, "the Court's decision today need not be the last word on the matter. If Congress wants to amend the FDCPA to make explicit what in my view is already implicit in the law, it need only say so."[256]

C. Debt Collectors Beware: Fifth Circuit Expands Scope of Potential Fair Debt Collection Practices Act Violations in *Daugherty v. Convergent Outsourcing, Inc.*

The U.S. Court of Appeals for the Fifth Circuit recently weighed in on the growing conflict among the circuit courts regarding the permissibility of a collection letter offering to "settle" a time-barred debt. In *Daugherty v. Convergent Outsourcing, Inc.*, the Fifth Circuit held that a collection letter, which is silent as to litigation but offers to "settle" a time-barred debt without disclosing its unenforceability, may be sufficiently deceptive or misleading to constitute a violation of the FDCPA.[257] In doing so, the Fifth Circuit agreed with the more debtor-friendly decision of the U.S. Court of Appeals for the Seventh Circuit and expanded the scope of potential FDCPA violations.

After Roxanne Daugherty (the Debtor) defaulted on an accumulated $12,824.24 in credit card debt, LVNV Funding, L.L.C. (LVNV) purchased the debt from the creditor and hired Convergent Outsourcing, Inc. (Convergent) to collect the debt on its behalf. Over the course of several years, the debt had increased to $32,405.91. In January 2014, after the statute of limitations on collection of the debt had expired, Convergent sent the Debtor a letter entitled "Settlement Offer." The letter proposed that the Debtor make a payment of $3,240.59—representing ten percent of the Debtor's total balance—to "settle" a "past due balance of $32,405.91."[258] The letter requested a response within sixty days and offered three payment options: (1) a "Lump Sum Settlement Offer of 10%," which required a single payment of $3,240.59; (2) a "Settlement Offer of 25% & Pay Over 3 Months," which required three payments of $2,700.49; or (3) "Spread Your Payments Over 12 Months," which required monthly payments of $2,700.49 over a year.[259]

The Debtor filed a lawsuit against Convergent and LVNV, alleging violations of the FDCPA. Specifically, the Debtor alleged that Convergent and LVNV—both "debt collectors" under the FDCPA—violated 15 U.S.C. § 1692e by using false, deceptive, or misleading representations in collecting her debt. In addition, the Debtor alleged that Convergent and

256. *Id.* at 1421.
257. Daugherty v. Convergent Outsourcing, Inc., 836 F.3d 507, 507 (5th Cir. 2016).
258. *Id.* at 509.
259. *Id.* at 510.

LVNV violated 15 U.S.C. § 1692f by using unfair or unconscionable means in attempting to collect her debt. The Debtor faulted Convergent's letter for failing to disclose that the debt was judicially unenforceable and that partial payment would both trigger tax liability and revive the entire debt.

Convergent and LVNV moved to dismiss the Debtor's suit under Federal Rule of Civil Procedure 12(b)(6) for failure to state a claim upon which relief could be granted. The U.S. District Court for the Southern District of Texas granted the motion, holding that a debt collector is permitted to seek voluntary repayment of a time-barred debt under the FDCPA so long as there is no threat or initiation of legal action.

On appeal, the Fifth Circuit began with the premise that Congress intended the FDCPA to have a "broad remedial scope," and that the FDCPA therefore must be construed "broadly and in favor of the consumer."[260] The Fifth Circuit noted a split in the circuits with respect to whether a collection letter offering "settlement" of a time-barred debt can violate the FDCPA if the creditor does not expressly threaten litigation. While the U.S. Court of Appeals for the Third and Eighth Circuits have found that such circumstances do not constitute a violation of the FDCPA, the U.S. Court of Appeals for the Sixth and Seventh Circuits have ruled that it may constitute a violation if the creditor conveys the impression that the debt is legally enforceable. After a careful analysis of the split, the Fifth Circuit adopted the Seventh Circuit's interpretation of the FDCPA as articulated in *McMahon v. LVNV Funding, LLC*.[261]

In *McMahon*, the debt collectors sent letters that offered to "settle" certain debts at a substantial discount, but failed to disclose that the statute of limitations periods had already expired.[262] The Seventh Circuit acknowledged that efforts to collect on a time-barred debt are not "automatically improper," but noted that offers to "settle" may mislead an unsophisticated consumer into believing that the debt is judicially enforceable.[263] The Seventh Circuit highlighted that the Federal Trade Commission (FTC) and the Consumer Financial Protection Bureau (CFPB) have previously argued that a debt collector collecting on a time-barred claim is required to disclose the unenforceability of the debt.[264] Because the letters at issue could have misled a consumer into believing that the claim was judicially enforceable, the Seventh Circuit held that each plaintiff's claim should survive the motion to dismiss.[265]

Similarly, in *Buchanan v. Northland Group, Inc.*, the U.S. Court of Appeals for the Sixth Circuit considered the impact of a collection letter offering to "settle" a time-barred claim and concluded that misrepresent-

260. *Id.*
261. 744 F.3d 1010, 1013–14 (7th Cir. 2014).
262. *Id.*
263. *Id.* at 1020.
264. *Id.* at 1021.
265. *Id.* at 1022.

ing the legal status of the debt may constitute an FDCPA violation.[266] In reaching its conclusion, the Sixth Circuit emphasized the letter's dangerous potential to lead a debtor to inadvertently revive the entire debt. The Sixth Circuit reasoned that an unsophisticated consumer who could not afford the entire settlement might assume that a partial payment on the balance would be advisable, without realizing that such payment would restart the statute of limitations on the principal debt.[267]

Conversely, in *Freyermuth v. Credit Bureau Services, Inc.*, the U.S. Court of Appeals for the Eighth Circuit held that a collection letter demanding payment on a time-barred debt—but lacking any disclosure about the legal status of the debt—was permissible under the FDCPA.[268] The Eighth Circuit reasoned that "a statute of limitations does not eliminate the debt; it merely limits the judicial remedies available."[269] Shortly thereafter, the U.S. Court of Appeals for the Third Circuit followed suit in *Huertas v. Galaxy Asset Management*, noting that a debt collector may request voluntary repayment of a time-barred debt so long as the collection letter does not contain a threat of litigation.[270]

In *Daugherty*, the Fifth Circuit noted the "differing perspectives" offered by the Sixth and Seventh Circuits on the extent to which their opinions conflict with *Freyermuth* and *Huertas*.[271] While the Sixth Circuit distinguished *Freyermuth* and *Huertas* based on the fact that the collection letters at issue did not offer to "settle" the debt, the Seventh Circuit explicitly rejected the Third and Eighth Circuit's reading of the FDCPA, acknowledging that its "opinion create[d] a conflict in the circuits."[272]

In *Daugherty*, the Fifth Circuit adopted the Seventh Circuit's interpretation of the FDCPA and held that a collection letter offering to "settle" a time-barred debt without disclosing its unenforceability or the potential consequences of partial payment may constitute a violation of the FDCPA.[273] Accordingly, the Fifth Circuit found that the Debtor's claim was facially plausible and reversed the district court's grant of Convergent and LVNV's motion to dismiss.[274]

The Fifth Circuit's broad reading of the FDCPA falls in line with the intent of the statute—consumer protection. The letter did not threaten litigation, but the Debtor had a viable claim, and point of argument, that inclusion of settlement language is misleading to an unsophisticated consumer. It will be interesting to see how this case plays out on the merits, especially in light of the Supreme Court case of *Midland Funding, LLC v.*

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266. Buchanan v. Northland Grp., Inc., 776 F.3d 393, 400 (6th Cir. 2015).
267. *Id.* at 300–400.
268. Freyermuth v. Credit Bureau Servs., Inc., 248 F.3d 767, 771 (8th Cir. 2001).
269. *Id.*
270. Huertas v. Galaxy Asset Mgmt., 641 F.3d 28, 32–33 (3d Cir. 2011).
271. Daugherty v. Convergent Outsourcing, Inc., 836 F.3d 507, 513 (5th Cir. 2016).
272. *Buchanan*, 776 F.3d at 399; McMahon v. LVNV Funding, LLC, 744 F.3d 1010, 1020 n.1 (7th Cir. 2014).
273. *Daugherty*, 836 F.3d at 513.
274. *Id.* at 513–14.

Johnson.[275] If the Fifth Circuit's consumer-friendly decision is telling, then creditors and debt collectors beware. However, if *Johnson* holds, the floodgates may be opened and the script flipped—debtors would need to be weary. This is a case to keep an eye on, as it should illuminate, at least some, to the potential breadth of *Johnson* and the implications it could have on debt collection practices.

VII. CLAIMS

A. Ignorance is not Always Bliss: Failure to List a Potentially Bad Debt in a Previous Bankruptcy Petition Has Judicial Estoppel Effect—*Feuerbacher v. Wells Fargo Bank, N.A.*

In *Feuerbacher v. Wells Fargo Bank, N.A.*,[276] the U.S. Court of Appeals for the Fifth Circuit held that even though a debtor did not know about a claim at the time of filing for bankruptcy, she can be judicially estopped from making that claim in the future. *Ignorantia juris non excusat*[277] has long been a mantra of the law—the Fifth Circuit reaffirmed that principle.[278]

In 2006, Alan Feuerbacher (Alan) sought a home equity loan.[279] He found a company that provided him such loan (the Note). Wells Fargo Bank, N.A. (Wells Fargo), acted as the holder of the Note and was assigned the Security Instrument by Sand Canyon Corporation (Sand Canyon).[280]

In October 2009, Billie Feuerbacher (Billie), Alan's wife, filed for bankruptcy. She represented in her bankruptcy that "she did not have any 'contingent and unliquidated claims of [any] nature, including tax refunds, counterclaims of the debtor, and rights to setoff claims.' "[281] She also claimed that she had been making payments on the home equity loan and "that she intended to retain the property and reaffirm the debt."[282] Billie was granted a discharge in January 2010.[283]

In March 2013, Ocwen Loan Servicing (Ocwen) began to service the Note. Later in 2013, the Feuerbachers defaulted on their home equity loan. After they defaulted, Wells Fargo sought and gained approval to foreclose on the Feuerbachers' home. In January 2015, the Feuerbachers filed suit against Wells Fargo, Sand Canyon, and Ocwen (collectively, the Defendants) seeking to vacate the order permitting the foreclosure. They claimed that the loan was invalid from its inception due to violations of

275. 137 S. Ct. 1407 (2017) (Breyer, J.) (discussed previously).
276. 701 F. App'x 297 (5th Cir. 2017).
277. "Ignorance of the law excuses not."
278. *Feuerbacher*, 701 F. App'x at 300.
279. A home equity loan is a loan where the borrower uses the equity he has already put into his house as collateral against the loan.
280. *Feuerbacher*, 701 F. App'x at 298.
281. *Id.* at 299.
282. *Id.*
283. *Id.*

the Texas State Constitution.[284]

The procedural history of this case is confusing, but the U.S. District Court for the Eastern District of Texas ultimately granted summary judgment in favor of the Defendants based on judicial estoppel.[285] On appeal, the Feuerbachers argued that the district court erred in using judicial estoppel to resolve this case. They asserted three specific grounds: (1) "their quiet title and breach of contract claims did not accrue until after the bankruptcy proceeding"; (2) judicial estoppel does not apply because they are dealing with exempt property (their homestead); and (3) a "lien cannot be estopped into existence" and thus judicial estoppel cannot apply.[286]

The Fifth Circuit resolved two of the three arguments the Feuerbachers raised by dismissing them, mainly because they failed to raise these issues in district court. The only issue the Fifth Circuit discussed was if the quiet title and breach of contract claims accrued when Billie filed for bankruptcy.[287]

The Fifth Circuit took particular note with the fact that Billie did not list any of the claims raised in this suit as potential claims in her schedule when she filed for bankruptcy in 2009. In response, the Feuerbachers argued that they had no duty to disclose the claims because they were not "potential claims."[288] The Fifth Circuit disagreed, holding that the claims should have been disclosed, and the failure to disclose them in 2009 judicially estopped the Feuerbachers from claiming them in 2015.[289]

The holding by the Fifth Circuit was based on "well-settled" Texas law.[290] "Under Texas law, '[c]auses of action accrue . . . when facts come into existence that authorize a claimant to seek a judicial remedy.' "[291] The cause of action came into existence when Billie Feuerbacher signed the home equity loan agreement back in 2006, and her failure to list the potential claims in her 2009 bankruptcy schedules barred her from raising the issues entirely.[292]

This appears to be a rather harsh judgment against the Feuerbachers, and more generally, debtors. The Feuerbachers' contentions might have had merit, which in turn could have allowed the Feuerbachers to avoid foreclosure. Invalidity of the loan would have given them a fresh start, but instead, the Feuerbachers were strung to the terms of a potentially invalid home equity loan.

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284. *Id.*
285. Feuerbacher v. Wells Fargo Bank, No. 4:15-CV-59, 2016 WL 3669744, at *9 (E.D. Tex. July 11, 2016), *aff'd sub nom.* Feuerbacher v. Wells Fargo Bank, 701 F. App'x 297 (5th Cir. 2017).
286. Feuerbacher v. Wells Fargo Bank, 701 F. App'x 297, 300 (5th Cir. 2017).
287. *Id.*
288. *Id.*
289. *Id.* at 301.
290. *Id.*
291. *Id.* (citing Exxon Corp. v. Emerald Oil & Gas Co., 348 S.W.3d 194, 202 (Tex. 2011)); *see* Stine v. Stewart, 80 S.W.3d 586, 592 (Tex. 2002).
292. *Feuerbacher*, 701 F. App'x at 301.

A debtor looking to file bankruptcy with existing loans or agreements they plan to reaffirm may think twice before doing so. Debtors must now be entirely sure that they have no issues or claims with a contract before omitting those potential claims from their bankruptcy schedules. This may lead a debtor to hire a lawyer in an effort to ensure there are no loose claims. Lawyers cost money, and what is seen as a rather miniscule act may in turn drain the estate of valuable resources that could be used to pay other creditors. But, debtors need to be diligent in assessing potential claims of the estate, and expenditure of estate funds to do so seems necessary in light of this ruling.

And as to creditors, the reliance on bankruptcy schedules to show these potential claims could be of great benefit. It seems they can now confidently assert the defense that a claim is time barred when it is left out of a bankruptcy petition. This ruling enhances the power of judicial estoppel and adds another arrow to creditors' quivers.

B. No Assets, No Problem: Fifth Circuit Holds That a No-Asset Bankruptcy Does Not Trigger the Claims Allowance Process in *Kipp Flores Architects, LLC v. Mid-Continent Casualty Company*

In *Kipp Flores Architects, L.L.C. v. Mid-Continent Casualty Company*, the U.S. Court of Appeals for the Fifth Circuit clarified that in a no-asset bankruptcy, a creditor's proof of claim for copyright infringement damages is not deemed allowed.[293] A no-asset bankruptcy does not trigger the claims allowance process; therefore, any claim a creditor may bring is superfluous and does not require an objection from the trustee, debtor, or the court.[294] If a claim is not deemed allowed, then it cannot be used as a final judgment to force collection against a debtor's liability insurer.

Kipp Flores Architects, L.L.C. (KFA) sold house designs to Hallmark Collection of Homes L.L.C. (Hallmark Collection), authorizing a one-time use of each design. If Hallmark Collection used a design more than once, KFA would be compensated by Hallmark Collection an additional amount based on the number of designs used.

Hallmark Collection built several hundred homes from KFA's designs without paying the additional fees. In response, KFA filed suit for copyright infringement. The suit named several defendants: Hallmark Collection, Hallmark Design Homes, L.P. (Hallmark Design), and Joe Partain (an owner of Hallmark Collection). In the middle of the suit, both Hallmark Collection and Hallmark Design filed for Chapter 7 bankruptcy.[295]

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293. Kipp Flores Architects, L.L.C. v. Mid-Continent Cas. Co., 852 F.3d 405 (5th Cir. 2017). A no-asset bankruptcy is a bankruptcy proceeding where the debtor has no assets that can be liquidated to pay claims to its creditors. *See id.* at 411. 11 U.S.C. § 502(a) reads: "A claim or interest, proof of which is filed under section 501 of this title, is generally deemed allowed, unless a party in interest . . . objects." 11 U.S.C. § 502(a) (West 2005).

294. *Kipp Flores*, 852 F.3d at 413.

295. *Id.* at 407.

Hallmark Collection was a no-asset bankruptcy with liabilities of about $2.5 million. KFA had an unsecured non-priority claim for its pending lawsuit against Hallmark Collection. KFA filed a proof of claim for $63.471 million against Hallmark Collection's estate for the potential copyright infringement damages.[296] The claim received no objection or response from the trustee or Hallmark Collection, nor did the U.S. Bankruptcy Court for the Southern District of Texas issue an order in regard to KFA's claim.[297] Hallmark Collection's estate had no proceeds to distribute to creditors, and the U.S. Bankruptcy Court for the Southern District of Texas closed the case five weeks later.[298]

Remember, Hallmark Design's bankruptcy was still ongoing. The U.S. District Court for the Southern District of Texas in that bankruptcy lifted the automatic stay to allow KFA to continue with its copyright suit. KFA eventually won that suit and was awarded $3.231 million in damages. "KFA was granted an 'allowed unsecured claim' for $3,239,688.40 in the Hallmark Design bankruptcy."[299] After some challenge, Mid-Continent Casualty Co. (Mid-Continent), the insurer for Hallmark Design, paid about $3 million on behalf of its client for KFA's claim. While litigation over the award from Hallmark Design was pending, KFA demanded Mid-Continent do the same regarding Hallmark Collection—pay the $6 million face value policy it had for Hallmark Collection based on the final judgment of KFA's proof of claim in Hallmark Collection's bankruptcy. Mid-Continent refused to pay the claim and KFA filed suit for breach of contract. The U.S. District Court for the Southern District of Texas assigned the case to pretrial management. The magistrate judge heard the case and ruled against KFA.[300] The magistrate judge held that because the Hallmark Collection bankruptcy was a no-asset bankruptcy, the claims allowance process had never been triggered. The district court adopted the magistrate judge's recommendation and KFA appealed to the Fifth Circuit.[301]

On appeal, KFA argued that the district court created an improper exception for no-asset bankruptcies at odds with the plain meaning of the Bankruptcy Code.[302] KFA believed that an unobjected-to claim constituted a final judgment under Section 502(a).[303] KFA also argued Mid-Continent, as a "party in interest," had a duty to object to the claim if it disagreed. Since Mid-Continent did not object, KFA could hold its claim as a final judgment against the insurer to indemnify its client, Hallmark

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296. These damages were calculated from Hallmark Collection's gross income from the sales of the KFA designed homes. *Id.* at 408.

297. *Id.* at 407–08.

298. *Id.* at 408.

299. *Id.*

300. *Id.* at 409.

301. *Id.*

302. *Id.*

303. *Id.*

Collection.[304] Mid-Continent responded that the Bankruptcy Code, if looked at in its entirety, required that assets must be available in a debtor's estate for a creditor to file an actionable proof of claim. Mid-Continent argued that the allowance of KFA's claim "served no bankruptcy purpose because there were no assets to be marshalled and distributed among creditors."[305]

The Fifth Circuit began its analysis with a thorough statutory interpretation of Bankruptcy Code § 502(a). The Fifth Circuit immediately sought guidance outside this one section, and instead looked at the Bankruptcy Code in its entirety. The Fifth Circuit considered the multiple, different uses and definitions of key words found throughout § 502(a), and, more broadly, the entire Bankruptcy Code. The Fifth Circuit narrowed its focus to the use of the word "may," and how the Bankruptcy Code often references what a creditor "may," "shall," or "must" do.[306] In a number of cases, and in-line with the Bankruptcy Rules, the court found that a creditor is often requested to *not* file a proof of claim unless there is the "possibility of asset distribution."[307] Furthermore, the Fifth Circuit found that if an asset is discovered during a bankruptcy proceeding, the bankruptcy court will give notice to creditors that they should file proofs of claims. This notice protects creditors and would have protected KFA just the same.[308]

Additionally, the Fifth Circuit took a practical approach, evaluating what a party in interest involved in a no-asset bankruptcy should do if it is in a similar situation as Mid-Continent. Harping on judicial economy, the Fifth Circuit found that "[s]ection 502(a) would be significantly transformed if . . . certain 'parties in interest' in no asset cases would be required to monitor, object to, and litigate proofs of claim that need not even be filed."[309] The fear that parties in interest would have to constantly lookout for claims in situations that did not make sense worried the Fifth Circuit.

Ultimately, the Fifth Circuit held that KFA's interpretation of § 502(a) was too strict.[310] KFA did not need to file a proof of claim in an estate with no assets, and in fact, such action is generally wasteful. Nothing in the Bankruptcy Code, Bankruptcy Rules, nor in applicable case law required claims allowance in this situation. No notice was ever given to creditors about raising claims because no assets were ever discovered by the court. Furthermore, "no bankruptcy purpose would have been served by [adjudication of] KFA's claim."[311] Therefore, KFA did not have a

304. A party in interest is generally a debtor, creditor, trustee, indenture trustee, or an equity security holder. *Id.* at 413.

305. *Id.* at 409.

306. *Id.* at 410–11.

307. *Id.* at 412.

308. *Id.* at 413.

309. *Id.*

310. *Id.* at 415–16.

311. *Id.* at 416.

"deemed allowed" claim that constituted res judicata against Mid-Continent.[312]

This opinion's result is quite practical. The outcome of this case lifts the burden off the shoulders of debtors and parties in interest in no-asset bankruptcies. While maybe already assumed, this clarification also benefits creditors, who can breathe easier knowing that their rights will be protected in a no-asset bankruptcy case even in the absence of filing a proof of claim. Instead of constantly being on guard for claims to object to, debtors and parties in interest can now confidently focus attention to more pressing matters. Overall, this decision acts to better streamline the bankruptcy process by avoiding clogs through unnecessary proof of claims by creditors. The Fifth Circuit's recognition of the need for judicial economy rendered a ruling that is in line with the Bankruptcy Code and the bankruptcy process.

VIII. PROCEDURE

A. Know the Rules: Confusing the Federal Rules of Civil Procedure for the Federal Rules of Bankruptcy Procedure is Not Excusable Neglect in *Netsch v. Sherman* (*Matter of Prism Graphics, Inc.*)

In *Netsch v. Sherman*, counsel's actions—confusing filing deadlines in regards to an appeal—did not rise to excusable neglect under Bankruptcy Rule 8002(d)(1)(B).[313] Interpreting and applying U.S. Supreme Court precedent, the U.S. Court of Appeals for the Fifth Circuit reasoned that attorneys who operate within bankruptcy proceedings should know the Bankruptcy Code. A simple mistake confusing deadlines between the Federal Rules of Civil Procedure and the Federal Rules of Bankruptcy Procedure is no excuse.[314]

On November 20, 2014, in a Chapter 7 bankruptcy adversary proceeding, the bankruptcy court entered a final judgment against the debtor's principal and an associated entity (the Defendants) under a fraudulent transfer theory.[315] The Defendants intended to appeal the ruling. The deadline to file an appeal was December 4, 2014 (fourteen days per the Federal Rules of Bankruptcy Procedure).[316] The Defendants' counsel mistakenly believed he had until December 18, 2014, to file (twenty-eight days per the Federal Rules of Civil Procedure).[317]

312. *Id.* at 415–16.
313. Matter of Prism Graphics, Inc., 666 F. App'x 355, 357–58 (5th Cir. 2017) (per curiam).
314. *Id.*
315. This was the date of an amended final judgment the court entered due to clerical error.
316. Fed. R. Bankr. P. 8002(a)(1).
317. *Matter of Prism Graphics*, 666 F. App'x at 356.

Upon realizing his mistake, the Defendants' counsel filed a motion to extend time and an untimely notice of appeal on December 16, 2014, after the deadline established under the Federal Rules of Bankruptcy Procedure. Counsel urged the court to grant the motion to extend time and allow the appeal under Bankruptcy Rule 8002(d)(1)(B) due to "excusable neglect" (the applicable standard).[318] The bankruptcy court denied the motion, ruling that this kind of mistake did not rise to excusable neglect and an extension was therefore not permitted. The U.S. District Court for the Northern District of Texas affirmed and the Defendants appealed to the Fifth Circuit.[319]

On appeal, the Defendants argued "that the bankruptcy court and district court improperly applied the factors articulated in *Pioneer* by placing undue emphasis on a single factor."[320] There are four *Pioneer* factors that would justify such delay: "(1) 'whether the movant acted in good faith'; (2) 'the danger of prejudice' to the nonmovant; (3) 'the length of the delay and its potential impact on judicial proceedings'; and (4) 'the reason for the delay, including whether it was within the reasonable control of the movant.' "[321] The Defendants argued that the courts overemphasized the fourth factor (the reason for delay), and such overemphasis changed the test articulated in *Pioneer* from a balancing test to an all-or-nothing test. The Defendants also contended that the merits of the case rose to excusable neglect under Rule 8002.[322]

After evaluating the bankruptcy court's use of the factors, the Fifth Circuit agreed with the reasoning of the lower courts, conceding that the first three factors of *Pioneer* weighed in favor of the Defendants and their counsel, but that the fourth factor—reason for the delay—weighed strongly against a finding of excusable neglect, so much so that the counsel's actions could not constitute excusable neglect.[323] Of particular importance was the fact that the parties had been using the Federal Rules of Bankruptcy Procedure throughout the adversary proceeding: these rules were known to the parties, and the parties had no difficulty following these rules until the mistake.[324]

In *Pioneer*, the U.S. Supreme Court specifically noted that "inadvertence, ignorance of the rules, or mistakes construing the rules do not usually constitute excusable neglect."[325] Relying heavily on this precedent, and citing one Fifth Circuit case that followed the same interpretation about rule mistakes, the Fifth Circuit held that the bankruptcy court properly applied the *Pioneer* factors and that counsel's mistake was not

318. *Id.*
319. *Id.*
320. *Id.* at 356; Pioneer Inv. Servs. Co. v. Brunswick Assoc. Ltd. P'ship, 507 U.S. 380 (1993).
321. *Matter of Prism Graphics*, 666 F. Appx. at 356–57; *see Pioneer*, 507 U.S. at 395.
322. *Matter of Prism Graphics*, 666 F. App'x at 357.
323. *Id.* at 357–58.
324. *Id.* at 357.
325. *Id.* at 358–59; *see Pioneer*, 507 U.S. at 392.

excusable neglect—the motion to extend time was properly denied.[326]

The Fifth Circuit solidified the approach used to determine excusable neglect under Federal Bankruptcy Rule of Civil Procedure 8002. In applying Supreme Court precedent, the Fifth Circuit solidified that *Pioneer* is supposed to be a balancing test, not an all-or-nothing test. That said, one factor can weigh so heavily against a party to render the other factors almost obsolete. In determining excusable neglect, courts will holistically look at the situation and make a determination on a case-by-case basis. All circumstances surrounding the parties' mistakes will be considered. Given the outcome of this case, and the circumstances (one factor weighing so heavily against a party as to render the three other factors nonmeritorious), "excusable neglect" appears to be a demandingly high burden.[327]

The authors included a discussion of this case as a practical matter; it serves as an important reminder for lawyers operating in bankruptcy courts who may not be entirely familiar with the Federal Rules of Bankruptcy Procedure—sometimes mistakes are not forgiven. Though mistakes will be made, this Fifth Circuit ruling reaffirming the *Pioneer* factors makes clear that mistakes will not be undone unless the conduct rises to the level of excusable neglect, which *Prism Graphics* hints is a high burden to meet. It is important to always be mindful, for both you and more importantly the client, of what rules control.

IX. CONCLUSION

Hopefully the reader learned something useful from this year's selection of bankruptcy cases. Perhaps, at least, how to stay out of trouble!

326. *See* Halicki v. La Casino Cruises, Inc., 151 F.3d 465, 469 (5th Cir. 1998); *Matter of Prism Graphics*, 666 F. App'x at 358.

327. *Matter of Prism Graphics*, 666 F. App'x at 356, 358.