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# Bankruptcy

Honorable Harlin Hale
*Northern District of Texas*

Nicole L. Hay

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## I. INTRODUCTION

Courts at all levels were busy issuing bankruptcy opinions during this Survey period. In fact, the U.S. Supreme Court issued five, which must be close to a record for the high court. This Survey is a selection of cases the authors believe will have the most impact on lawyers and how they counsel their clients in insolvency proceedings.

## II. JURISDICTION

### A. How Courts Should Address a *Stern* Claim—*Executive Benefits Insurance Agency v. Arkinson*

*Stern v. Marshall*[1] continues to affect bankruptcy practice. Thankfully, in two cases, the U.S. Supreme Court has provided much needed direction. Two terms after that watershed decision in *Executive Benefits Ins. Agency v. Arkinson*, the Supreme Court faced the question of how bankruptcy courts should proceed when faced with a *Stern* claim.[2] The Supreme Court answered this question by establishing a bright-line rule.

The facts of *Executive Benefits* were rather straightforward. The Chapter 7 trustee filed a complaint in bankruptcy court against the corporate debtor, alleging that the debtor used "various methods to fraudulently convey" assets belonging to the bankruptcy estate.[3] The bankruptcy court granted the trustee's motion for summary judgment against the debtor. On appeal, the district court conducted *de novo* review and affirmed the bankruptcy court's decision. Likewise, the Ninth Circuit affirmed the lower court's ruling and held that the debtor had impliedly consented to the bankruptcy court's jurisdiction, and therefore the adjudication was

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1. 464 U.S. 462 (2011).
2. Exec. Benefits Ins. Agency v. Arkison, 134 S. Ct. 2165, 2168 (2014).
3. *Id.* at 2169.

permissible.[4]

The Supreme Court did not address the issue of whether the parties had consented below, but instead tackled the more challenging task of providing bankruptcy courts with a roadmap to follow when facing a *Stern* claim.[5] Where a *Stern* claim was raised before a bankruptcy court, the Supreme Court held, absent party consent to adjudicate, the proper course was to issue proposed findings of fact and conclusions of law that would be reviewed *de novo* by the district court as if the parties had raised a non-core claim.[6] The Supreme Court supported this holding based on the severability provision of 28 U.S.C. § 151, which holds intact the remaining provisions of the Bankruptcy Code in the event that one provision is struck down.[7] Under this reasoning, although the core proceeding provisions of § 157(b) were unconstitutional as to a *Stern* claim, the remainder of the Bankruptcy Code remained in full force and effect.[8] As a result of § 157(b) being stricken, the *Stern* claim proceeded under the only remaining applicable provisions for non-core claims, found within § 157(c).[9] The Supreme Court clarified that the determination did not turn on whether the claim was a core or non-core claim but whether the claim was "otherwise related to a case under" the Bankruptcy Code, as opposed to "arising in" or "arising under."[10]

The practical effects of this case could be limited by the Supreme Court's decision last term in *Wellness International Network, Ltd. v. Sharif*, described below.[11] A bankruptcy court may be inclined to proceed with caution until consent is further defined by the case law. If consent to adjudication of an apparent *Stern* claim is unclear, a bankruptcy court should follow the road map established by *Executive Benefits* and issue proposed findings of fact and conclusions of law.

### B. Consent to Jurisdiction—*Wellness International Network, Ltd. v. Sharif*

In this Survey period, the U.S. Supreme Court finally ruled on whether parties could consent to adjudication of a *Stern* claim in bankruptcy court. The Supreme Court's decision in *Wellness International Network, Ltd v. Sharif*[12] will undoubtedly save district courts' dockets from a torrent of bankruptcy matters. With this ruling, it seems the Supreme Court is supplying § 157(c)(2) the constitutional backbone it has desperately needed since *Stern v. Marshall*.[13]

4. *Id.*
5. *See id.* at 2170.
6. *Id.* at 2173.
7. *Id.*
8. *Id.*
9. *Id.*
10. *Id.*
11. *See generally* Wellness Int'l Network, Ltd. v. Sharif, 135 S. Ct. 1932 (2015).
12. *See generally id.*
13. *See* 28 U.S.C. § 157(c)(2) (2012).

In *Wellness*, the Chapter 7 debtor (Sharif) failed to respond to Wellness, a listed creditor, regarding questions about a trust that Sharif claimed was outside his estate.[14] Wellness initiated an adversary proceeding, seeking, among other things, non-dischargeability of Wellness's claims and "a declaratory judgment that the [t]rust was Sharif's alter ego."[15] In his answer, Sharif did not dispute that "the adversary proceeding was a 'core proceeding,'" and in fact, sought a ruling in his favor.[16] The bankruptcy court then entered a default judgment against Sharif in the adversary proceeding, because Sharif did not comply with discovery rules. The bankruptcy court determined the trust's assets, if any, belonged to Sharif's bankruptcy estate based on an alter ego theory, which became the controversial *Stern* claim.[17] The Seventh Circuit disagreed that the bankruptcy court could enter final judgment on Wellness' alter ego claim and the Supreme Court accepted the case.

The Supreme Court confronted the constitutional issue of whether litigants may validly consent to adjudication of their case by bankruptcy courts. The Supreme Court relied on its earlier decision in *Commodity Futures Trading Commission v. Schor*,[18] which held that "[a]s a personal right, Article III's guarantee of an impartial and independent federal adjudication [was] subject to waiver."[19] The ultimate question, the majority claimed, was "whether allowing bankruptcy courts to decide *Stern* claims by consent would 'impermissibly threate[n] the institutional integrity of the Judicial Branch.'"[20] The Supreme Court answered this question in the negative.[21] In reaching this conclusion and permitting adjudication by consent, the Supreme Court relied in large part on the statutory framework that permitted district courts to refer cases to bankruptcy courts for hearing, either *sua sponte* or on request.[22]

Practical considerations also may have helped sway the decision in *Wellness*. The majority acknowledged the influx of cases in district courts due to *Stern*.[23] Moreover, Congress had already enhanced the capacity of district courts through the mere existence of bankruptcy judges; it would seem ignorant, if not absurd, to ignore bankruptcy judges' proficient capacity to adjudicate *Stern* claims when both parties consented to such adjudication. The pragmatic values of "increasing judicial efficiency and checking gamesmanship" were identical to the values that "motivated [the] adoption . . . for consent-based adjudications by magistrate

14. *See Wellness Int'l Network, Ltd.*, 135 S. Ct. at 1940.
15. *Id.*
16. *Id.* at 1941.
17. *Id.*
18. 478 U.S. 833 (1986).
19. *See Wellness Int'l Network, Ltd.*, 135 S. Ct. at 1943 (quoting Commodity Futures Trading Comm'n v. Schor, 478 U.S. 833, 848 (1986)).
20. *Id.* at 1943 (quoting *Schor*, 478 U.S. at 851).
21. *Id.* at 1944–45.
22. *Id.* at 1945.
23. *See id.* at 1946.

judges."[24]

What constitutes consent? The Supreme Court declared that nothing in the Constitution or the relevant statute required consent to be express.[25] Instead, it applied the implied consent standard in *Roell v. Withrow*.[26] Whether implied or express, the majority noted, consent always needed to be knowing and voluntary.[27] The Supreme Court did not decide whether Sharif consented to adjudication, but left the determination to the Seventh Circuit to decide on remand.[28]

The majority did not confront the question of whether the bankruptcy court's adjudication of the alter ego claim violated Article III based on *Stern*. In the dissent, Chief Justice Roberts was quick to point out this oversight.[29] The dissent asserted that the Supreme Court should not have addressed the broader question of whether parties could consent to adjudication of a *Stern* claim in bankruptcy court, because the alter ego claim was not a *Stern* claim.[30] The dissent expressed its opinion that the majority had created much ado about nothing.[31]

Looking at this case from afar, the most glaring constitutional concern was the battle between functionalism and formalism. The majority was abundantly clear that the question of consent should be answered "with an eye to the practical effect" and not by "formalistic and unbending rules."[32] Yet, this opinion begs follow-up questions. What satisfies implied consent? The Supreme Court remanded that issue in this case to the Seventh Circuit but it will surely lead to varying results in multiple cases. The Supreme Court's reliance on *Schor* will also likely cause confusion. The Supreme Court reiterated that *Schor* permitted waiver of the right to "impartial and independent federal adjudication" to the extent that the structure of the Constitution was not implicated.[33] When the *Schor* rational is read conjunction with the Supreme Court's reliance on the language of 28 U.S.C. § 157, a potential issue arises.[34] The Supreme Court does not define what implicates the structural principle of separation of powers, but it is clear that a bankruptcy court cannot adjudicate a *Stern* claim to final resolution.[35] How does this reconcile with *Wellness*? Do no

24. *Id.* at 1948.
25. *See id.* at 1947.
26. *Id.* at 1944–45; Commodity Futures Trading Comm'n v. Schor, 538 U.S. 580, 590 (2003).
27. *Wellness Int'l Network, Ltd.*, 135 S. Ct. at 1948 (citing Roell v. Withrow, 538 U.S. 580, 588 n.5 (2003) ("'notification of the right to refuse' . . . 'is a prerequisite to any inference of consent'")).
28. *Id.* at 1948–49.
29. *See id.* at 1950 (Roberts, C.J., dissenting).
30. *Id.* at 1954.
31. *Id.* at 1959.
32. *Id.* at 1944 (majority opinion).
33. *See id.* at 1942.
34. *See id.* at 1947 (citing 28 U.S.C. § 157(c)(2) (2012) (that "a bankruptcy court must obtain 'the consent of all parties to the proceeding' before hearing and determining a noncore claim")).
35. *See Schor*, 106 S. Ct. at 3257–58.

*Stern* claims implicate the structural separation of powers? If so, it seems that any proficient attorney could argue, with merit, that this same rational should apply to non-core proceedings as well.

### C. "Related to" Jurisdiction—*In re Galaz*

In *In re Galaz*, the U.S. Court of Appeals for the Fifth Circuit dissected the requirements for a "related to" claim for purposes of subject-matter jurisdiction and reiterated the general rule that "'related to' jurisdiction is lacking in connection with third-party complaints."[36] The case involved a Chapter 13 debtor who filed an adversary proceeding against her ex-husband, his father and the company that the father owned (collectively, the Defendants).[37] The debtor claimed that her ex-husband fraudulently transferred assets to the father's company from a company that the ex-husband had owned with a partner, Julian Jackson (Jackson). The debtor also claimed that her ex-husband, who had transferred half of his interest in the former company to her as a result of their divorce, breached a fiduciary duty he owed to her on account of her company interest. After the Defendants filed a third-party complaint against Jackson, he counterclaimed, alleging breach of fiduciary duty, among other claims.[38] The bankruptcy court ruled in favor of both the debtor and Jackson, and the district court, after first remanding for a recalculation of damages, affirmed.

On appeal, the Fifth Circuit reversed the lower courts, determining that Jackson's claims "[would] not result in any recovery for [the debtor], nor [would] they have any effect on her bankruptcy case."[39] These claims, therefore, did not satisfy the standard for "related to" jurisdiction under 28 U.S.C. § 1334(b).[40] But the debtor's claims differed; a judgment in her favor "could, at least conceivably, increase the size of [her] bankruptcy estate."[41] These claims, therefore, established "related to" jurisdiction and the lower courts had properly characterized them as non-core matters under 28 U.S.C. § 157(b)(2).[42]

The problem, however, was that the U.S. Supreme Court had not yet decided *Wellness* and the bankruptcy court had entered a final judgment on the "related to," non-core matters based on the parties' implied consent.[43] At the time of the opinion, the Fifth Circuit recognized that this issue of consent was on certiorari before the Supreme Court. But because the Supreme Court had not yet resolved the issue, the Fifth Circuit's precedent declaring that consent could not cure constitutional deficiencies

36. *In re* Galaz, 765 F.3d 426, 431 (5th Cir. 2014).
37. *Id.* at 428–29.
38. *Id.* at 429.
39. *Id.* at 431.
40. *Id.*
41. *Id.* at 430.
42. *Id.* at 431–32.
43. *Id.*

prevailed.[44] The Fifth Circuit, therefore, remanded and ordered the district court to consider the bankruptcy court's ruling on the debtor's claims as proposed findings of fact and conclusions of law.[45] After *Wellness*, this outcome would have been different and the Fifth Circuit would, almost certainly, have affirmed based on implied consent.

### D. Jurisdiction Over Indemnity Cross-Claims—*In re KSRP*

In a post-*Wellness* case raising issues similar to those in *In re Galaz*, the U.S. Court of Appeals for the Fifth Circuit, in *In re KSRP*, upheld dismissal of an adversary proceeding, finding that cross-claims for indemnity and contribution from the bankruptcy debtor were strong enough to establish "related to" jurisdiction.[46] As in *In re Galaz*, the Fifth Circuit analyzed the plaintiff's cross-claims against the debtor under the "conceivable effect" test, and upheld the bankruptcy court's determination that it had jurisdiction to issue a recommendation and report to the district court.[47] The interesting issue in the case confronted by the Fifth Circuit was not whether the indemnity and contribution claims indeed could conceivably affect the bankruptcy estate, but whether jurisdiction was prevented because the claims lacked merit.[48] The Fifth Circuit "reject[ed] this dichotomy," refusing to conflate merits with jurisdiction.[49] The Fifth Circuit acknowledged that an exception to the general rule against conflating the two did exist, if the claim "[was] not colorable, i.e., if it [was] 'immaterial and made solely for the purpose of obtaining jurisdiction' or [was] 'wholly insubstantial and frivolous.'"[50] Under Texas law and the Limited Partnership Agreement that governed the relationship between the plaintiff and the debtor, the claims for contribution and indemnity were not "wholly insubstantial or frivolous."[51] Although the Fifth Circuit noted that it reviewed jurisdiction when the lawsuit was removed, its conclusion that the claims were not frivolous was supported by the two-day bench trial that the bankruptcy court held on the claims.[52]

As a precedential matter, it is significant that the Fifth Circuit has deemed indemnity and contribution claims sufficient to establish "related to" jurisdiction under rather common facts. Practitioners should note, as a practical matter, the great benefit of winning the jurisdictional battle in the bankruptcy court level for purposes of appeal.

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44. *Id.*
45. *Id.* at 432.
46. *In re* KSRP, 809 F.3d 263, 265 (5th Cir. 2015).
47. *Id.* at 267–69.
48. *Id.* at 266–67.
49. *Id.* at 267.
50. *Id.* (citing Arbaugh v. Y&H Corp., 546 U.S. 500, 510–11, 515 (2006)).
51. *Id.*
52. *Id.* at 269.

## III. ATTORNEYS' FEES

### A. COMPENSATION FOR FEE-DEFENSE UNDER § 330(A)(1)(A)— *BAKER BOTTS L.L.P. v. ASARCO L.L.C*

The bankruptcy court's fee award to Baker Botts L.L.P. for fee-defense in the Chapter 11 bankruptcy of ASARCO was nothing out-of-the-ordinary under the flexible bankruptcy scheme for fee approval, although the amounts at issue were certainly large enough to draw attention.[53]

Under § 327(a), ASARCO retained Baker Botts L.L.P. and Jordan, Hyden, Womble, Culbreth & Holzer, P.C. (together, Baker Botts) as debtor's counsel in their Chapter 11 bankruptcy. Baker Botts represented ASARCO in a number of bankruptcy matters and proceedings. The case was extremely successful, and after four years in bankruptcy, ASARCO emerged from Chapter 11 with $1.4 billion in assets, little debt, and very few liabilities.[54] At the conclusion of the bankruptcy case, Baker Botts filed fee applications under § 330(a)(1), which provides that a bankruptcy court "may award . . . reasonable compensation for actual, necessary services rendered by professionals hired under § 327(a)."[55] The debtor's parent company, from which Baker Botts had recovered fraudulent transfers and which then-controlled ASARCO, challenged the requested compensation.[56] The bankruptcy court rejected these challenges and awarded Baker Botts $120 million for their work in the bankruptcy case plus another $4.1 million as a fee enhancement for their performance. The bankruptcy court further awarded $5 million to Baker Botts for time spent defending their fee applications. ASARCO appealed this award to the district court, which affirmed. The Fifth Circuit, however, reversed the award of attorneys' fees for fee-defense, and the U.S. Supreme Court upheld the Fifth Circuit's reversal.[57]

Justice Thomas, writing for the majority, started with the "bedrock principle" that statutes should be read with the presumption that they do not deviate from the American Rule, which requires each party to bear its own costs.[58] Typically, he wrote, the Supreme Court has found an intent to shift fees where statutes expressly references a "'prevailing party' in the context of an adversarial 'action.'"[59] This narrow premise, inapplicable to many matters in bankruptcy, was a portent for the Supreme Court's holding. The majority looked to Congressional intent in drafting § 330(a)(1)(A)'s allowance of "reasonable compensation for actual, necessary services rendered" and found that "Congress did not expressly depart from the American Rule to permit compensation for fee-defense

53. *See* Baker Botts L.L.P. v. ASARCO L.L.C., 135 S. Ct. 2158, 2163 (2015).
54. *Id.* at 2163.
55. *Id.* (internal quotation marks omitted); *see also* 11 U.S.C. § 330(a)(1)(A) (2012).
56. *Baker Botts*, 135 S. Ct. at 2163.
57. *Id.*
58. *Id.* at 2164.
59. *Id.*

litigation" for § 327(a) professionals.[60]

In his dissent, Justice Breyer noted that the Supreme Court had held that "Congress ma[d]e specific and explicit [its] provisio[n] for the allowance of attorneys' fees," showing an intent to replace the American Rule.[61] The dissent critiqued that the majority was in fact carving out the scenario of fee-defense litigation from this specific and explicit provision.[62] The dissent asserted that the Supreme Court had previously found fee-shifting for fee-defense litigation under the Equal Access to Justice Act, despite the fact that this specific scenario was not in the text.[63] The majority countered that this was not a carve-out; if Congress had intended to permit fees for fee-defense litigation, it would have done so with language similar in specificity to other sections of the Bankruptcy Code, such as § 110(i) or other statutes, such as the Equal Access to Justice Act.[64] Section 110(i) specifically allowed fee-shifting for fees incurred in litigating a bankruptcy petition preparer's fraud.[65] The Equal Access to Justice Act awarded fees to the prevailing party for any civil action under the Act.[66] In the eyes of the dissent, this level of specificity required too much of Congress.[67]

The majority's opinion was predicated upon the meaning of the term, services rendered, under § 330(a)(1)(A).[68] The dictionary defined the term *services* as "labor performed for another."[69] The majority noted that the Supreme Court had previously construed this provision as implying disinterested and loyal service.[70] Along with § 327(a), which the majority interpreted as authorizing employment of professionals "to serve the administrator of the estate, for the benefit of the estate," it followed that § 330(a)(1)(A) only contemplated reasonable compensation for labor performed for the estate administrator and in the estate's interest.[71] The majority concluded that a professional's defense of its fees was not "labor performed for" the estate administrator, much less disinterested labor.[72]

The United States and Baker Botts both addressed the meaning of "services" under § 330(a)(1)(A), but differed in position. Baker Botts argued that fee-defense qualified as a service provided to the estate administrator.[73] As Amicus Curiae, the United States urged that fee-defense litigation was not considered a service by itself, but was compensable as a component of an underlying service provided by the attorneys for the

60. *Id.*; *see also* 11 U.S.C. § 330(a)(1)(A) (2012).
61. *Baker Botts*, 135 S. Ct. at 2171 (Breyer, J., dissenting).
62. *Id.*
63. *Id.* at 2171–72.
64. *Id.* at 2165–66 (majority opinion).
65. *Id.* at 2166; *see also* 11 U.S.C. § 110(i).
66. *Baker Botts*, 135 S. Ct. at 2171–72 (Breyer, J., dissenting).
67. *Id.* at 2171.
68. *Id.* at 2165 (majority opinion).
69. *Id.*
70. *Id.*
71. *Id.* at 2164–65.
72. *Id.* at 2165.
73. *Id.* at 2166.

estate.[74] Compensation for the underlying services rendered would be diluted if compensation for fee defense work was not awarded.[75]

The dissent adopted the government's argument regarding the definition of "services" and pointed to two provisions in support of a possible award of fees incurred for fee-defense litigation.[76] First, the dissent reasoned it was within the bankruptcy court's discretion to determine if fee-defense litigation was a relevant factor of services rendered under § 330(a)(3).[77] Similarly, § 330(a)(6) directed a bankruptcy court to account for the level of skill required to prepare a fee application in awarding fees for that service.[78] The dissent noted that this provision was not the authority for compensating the preparation of a fee application, but assumed that this compensation was authorized as an "actual, necessary servic[e] rendered" under § 330(a)(1).[79] How could the Supreme Court decide that the preparation of a fee application was a compensable service under § 330(a)(1) but the support of that fee application was not? In a particularly memorable spar in the opinion, the majority responded to this criticism by analogizing a professional's preparation of a fee application to a mechanic's preparation of a bill for services.[80] The bill preparation was a service to the customer just as the fee application preparation was a service to the estate, because the product enabled the customer and estate to understand and even protest the billing.[81] The dissent cleverly quipped that this analogy did not support the majority's distinction between preparation and defense, because a mechanic would not charge its customer "for the time spent on preparing the bill."[82] On the contrary, Congress allowed this type of compensation explicitly under § 330(a)(6) and implicitly under § 330(a)(1), which showed its intent to compensate a broader genre of actions than provided by the majority's narrow interpretation of "services."[83]

The policy concerns adopted by the dissent reflected concerns undoubtedly shared by estate professionals. The dissent urged that the majority's interpretation of § 330(a)(1)(A) "undercut a basic objective" underlying the bankruptcy scheme: making "high-quality attorneys . . . available to trustees."[84] In an earlier case, *Perdue v. Kenny A.*, the Supreme Court had determined that a reasonable fee for a § 327(a) professional was a fee sufficient to induce professionals into service for the trustee.[85] To be comparable with non-bankruptcy law practice, the dissent

74. *Id.*
75. *Id.*
76. *Id.* at 2169 (Breyer, J., dissenting).
77. *Id.* at 2170.
78. *Id.* at 2172.
79. *Id.*
80. *Id.* at 2167 (majority opinion).
81. *Id.*
82. *Id.* at 2172 (Breyer, J., dissenting opinion).
83. *Id.* at 2172–73.
84. *Id.* at 2170–71.
85. *Id.* (citing Perdue v. Kenny A., 559 U.S. 542, 552 (2010)).

maintained, a bankruptcy court may need to award fees for fee-defense in certain cases.[86] Indeed, the American Rule usually arose outside of bankruptcy in a two-party dispute, whereas multiple parties in interest could object to the fees of a debtor's professionals within bankruptcy.[87] The majority's response to these concerns was not a denial. Instead, it was common adage that it was not the role of the Supreme Court to make policy, but rather the role of Congress.[88]

The Supreme Court's ruling in *ASARCO* quite possibly created fertile ground for fee opposition in Chapter 11 bankruptcy cases. As a market response, debtor's attorneys include specific terms promising compensation for fee-defense fees in their engagement agreements. Given a bankruptcy court's role as gatekeeper for fee compensation under § 330, it is unknown whether these contractual terms will be upheld or determined unenforceable. From an academic perspective, the *ASARCO* opinion raises questions about whether the ruling forecloses compensation for fees incurred by a debtor's attorneys in all matters of an adversarial nature. What if a debtor's attorney was compelled to litigate to enforce a carve-out of his fees under a cash collateral order? Is there an opening for bankruptcy courts to award fees where a litigious creditor or party-in-interest, rather than the debtor, protests? Certainly future litigation will test the boundaries of the Supreme Court's interpretation of the term "services" under § 330(a)(1)(A). The majority referenced a number of standards in this interpretation, including whether the labor was "in the best interests of the estate," disinterested and loyal, or primarily benefitted the professional.[89] Which standard or mixture of standards courts will apply to fee application matters following *ASARCO* is perhaps less certain than before.

### B. Prospective Standard for Fee Awards—*In re Woerner*

While *ASARCO* disappointed bankruptcy debtor attorneys across the country, bankruptcy professionals in the Fifth Circuit saw hope in a recent ruling. Last year, the U.S. Court of Appeals for the Fifth Circuit overruled the much-criticized *Pro-Snax* attorney fee standard that had drawn ire for years.[90] In *In re Pro-Snax*, the Fifth Circuit established a hindsight "material benefit" analysis for the award of attorney's fees under § 330.[91] The hindsight analysis required fee applicants to prove that their service resulted in an "identifiable, tangible, and material benefit to the bankruptcy estate."[92] In an en banc ruling, *In re Woerner*, the Fifth Circuit reversed the hindsight standard established in *Pro-Snax*.[93] In

86. *Id.*
87. *Id.* at 2171.
88. *Id.* at 2168–69 (majority opinion).
89. *Id.* at 2165.
90. *See In re* Woerner, 783 F.3d 266, 268 (5th Cir. 2015).
91. *See In re* Pro-Snax Distrib., Inc., 157 F.3d 414, 426 (5th Cir. 1998).
92. *Id.*
93. *In re Woerner*, 783 F.3d at 268.

hindsight, the Fifth Circuit replaced the hindsight analysis with a prospective inquiry into whether the services were "reasonably likely to benefit the estate" at the time performed.[94] This new prospective approach to attorneys' fees mirrors that of the Second, Third, and Ninth Circuits,[95] will undoubtedly afford bankruptcy court more discretion in fee awards, and comports with the statute.

In *In re Woerner*, Barron & Newburger (B & N) represented a Chapter 11 debtor.[96] The bankruptcy court later converted the case to Chapter 7. With its services no longer needed, B & N filed an application for fees in excess of $130,000. The bankruptcy court awarded B & N nearly $20,000 of the requested fees and disallowed the remainder. The district court affirmed and the law firm appealed, "contending that the bankruptcy court misapplied Fifth Circuit precedent and . . . § 330 in reducing" the fee award.[97] A panel of three judges on the Fifth Circuit affirmed. But at the suggestion of all three judges on the panel, the Fifth Circuit agreed to reconsider this affirmance and the controlling precedent of *Pro-Snax* en banc.[98]

Revisiting *Pro-Snax*, the Fifth Circuit began with the text of § 330(a)(3)(c), which directed bankruptcy courts to consider "whether the services were necessary to the administration of, or beneficial *at the time at which the service was rendered*" in determining fee compensation.[99] The Fifth Circuit noted that the temporal language in § 330(a)(3)(C) was added by the 1994 Amendments to the bankruptcy code.[100] Additionally, § 330(a)(4)(A)(ii) required a bankruptcy court to disallow compensation for services "not reasonably likely to benefit the debtor's estate."[101] Read together, the Fifth Circuit concluded that the plain language of these texts foreclosed a retrospective, material benefit standard.[102] *Pro-Snax*, the Fifth Circuit remarked, relied upon a case that construed § 330 pre-1994 Amendments.[103] The Fifth Circuit pointed to the legislative history behind the addition of temporal language in these amendments to support its conclusion that a prospective standard should be applied.[104]

In its decision, the Fifth Circuit opined that the prospective standard "permit[ted] a court to compensate an attorney not only for activities that were 'necessary' but also for good gambles."[105] This "good gamble" rhet-

94. *Id.* at 276.
95. *See id.*
96. *Id.* at 268.
97. *Id.*; *see also* 11 U.S.C. § 330 (2012).
98. *In re Woerner*, 783 F.3d at 268.
99. *Id.* at 273 (quoting 11 U.S.C. § 330(a)(3)(C)).
100. *Id.* at 275.
101. *Id.* at 273 (quoting 11 U.S.C. § 330(a)(4)(A)(ii)).
102. *Id.*
103. *Id.* at 275.
104. *Id.* at 276.
105. *Id.* at 274.

oric, originally mentioned in *In re Taxman Clothing Co.*,[106] may sound broad, but the rhetoric demands caution to those thinking all actions will be awarded by the courts. Attorneys must still prove that these good gambles were "objectively reasonable at the time they were made," even if the gamble did "not produce an 'identifiable, tangible, and material benefit.'"[107] Under the Fifth Circuit's new prospective standard, it is still apparent that results matter. Attorneys for the estate will still have to justify their fees, and under *ASARCO*, they will most likely need to pay for defending them.

## IV. PROCEDURE

### A. Final Orders—*Bullard v. Blue Hills Bank*

Because of the U.S. Supreme Court's decision in *Bullard v. Blue Hills Bank*, a Chapter 13 debtor will be confronted with a Hobson's choice after the denial of plan confirmation. In *Bullard*, the bankruptcy court denied confirmation of the debtor's third amended plan.[108] The debtor appealed the denial to the First Circuit Bankruptcy Appellate Panel (BAP).[109] The BAP commenced its analysis with the general rule that an order must be final to be appealable as a matter of right. The confirmation order, the BAP determined, was not final because the debtor was "free to propose an alternate plan."[110] Nevertheless, the BAP treated the appeal as discretionary under § 158(a)(3) and affirmed the denial of plan confirmation.[111] The First Circuit disagreed that the BAP could exercise its discretion to hear the appeal because it had failed to certify the appeal under this discretionary provision.[112] Therefore, whether the order was appealable depended on its finality. On this point, the First Circuit agreed with the BAP and the majority of circuits in deciding that the order denying confirmation was not a final, appealable order.[113]

The U.S. Supreme Court resolved a circuit split concerning whether a denial of confirmation was a final order in favor of the majority and also the mortgagee.[114] The decision hinged upon the meaning of an immediately appealable "proceeding" under § 158(a) of the Bankruptcy Code.[115] The Supreme Court rejected the debtor's argument that each proposed plan in bankruptcy constituted a proceeding and instead held that a proceeding entailed the entire plan confirmation process, including multiple proposed and denied plans.[116] Without lingering on the textual analysis,

106. *See In re* Taxman Clothing Co., 49 F.3d 310, 313 (1995).
107. *In re* Woerner, 783 F.3d at 274.
108. *See* Bullard v. Blue Hills Bank, 135 S. Ct. 1686, 1690–91 (2015).
109. *Id.*
110. *Id.*
111. *Id.* at 1691; *see also* 28 U.S.C. § 158(a)(3) (2012).
112. *In re Bullard*, 135 S. Ct. at 1690–91.
113. *Id.*
114. *Id.* at 1692.
115. *Id.* at 1691.
116. *Id.* at 1691–92.

the Supreme Court turned to the practicalities and policies regarding appeals in the plan context.[117] The Supreme Court reasoned that a denial of plan confirmation, as opposed to a grant, did not resolve or solidify the obligations between the debtor and creditors such that finality occurred.[118]

In aid of its decision, the Supreme Court focused upon the impact that a plan denial had on creditors, due to the general leeway a Chapter 13 debtor received in presenting multiple plans for confirmation.[119] Consumer bankruptcy attorneys, creditors, and debtors alike are familiar with a bankruptcy court's typical practice of giving a Chapter 13 debtor multiple bites at the confirmation apple. But in emphasizing this marathon for creditors, the Supreme Court gave short shrift to the practical effect of its holding upon a debtor seeking to confirm a Chapter 13 plan.[120] After *Bullard*, a Chapter 13 debtor whose plan is denied confirmation will be confronted with the difficult choice between proposing a new plan for confirmation and waiting until dismissal to appeal. Moreover, a debtor will need to obtain a stay pending appeal after dismissal, because dismissal eliminates the benefit of the automatic stay. The Supreme Court's response to this consequence in *Bullard*, and what most debtors' attorneys will likely turn towards, was that a debtor can seek discretionary review of an order denying confirmation under § 158(d)(2).[121] A rise in these interlocutory appeals may appear if the courts seem amenable to their certification. But if courts do not favor allowing discretionary review, Chapter 13 debtors and their attorneys are faced with a Hobson's choice: proposing a less-favorable plan or letting the denied plan ride.

### B. Who Is a Creditor for Purposes of Standing?—*In re Buescher*

The U.S. Court of Appeals for the Fifth Circuit's holding in *In re Buescher* handed mortgage companies and their attorneys a major procedural victory. In *Buescher*, the bankruptcy court denied joint debtors, Mr. and Mrs. Buescher, their discharge because of First United Bank's (First United) adversary proceeding seeking denial of the debtors' discharges under § 727(a)(2)–(5).[122] First United loaned Mr. Buescher a $19 million loan for his home-building business, which he personally guaranteed.[123] In the adversary proceeding, Mrs. Buescher argued that First United had no standing to object to her discharge. The bankruptcy court rejected this standing argument and denied Mrs. Buescher's discharge after a bench

117. *Id.* at 1692–93.
118. *Id.* at 1692.
119. *Id.* at 1693.
120. *Id.* at 1692–93.
121. *Id.* at 1695; 28 U.S.C. § 158(d)(2) (2012).
122. *In re* Buescher, 783 F.3d 302, 305 (5th Cir. 2015); *see also* 11 U.S.C. § 727(a)(2)–(5) (dealing with knowing or fraudulent concealment of property or books and information, knowing or fraudulent misrepresentations, and failure to satisfactorily explain a loss or deficiency in assets).
123. *In re Buescher*, 783 F.3d at 305.

trial.[124] The district court affirmed.

On appeal, the Fifth Circuit began with the statutory text of § 727(c), which gave only "[t]he trustee, a creditor, or the United States trustee" the ability to object to a debtor's discharge under § 727(a).[125] Mrs. Buescher argued that First United was not her creditor, because she, unlike her husband, had not personally guaranteed the loan from First United.[126] She had no contractual relationship with First United that would make her personally liable.[127] The Fifth Circuit, however, disagreed.[128] Under the Texas Family Code § 3.202(c), "First United ha[d] an *in rem* claim against any community property" jointly held by the debtor spouses.[129] Therefore, the Fifth Circuit reasoned, First United would be able to pursue an *in rem* action against Mrs. Buescher.[130] The Fifth Circuit then turned back to the statutory text.[131] The Bankruptcy Code defined a creditor as including an "entity that has a community claim."[132] A "community claim" was defined as a claim for which an entity could look to "property of the kind specified in section 541(a)(2)" for relief.[133] Section 541(a)(2) included sole or joint management community property of the debtor as well as property that could be liable for an allowed claim against the debtor and his spouse.[134] Following this logic, the Fifth Circuit concluded that First United was a creditor of Mrs. Buescher, because it could seek to satisfy its claim against community property that became part of Mrs. Buescher's bankruptcy estate.[135] First United, therefore, had standing to object to her discharge.[136]

Through its standing determination in favor of the mortgagee in *Buescher*, the Fifth Circuit provides leverage, not only to mortgagees, but also to any creditor who has an *in rem* claim against a debtor's community property. At first blush, debtor spouses may rethink the benefit of joint filing when creditors of community property exist. But this thinking is deceptive, because under state law, an *in rem* creditor could proceed against a non-filing spouse's jointly managed community property.[137] The holding in *Buescher* simply aligns an *in rem* creditor's rights in bankruptcy with those outside of bankruptcy.[138] It is important, however, to

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124. *Id.*
125. *Id.* (quoting 11 U.S.C. § 727(c)(1)).
126. *Id.* at 305.
127. *Id.*
128. *Id.* at 306.
129. *Id.* (referring to Tex. Fam. Code Ann. § 3.202(c) (West 2016)); *see also* United States v. Loftis, 607 F.3d 173, 179 (5th Cir. 2010) ("Section 3.202(c) . . . renders all jointly-managed community property subject to the nontortious liabilities incurred by [the debtor spouse].").
130. *Id.*
131. *See id.*
132. 11 U.S.C. § 101(10)(C) (2012).
133. *Id.* § 101(7); *In re Buescher*, 783 F.3d at 306.
134. 11 U.S.C. § 541(a)(2); *In re Buescher*, 783 F.3d at 306.
135. *In re Buescher*, 783 F.3d at 306.
136. *Id.*
137. *See id.*
138. *See id.*

realize that standing is merely a preliminary hurdle and creditors, like those in *Buescher*, still have a high burden to prevail on an objection to discharge under § 727.

### C. Standing Under the "Person Aggrieved" Test—*Fortune Natural Resources Corp. v. United States DOI*

In *Fortune Natural Resources Corp. v. United States DOI*, the U.S. Court of Appeals for the Fifth Circuit re-emphasized the "person aggrieved" test for bankruptcy standing and resolved that a creditor had no standing to appeal a sale order that did not include assets in which it had an interest.[139] *Fortune* involved a creditor with a working interest in an oil and gas lease belonging to a Chapter 11 debtor (the Lease).[140] The creditor and debtor had also entered into a joint operating agreement prior to bankruptcy, under which the debtor was required to perform certain decommissioning obligations related to the Lease. In Chapter 11, the debtor sought to sell certain assets that the Lease did not include. By agreement with the Department of Interior, the debtor would establish a trust fund to pay certain decommissioning obligations.[141]

The bankruptcy court upheld the sale and the creditor appealed, arguing that it was harmed by the sale because the debtor would be left without assets to pay its decommissioning costs under the joint operating agreement.[142] The creditor also protested the exclusion of its Lease from those that would receive trust distributions under the final sale order.[143] Subsequently, the district court dismissed the creditor's appeal for lack of standing and the Fifth Circuit affirmed.[144]

In affirming the dismissal, the Fifth Circuit relied upon its previously established person aggrieved test, noting that this standing test for bankruptcy was more stringent than a test for constitutional standing.[145] The Fifth Circuit acknowledged that the creditor showed that the sale order could adversely affect it economically.[146] But in order to satisfy the "person aggrieved" test, the creditor must show that the creditor would have received funds from the bankruptcy case had the bankruptcy court not entered the sale order.[147] Because a large variety of outcomes can occur in Chapter 11 bankruptcy cases, the high burden that the holding in *Fortune* imposes on a creditor for bankruptcy standing may bar a significant number of appeals.

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139. Fortune Nat. Res. Corp. v. United States DOI, 806 F.3d 363, 367 (5th Cir. 2015).
140. *Id.* at 365.
141. *Id.*
142. *Id.* at 365–66.
143. *Id.*
144. *Id.*
145. *Id.* at 366.
146. *Id.* at 367.
147. *Id.*

## V. FRAUD

### A. Whether Fraud Requires a Misrepresentation—*In re Ritz*

Under 11 U.S.C. § 523(a)(2)(A), a debt is excepted from discharge if "obtained by . . . false pretenses, a false representation, or actual fraud."[148] In the context of a perceived circuit split,[149] the U.S. Court of Appeals for the Fifth Circuit had to decide whether a representation was necessary to satisfy "actual fraud" under the Bankruptcy Code.

*In re Ritz* dealt with three important players: a lender, a corporate debtor, and an individual who owned a significant portion of common stock in the corporate debtor.[150] Prior to the lender initiating debt collection proceedings, the individual began a series of transfers that repositioned the corporate debtor's funds into various entities, all of which were controlled by the individual.[151] In light of these transfers, the lender sued in federal district court, attempting to hold the individual personally liable for the $163,999.83 debt.[152] This lawsuit was interrupted when the individual filed for voluntary Chapter 7 bankruptcy, seeking to discharge his debt with respect to the lender.[153] The lender objected, filing a complaint to except the debt from discharge under 11 U.S.C. § 523(a)(2)(A).[154] Specifically, the lender claimed that the individual had committed actual fraud with respect to the debt.[155] In determining what constituted actual fraud, both the bankruptcy court[156] and the district court, held that a *misrepresentation to obtain the debt* was required for a showing of actual fraud, and the record was devoid of such false representation.[157] Without a misrepresentation by the individual to obtain the debt, the lender's actual fraud claim was meritless.[158]

In its appeal to the Fifth Circuit, the lender relied on the Seventh Circuit decision that dealt with similar facts: *McClellan v. Cantrell*.[159] *McClellan* stood for the proposition that actual fraud was not limited to misrepresentations, but was a broad term meant to encompass other fraudulent activities.[160] This broad use of actual fraud led the Seventh

148. 11 U.S.C. § 523(a)(2)(A) (2012).
149. *See In re* Ritz, 787 F.3d 312, 317 n.6 (5th Cir. 2015), *rev'd and remanded*, Musky Int'l Elec. v. Ritz, 136 S. Ct. 1581 (2016); *see also* McClellan v. Cantrell, 217 F.3d 890 (7th Cir. 2010).
150. *In re Ritz*, 787 F.3d at 314.
151. *Id.*
152. *Id.*; *see also* Tex. Bus. Orgs. Code Ann. § 21.223(b) (West 2016) (noting the statute deals with limited liability exceptions and "piercing the corporate veil").
153. *In re Ritz*, 787 F.3d at 315.
154. 11 U.S.C. § 523(a)(2)(A) (2012).
155. *In re Ritz*, 787 F.3d at 315.
156. *See also id.* (The bankruptcy court also held that the lender could not pierce the corporate veil on a theory of "actual fraud" under Texas Business Organizations Code § 21.223(b) because no misrepresentation occurred).
157. *Id.* at 315–16 (emphasis added) (noting that the subsequent transfer of funds was not connected to obtaining the debt).
158. *See id.*
159. *Id.* at 316.
160. *See id.* at 317; *see* McClellan v. Cantrell, 217 F.3d 890, 893 (7th Cir. 2010).

Circuit, in a split decision, to hold that fraudulent conveyances intended to hinder the creditor constituted "actual fraud" under § 523(a)(2)(A), and thus non-dischargeable debt.[161]

Relying upon Fifth Circuit and U.S. Supreme Court precedent, as well as Bankruptcy Code provisions and underlying policy, the Fifth Circuit dismantled the lender's argument.[162] First, noting that "no subsequent appellate court ha[d] adopted the interpretation of § 523(a)(2)(A) endorsed by the *McClellan* majority," the Fifth Circuit adopted the definition of actual fraud as interpreted by the Supreme Court in *Field v. Mans*.[163] Looking to the 1978 common law meaning of actual fraud, the Restatement (Second) of Torts § 537, and Prosser's Law of Torts, the Supreme Court in *Field* declared that actual fraud required justifiable reliance, and thus assumed throughout its opinion that a false representation was a necessary prerequisite to a finding of actual fraud.[164] Moreover, nowhere in *Field* did the Supreme Court state that actual fraud carried a different meaning depending on the fraud committed.[165] Instead, a proper interpretation of the case implied a uniform definition of actual fraud under the 1978 common law meaning of the term—a common law meaning that did not encompass fraudulent transfers.[166]

Besides disagreeing with *McClellan*'s interpretation of Supreme Court precedent, the Fifth Circuit found *McClellan* at odds with its own precedent, in which it had affirmatively stated (on multiple occasions) that representations were a required element for non-dischargeability under an actual fraud theory.[167] The Fifth Circuit pointed out that *McClellan*'s broad construction of actual fraud rendered other exceptions to discharge redundant, and further noted that an actual fraudulent transfer was an exception to discharge under 11 U.S.C. § 727 (a)(2)(A).[168] The Fifth Circuit also pointed to prevalent Bankruptcy Code policy that aimed to grant debtors a fresh start, emphasizing that exceptions to discharge should be construed in favor of debtors to relieve them from preexisting financial burdens and entitle them to a fresh start.[169] In sum, the Fifth Circuit held that a representation was a necessary prerequisite to a finding of actual fraud, and without any showing of one in the record, the debt was not excepted from discharge under § 523(a)(2)(A).[170]

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161. *McClellan*, 217 F.3d at 894–95; *see* 11 U.S.C. § 523(a)(2)(A) (2012).

162. *See In re Ritz*, 787 F.3d at 318–20.

163. *See id.* at 317.

164. *See* Field v. Mans, 516 U.S. 59, 68–71 (1995).

165. *See In re Ritz*, 787 F.3d at 318; *see also Field*, 516 U.S. at 70.

166. *In re Ritz*, 787 F.3d at 318.

167. *Id.* at 319; *see* RecoverEdge L.P. v. Pentecost, 44 F.3d 1284, 1293 (5th Cir. 1995); Gen. Elec. Capital Corp. v. Acosta (*In re* Acosta), 406 F.3d 367, 372 (5th Cir. 2005).

168. *In re Ritz*, 787 F.3d at 320; *see* 11 U.S.C. § 727 (a)(2)(A) (2012) ("The court shall grant the debtor a discharge, unless . . . the debtor, with intent to hinder, delay, or defraud a creditor . . . has transferred . . . property of the debtor.").

169. *In re Ritz*, 787 F.3d. at 321; *see* Fezler v. Davis (*In re* Davis), 194 F.3d 570, 573 (5th Cir. 1999).

170. *In re Ritz*, 787 F.3d at 321.

In between the time of this Survey's initial drafting and its publication, the U.S. Supreme Court decided the actual fraud circuit split after granting certiorari in *Husky International Electronics, Inc. v. Ritz*.[171] In a 7-1 decision, the Supreme Court adopted the Seventh Circuit's view and held that, for purposes of § 523(a)(2)(A), the phrase actual fraud did not necessarily require a false representation.[172] Instead, the Court held that actual fraud included *any* fraudulent conduct with intent to defraud.[173] In reaching this conclusion, the Court relied heavily on the history of common law fraud.[174] Additionally, the Court noted that Congress specifically amended § 523(a)(2)(A) to *add* the phrase "actual fraud"—so it was unlikely that Congress intended to contribute no additional meaning to the statute that already included false pretenses and false representations.[175]

The sole dissenter, Justice Clarence Thomas, asserted that the majority's ruling read the requirement that the debt be "obtained by" actual fraud out of the statute.[176] The majority opinion sidestepped this issue by asserting that "the recipient of the transfer . . . with the requisite intent . . . can 'obtai[n]' assets 'by' his or her participation in the fraud."[177] In response, the dissent noted that the Bankruptcy Court had "found that there was no evidence that [the transferor] transferred the funds to avoid" paying his debts—implying a lack of fraudulent intent.[178]

## VI. ESTOPPEL

### A. Limitations on a Court's Equitable Power to Deny Exemptions—*Law v. Siegel*

*Law v. Siegel*[179] was an important U.S. Supreme Court bankruptcy case, but was understated at the time—so understated, in fact, that it failed to make the cut for inclusion in the last bankruptcy survey. Over the past couple of years *Siegel* has emerged from the shadows to raise questions about the extent of a bankruptcy court's equitable powers to estop a debtor's use, or arguably abuse, of exemptions in bankruptcy. Bankruptcy courts, accustomed to broad equitable powers, have increasingly grappled with the opinion, and have interpreted it to pose serious limitations on their ability to do equity. In *Siegel*, the Chapter 7 debtor claimed a $75,000 California state exemption in his homestead, worth approximately $363,348, as provided by § 522(b)(3)(A) of the Bankruptcy Code. The debtor also claimed that two voluntary liens encumbered the homestead and that the value of these liens exceeded the non-exempt

171. 136 S. Ct. 1581 (2016).
172. *Id.* at 1586.
173. *Id.*
174. *Id.* at 1586–88.
175. *Id.* at 1586.
176. *Id.* at 1590–91 (Thomas, J., dissenting)).
177. *Id.* at 1589 (Sotomayor, J., majority decision).
178. *Id.* at 1592 (Thomas, J., dissenting).
179. 134 S. Ct. 1188 (2014).

value of the house.[180] The Chapter 7 trustee was unconvinced and proved through litigation that one of these liens was a sham, fraudulently created by the debtor to preserve the equity in his home.[181] Presumably, the debtor would have been able to retain his house had the liens both been valid because no unencumbered value would exist in the house for distribution to unsecured creditors upon sale. Because the trustee was successful in invalidating the lien, equity existed and the homestead was sold. In this process, the trustee incurred more than $500,000 in attorneys' fees over a period of five years, seeking to invalidate the fraudulent lien, defending against numerous appeals and overcoming objections by the debtor.[182] As a result of the debtor's misconduct, the bankruptcy court granted the trustee's request to surcharge the debtor's $75,000 homestead exemption to defray the attorneys' fees.[183]

On appeal by the debtor, the Ninth Circuit Bankruptcy Appellate Panel (B.A.P.) affirmed the bankruptcy court's approval of the surcharge, holding that Ninth Circuit precedent permitted an equitable surcharge of a statutory exemption under exceptional circumstances, such as a debtor's "inequitable or fraudulent conduct."[184] The majority noted that the Tenth Circuit disagreed with this precedent, but rejected its criticism.[185] Notably, Judge Markell filed a concurring opinion in which he acknowledged being bound by the Ninth Circuit precedent, but questioned whether it remained good law.[186]

The Supreme Court reversed the Ninth Circuit B.A.P. After writing a brief primer on Chapter 7 bankruptcy, Justice Scalia, for the majority, commented upon a bankruptcy court's equitable and inherent powers.[187] Justice Scalia acknowledged a bankruptcy court's broad powers under § 105(a) to "issue any order, process, or judgment that is necessary or appropriate to carry out the provisions" of the Bankruptcy Code, and inherent power to sanction abusive litigation matters.[188] The majority opinion continued, however, with a qualification—the exercise of these powers could not "contravene specific statutory provisions."[189] This limitation was the crux of the Supreme Court's ruling. The Supreme Court determined that the homestead surcharge contravened the exemption provisions found in § 522 of the Bankruptcy Code.[190] Section 522(b)(3)(A) permitted the debtor to claim the $75,000 homestead exemption under California law.[191] "Except in particular situations speci-

180. *Id.* at 1190.
181. *Id.* at 1193.
182. *Id.*
183. *Id.*
184. *Id.* at 1194 (citing Latman v. Burdette, 366 F.3d 774 (9th Cir. 2004)).
185. *Id.*
186. *Id.*
187. *Id.* at 1192.
188. *Id.* at 1194 (citing Marrama v. Citizens Bank of Mass., 549 U.S. 365, 375–76 (2007)); 11 U.S.C. § 105(a) (2012).
189. *Siegel*, 134 S. Ct. at 1194.
190. *Id.*
191. *Id.* at 1195 (citing 11 U.S.C. § 522(b)(3)(A)).

fied in the Code" not applicable in the case, the Supreme Court stated, this claimed exemption "'[wa]s not liable' for the payment of 'any [prepetition] debt' or 'any administrative expense.'"[192]

In holding that the surcharge contravened § 522, the Supreme Court gave little attention to the trustee's argument that the surcharge qualified as an "administrative expense" under § 503(b) for purposes of reimbursement, but not as an administrative expense for purposes of § 522(k)'s prohibition.[193] The Supreme Court determined that the trustee's interpretation did not comport with the general rule of statutory construction that words appearing in different sections of a statute be given the same meaning.[194] Similarly, the Supreme Court disagreed with the trustee and United States' amicus curie's argument that § 522 did not grant a debtor an absolute right to retain an exemption regardless of all circumstances.[195] The Supreme Court rejected the characterization of the surcharge as denial of an exemption because the trustee had failed to object and seek denial in the case.[196] Even if the Supreme Court did agree with this characterization, Justice Scalia wrote, if the debtor claimed an exemption under § 522, "the court [could] not refuse to honor the exemption absent a valid statutory basis for doing so."[197] Where a debtor elected state exemptions, a bankruptcy court could rely upon state law to surcharge or otherwise deny the exempt property.[198] Absent a state-created exception, federal law did not allow a bankruptcy court to deny or surcharge an exemption unless specified by the Bankruptcy Code.[199]

### B. DENYING EXEMPTION AMENDMENTS AFTER *LAW V. SIEGEL*—*IN RE SALDANA*

The ruling in *Law v. Siegel* has gained notoriety, or fame, depending on one's perspective, as numerous courts have begun to interpret its holding to impose a severe limitation upon a bankruptcy court's equitable powers with regards to not only exemptions, but also re-characterizations of debt to equity.[200] Some critics now argue that these bankruptcy courts have interpreted *Siegel* too broadly.[201] In the Fifth Circuit, the issue arose in the case of *In re Saldana*, which has been appealed to the U.S. District

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192. *Id.* at 1192 (citing 11 U.S.C. § 522(c)).
193. *Id.* at 1195 (citing 11 U.S.C. § 522(k)).
194. *Id.*
195. *Id.*
196. *Id.* at 1196.
197. *Id.*
198. *Id.* at 1196–97.
199. *Id.* at 1197.
200. *See, e.g.*, *In re* Alternate Fuels, Inc., 789 F.3d 1139, 1146 (10th Cir. 2015); *In re* Westry, 591 F. App'x 429, 432 (6th Cir. 2014); *In re* Gray, 523 B.R. 170, 173–74 (B.A.P. 9th Cir. 2014); *In re* Saldana, 531 B.R. 141, 146 (Bankr. N.D. Tex. 2015); *In re* Baker, 514 B.R. 860, 863 (E.D. Mich. 2014); *In re* Arellano, 517 B.R. 228, 231–32 (Bankr. S.D. Cal. 2014).
201. *See, e.g.*, Neil C. Gordon & Jonathan C. Azoff, *Law v. Siegel Dicta Leads Lower Courts Astray*, 34 AM. BANKR. INST. J. 34, 78 (2015).

Court for Northern District of Texas for determination.[202] In *In re Saldana*, the debtor belatedly sought to amend his homestead exemption, more than an hour into a hearing on the trustee and largest creditors' objection to his original homestead claim (the Objection Hearing).[203] The debtor's attorney, in fact, expressed this intent to amend the homestead exemption midway through the debtor's direct testimony on the witness stand. The U.S. Bankruptcy Court for the Northern District of Texas issued a show cause order that (i) granted the trustee's objections as to certain parcels; (ii) continued the hearing on the trustee's objection to homestead exemption; and (iii) ordered the debtor to amend his homestead exemption claim.[204] If the debtor elected to file an amended homestead exemption, he was ordered to (i) show cause as to whether bad faith or other estoppel arguments precluded such amendment; (ii) explain why this intent to amend was not raised at the beginning of the Objection Hearing; and (iii) explain why the debtor should not have to pay the fees and costs of the trustee, his attorney, and the objecting creditor's attorney related to the Objection Hearing.[205] After the debtor filed an amended homestead exemption and a hearing was held on all objections and show cause issues, the bankruptcy court issued its findings of facts and conclusions of law.[206]

Although ruling on the surcharge of exempt property, the bankruptcy court determined that *Siegel* "implicitly overruled prior case law . . . that enabled a bankruptcy court to deny an amendment to the debtor's homestead exemption based on bad faith or prejudice to creditors."[207] Nevertheless, the bankruptcy court still had authority to address the debtor's behavior. Relying upon *Siegel*'s dicta that its decision did not "denude bankruptcy courts of the essential 'authority to respond to debtor misconduct with meaningful sanctions,'" the bankruptcy court exercised its inherent power to sanction bad faith conduct, which it found coterminous with its authority under § 105(a).[208] The debtor's conduct, the bankruptcy court found, satisfied the Fifth Circuit's requirement that a court find a party's conduct "in the course of litigation" to be "callous and recalcitrant, arbitrary, and capricious, or willful, callous, and persistent" before shifting fees.[209] Based on this finding, the bankruptcy court found the debtor and his attorney jointly and severally liable for reimbursement of $5,109.50 in attorneys' fees and costs to the largest creditor and $25,245.00 in attorneys' fees and costs to the trustee.[210]

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202. *In re* Saldana, 531 B.R. 141 (Bankr. N.D. Tex. 2015), *aff'd in part, remanded in part*, 534 B.R. 678 (N.D. Tex. 2015).
203. *Id.* at 151–52.
204. *Id.* at 153.
205. *Id.* at 153–54.
206. *Id.* at 154–55.
207. *Id.* at 161.
208. *Id.* at 163 (citing Law v. Siegel, 134 S. Ct. 1188, 1998 (2015)).
209. *Id.* at 166–67 (referencing Rogers v. Air Line Pilots Assoc., Int'l, 988 F.2d 607, 615–16 (5th Cir. 1993)).
210. *Id.* at 168–69.

The debtor and his attorney appealed the bankruptcy court's finding of bad faith and sanctions.[211] The issues on appeal, specific to an interpretation of *Siegel*, include whether the bankruptcy court applied the wrong standard or failed to satisfy the proper standard for a finding of bad faith and imposition of sanctions.[212] The debtor and his attorney also appealed on the grounds that the debtor's attorney and the debtor were given insufficient due process regarding the sanctions, and that the bankruptcy court erroneously imposed the sanctions based upon First Amendment rights and valid, good faith assertions of privilege.[213]

The procedural due process issue may have more traction with regards to the debtor's attorney, who was not expressly ordered to show cause after the Objection Hearing. If the debtor's attorney alone prevails on this argument, the sanctions against the debtor may still stand. From a precedent point of view, the interesting question will be if and how the district court and, perhaps the circuit court thereafter interprets *Siegel*'s dicta regarding a bankruptcy court's inherent and § 105(a) powers to sanction in the context of exemptions. Any higher court that affirms will need to reconcile *Siegel* with the sanctions, whereas a reversal could occur without any *Siegel* discussion.

### C. Judicial Estoppel—*Allen v. C&H Distribs., L.L.C.* and *United States ex. rel. Long v. GSDMIdea City, L.L.C.*

*Allen v. C&H Distribs., L.L.C.* reflected an application of judicial estoppel that was much more familiar in the Fifth Circuit than the scot-free outcome of cases flowing from *Law v. Siegel*.[214] In *Allen*, the U.S. Court of Appeals for the Fifth Circuit affirmed the district court's determination that joint debtors, husband and wife, were judicially estopped from pursuing a personal injury claim on behalf of the wife.[215] The wife was allegedly injured from the collapse of a stool on which the wife had been sitting. The alleged personal injury occurred one month after the joint debtors confirmed their first Chapter 13 plan. The debtors subsequently amended their plan three times, but never disclosed the personal injury claim in their bankruptcy, despite the fact that they filed a state court lawsuit pursuing the personal injury claim just over one year after the first plan's confirmation. The bankruptcy case closed, but the debtors did not receive a discharge because they failed to complete their financial management courses.[216] Despite the debtor's failure to disclose the bankruptcy in discovery, the defendants in the state court lawsuit learned

211. Notice of Transmittal at 8, Saldana v. Saldana, No. 3:15-cv-1918-L (N.D. Tex. Jun. 6, 2015), ECF No. 1.
212. Appellant's Brief at 4–5, Saldana v. Saldana, No. 3:15-cv-1918-L (N.D. Tex. Jun. 6, 2015), ECF No. 6.
213. *Id.*
214. Allen v. C&H Distribs., L.L.C., 813 F.3d 566 (5th Cir. 2015).
215. *Id.* at 570.
216. *Id.*

about the non-disclosure in bankruptcy and moved for summary judgment based on judicial estoppel.

On appeal, the Fifth Circuit applied a de novo standard of review to the district court's grant of summary judgment, but it notably applied an abuse of discretion standard to the judicial estoppel determination because it was an equitable doctrine.[217] The Fifth Circuit analyzed the three elements necessary for judicial estoppel: (i) An inconsistent legal position; (ii) judicial acceptance; and (iii) the lack of inadvertence.[218] First, in assessing the inconsistent legal position, the Fifth Circuit emphasized its prior recognition that a debtor had a "continuing obligation to disclose post-petition causes of action."[219] Second, the Fifth Circuit found judicial acceptance, despite the debtors' failure to receive a discharge, because the bankruptcy court had accepted that no personal injury claim existed when it confirmed the debtors' Chapter 13 plan.[220] Third, the debtors satisfied the test for lack of inadvertence because they had a financial motive to conceal the personal injury claim.[221] Under this rationale, the Fifth Circuit rejected the debtors' argument that they lacked motive because they erroneously thought the cause of action was not a property of the estate and therefore, not required to be disclosed.[222]

An interesting aspect of the Fifth Circuit's holding in *Allen* was its consideration of an equitable *gloss* over the ruling—whether applying judicial estoppel led to an inequitable result.[223] Here, an inequity would result if the case were reopened, because a new lawsuit by the trustee would be time-barred.[224] The Fifth Circuit considered this argument, in light of *Reed v. City of Arlington*, and modified the holding of the lower courts in a manner that, perhaps, gives *Allen* its greatest significance.[225] Whereas the district court had noted that the trustee could seek to reopen the case and pursue the cause of action, the Fifth Circuit, acknowledging that the statute of limitations would have also run against the trustee, provided that a trustee could substitute in for the debtors and "pursue the claim within a reasonable time."[226] Perhaps this finale preserves the claim for the benefit of the bankruptcy estate and creditors.

The Fifth Circuit reached a similar conclusion in a case with similar facts, *United States ex. rel. Long v. GSDMIdea City, L.L.C.*[227] In *Long*, a Chapter 13 debtor failed to disclose his *qui tam* actions based on viola-

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217. *Id.* at 571–72.
218. *Id.* at 572–74.
219. *Id.* at 572 (quoting Flugence v. Axis Surplus Ins. Co. (*In re* Flugence), 738 F.3d 126, 129 (5th Cir. 2013)).
220. *Id.* at 572–73.
221. *Id.* at 573–74.
222. *Id.* at 574.
223. *Id.* at 574–75.
224. *Id.* at 575–76.
225. *Id.* at 576.
226. *Id.* at 575–76.
227. 798 F.3d 265 (5th Cir. 2015).

tions of the False Claims Act.[228] Defendant learned of the bankruptcy and obtained dismissal of the cause of action under a theory of judicial estoppel.[229] Here, the issue of inequity was not compelling, because the district court provided the bankruptcy trustee an opportunity to continue pursuing the *qui tam* claims.[230] The trustee, however, declined. The debtor argued that he inadvertently failed to disclose, because he had not understood that the cause of action needed to be disclosed as he was paying his creditors in full under his Chapter 13 plan.[231] The Fifth Circuit rejected the debtor's argument, just as it had done in *Allen*.[232] Because the debtor had a large financial incentive to conceal the *qui tam* cause of action, the Fifth Circuit upheld the district court's finding that the non-disclosure was not inadvertent and that judicial estoppel applied.[233]

## VII. NON-CONSENSUAL THIRD-PARTY RELEASES AND EXCULPATIONS

### A. Seeking a Standard, If Any, For Confirmation of Non-Consensual, Third-Party Releases in Chapter 11 Plans—*In re Millennium Lab Holdings II, LLC*

The issue of exculpatory provisions and non-consensual third-party releases of non-debtors in Chapter 11 bankruptcy restructure agreements has recently triggered a wide-spread debate amongst the circuits.[234] The widely disputed non-consensual third-party releases are widely disputed and circuit divisions demonstrate the need for an objective, uniform standard.[235] The non-consensual third-party releases provide a shield against liability for those included in the provision. But, because the Bankruptcy Code does not explicitly address the enforceability of these provisions, bankruptcy courts must rely on vacillating case law to determine whether to permit and enforce these provisions.[236]

Typically, a Chapter 11 reorganization plan will include an exculpatory clause that releases specified non-debtor third parties from future liabilities concerning the debtor.[237] These third parties often include the debtor's personnel or affiliates.[238] Circuits are divided whether the provi-

228. *Id.* at 269.
229. *Id.* at 270.
230. *Id.*
231. *Id.* at 272–74.
232. *Id.* at 273–74.
233. *Id.*
234. *See In re* Airadigm Commc'n, 519 F.3d 640, 656 (7th Cir. 2008); *In re* Lowenschuss, 170 F.3d 923, 932 (9th Cir. 1999); *In re* Zenith Elec. Corp., 341 B.R. 92, 110 (Bankr. D. Del. 1999).
235. *See In re* Airadigm Commc'n, 519 F.3d at 656; *In re Lowenschuss*, 170 F.3d at 932; *In re Zenith Elec. Corp.*, 341 B.R. at 110.
236. Jonathan P. Friedland et al., Commercial Bankruptcy Litigation § 10:22 Releases (2d ed. 2016).
237. *Id.*
238. *Id.*

sions are permitted under the Bankruptcy Code.[239] Arguments clash whether these provisions are productive for the parties involved.[240] Arguments for these provisions recognize that the releases provide a necessary protection for third parties.[241] In contrast, arguments against the provisions recognize the high probability that parties will abuse these provisions and take advantage of the liability shield.[242] A uniform standard has yet to be achieved.

Recently, a bankruptcy case in the Third Circuit—*In re Millennium Lab Holdings II, LLC*—has brought the spotlight on the issue of nonconsensual third-party release.[243] There, the U.S. Bankruptcy Court for the District of Delaware confirmed a Chapter 11 restructuring plan that included one of the broadest and most all-encompassing nonconsensual third-party releases.[244] The ruling in *In re Millennium* arguably contradicted bankruptcy precedent set in the Third Circuit[245] and seemingly adopted the most permissive standard of non-consensual third-party releases in the history of bankruptcy courts.[246]

In *In re Millennium*, the bankruptcy court addressed and refuted the Opt-Out Lenders' contention regarding the confirmation of the exculpatory release.[247] In response to the Opt-Out Lenders' argument that "resolution of this [i]ssue requires the resolution of conflicting decisions in this circuit and across circuits" and that the acceptance of the release conflicted with precedent, the bankruptcy court declared that the Opt-Out Lenders misinterpreted the cases they cited.[248] Contrary to the Opt-Out Lenders' interpretation that "nonconsensual third party releases are impermissible," the precedent recognized that "consensual releases are permitted."[249] The bankruptcy court concluded that it acted fully within its authority when it confirmed the plan and its third-party releases.[250]

In filing an appeal and stay pending appeal, the Opt-Out Lenders reiterated that confirmation of the non-consensual third-party releases was not within the bankruptcy court's authority because "the Third Circuit has never ruled that non-consensual third-party releases are permissible

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239. *Id.*
240. *Id.*
241. *In re* Congoleum Corp., 362 B.R. 167, 194 (Bankr. D.N.J. 2007); *In re* Johns-Manville Corp., 517 F.3d 52 (2d Cir. 2008), *rev'd and remanded sub nom.*, Travelers Indem. Co. v. Bailey, 557 U.S. 137 (2009); *In re* Metromedia Fiber Network, Inc., 416 F.3d 136, 142 (2d Cir. 2005).
242. *See id.*
243. *See generally In re* Millennium Lab Holdings II, LLC, 543 B.R. 703 (Bankr. D. Del. Jan. 12, 2016).
244. *Id.* at 707.
245. *See In re* Cont'l Airlines, 203 F.3d 203, 211 (3d Cir. 2000) (ruling that the restructure plan's third-party release was unenforceable because the "Bankruptcy Code does not explicitly authorize the release and permanent injunction of claims against non-debtors, except in one stance not applicable here.").
246. *See generally In re Millennium*, 543 B.R. at 713.
247. *Id.* at 713–14.
248. *Id.*
249. *Id.* at 714.
250. *Id.* at 716.

or established a standard for approving them" and that "the Non-Consensual Third-Party Release here far exceeds the outer bounds of [the most permissive] standard."[251] Because of the inconsistency within the Third Circuit itself and the obscure and erratic standards set forth in other circuits, Judge Silverstein entered an order "certifying the appeal [of this case] to the United States court of Appeals for the Third Circuit" on January, 12, 2016.[252] The Third Circuit, however, rejected certification and appeal is currently pending in district court.

The Third Circuit's *In re Millenium* decision is significant to the Fifth Circuit because *exculpatory* provisions in Chapter 11 bankruptcy restructure plans is a live issue in the Fifth Circuit and is an area where the U.S. Supreme Court is not unlikely to grant certiorari in the future. The Fifth Circuit is one of the most conservative courts to rule on this issue, showing a preference for voiding these provisions.[253] However, much like the other circuits, the Fifth Circuit has yet to come up with a uniform or clear standard. Instead, the lower courts within the Fifth Circuit have avoided the issue or used varied approaches, further emphasizing the need for clarity and uniformity in this area of law.[254]

Since its seminal 2009 case, *In re Pacific Lumber*, the Fifth Circuit's standard leaned toward voiding non-debtor, third-party releases and exculpations.[255] Recently, however, in *In re Houston Regional Sports Network*, the U.S. Bankruptcy Court for the Southern District of Texas approved a reorganization plan with exculpation provisions and releases of several of the debtors' affiliates.[256] In alignment with the other circuits, courts in the Fifth Circuit remain inconsistent with their approach to exculpatory provisions and releases, thus magnifying the relevance of this pending Third Circuit case.[257] Perhaps on appeal, the Third Circuit will create an objective standard that will guide the Fifth Circuit and other courts in their search for a consistent approach to nonconsensual third-party releases.

251. Motion of the Opt-Out Lenders for Stay Pending Appeal of Order Confirming Amended Prepackaged Joint Plan of Reorganization of Millennium Lab Holdings II, LLC, et al. at 4, *In re* Millennium Lab Holdings II, LLC, 543 B.R. 703 (Bankr. D. Del. 2016) (No. 15-12284).

252. *In re Millennium*, 543 B.R. at 717.

253. *See In re* Pac. Lumber, 584 F.3d 229, 253 (5th Cir. 2009).

254. *Id.* at 253; *In re* Patriot Place, 486 B.R. 773, 825–27 (Bankr. W.D. Tex. 2013); *In re* Tex. Rangers Baseball Partners, No. 10–43400 (DML), 2010 WL 4106713, at *11 (Bankr. N.D. Tex. 2010).

255. *In re Pac. Lumber*, 584 F.3d at 253.

256. *See* Third Amended Ch. 11 Plan of Reorganization at 27, *In re* Hous. Reg'l Sports Network, L.P., 514 B.R. 211 (Bank'r. S.D. Tex. 2014); Order Confirming Plan at 1, *In re* Hous. Reg'l Sports Network, L.P., 514 B.R. 211 (Bankr. S.D. Tex. 2014) (No. 13 – 35998).

257. *In re Millennium*, 543 B.R. at 717.

## VIII. LIEN STRIPPING

### A. Stripping Wholly Unsecured Liens in Chapter 7—*Bank of America v. Caulkett*

Through *Bank of America v. Caulkett*, the U.S. Supreme Court strengthened longstanding principles established in the after-criticized case, *Dewsnup v. Timm*,[258] and provided bad news for underwater homeowners. The Supreme Court addressed whether a Chapter 7 debtor could void a junior lien on his property, if the fair market value of the property was less than the amount owed on a senior lien.[259] The Supreme Court set forth to resolve two consolidated cases involving lien stripping: *Bank of America, N.A. v. Caulkett* and *Bank of America, N.A. v. Toledo-Cardona*.[260] In both cases, the debtor owed two mortgages on his home, against which Bank of America held the junior lien. The mortgages held by Bank of America were completely underwater, as the value of senior liens on each house was greater than the present fair market value of the homes.[261] In both proceedings, the debtors moved to strip the junior liens under 11 U.S.C. § 506(d), which provides: "To the extent that a lien secures a claim against the debtor that is not an allowed secured claim, such lien is void."[262] The bankruptcy court and district court both granted the motions under § 506(d).[263] The Eleventh Circuit affirmed, stating that the court was "bound by Circuit precedent holding that § 506(d) allowed debtors to void a wholly underwater mortgage lien."[264] Bank of America appealed and the Supreme Court accepted the case.

In a unanimous opinion, the Supreme Court held to *Dewsnup*, which precluded the Eleventh Circuit's interpretation of § 506.[265] In *Dewsnup*, the Supreme Court had concluded that if a claim "has been 'allowed' pursuant to § 502 of the [Bankruptcy] Code and is secured by a lien with recourse to the underlying collateral, it does not come within the scope of § 506(d)."[266] The Supreme Court defined "secured claim" under § 506(d) as "a claim supported by a security interest in property, regardless of whether the value of that property would be sufficient to cover the claim."[267] Thus, under the *Dewsnup* interpretation of § 506(d), this section voids "a lien whenever a claim secured by the lien itself has not been allowed."[268] But in *Caulkett*, the Supreme Court did not reject Bank of America's claims.[269] Instead, the Supreme Court ruled that the junior liens were secured claims, and therefore the liens securing them were

258. 502 U.S. 410 (1992).
259. Bank of Am. v. Caulkett, 135 S. Ct. 1995, 1998 (2015).
260. *Id.*
261. *Id.* at 1995–96.
262. 11 U.S.C. § 506(d) (2012).
263. *Caulkett*, 135 S. Ct. at 1998.
264. *Id.*
265. *Id.* at 2000–01.
266. *Dewsnup*, 502 U.S. at 415.
267. *Caulkett*, 135 S. Ct. at 1999; *see also Dewsnup*, 502 U.S. at 417.
268. *Dewsnup*, 502 U.S. at 416.
269. *See Caulkett*, 135 S. Ct. at 1999.

non-voidable.[270]

The question remaining after *Bank of America v. Caulkett* is whether the decision precludes any opportunity to challenge the often-criticized *Dewsnup* ruling.[271] The debtors in *Caulkett* did not ask the court to overrule *Dewsnup*, so the Supreme Court applied its own precedent.[272] Yet, had it been asked, the Supreme Court seemed willing to overrule *Dewsnup*, noting how controversial the ruling had become.[273] *Caulkett*'s holding, however, virtually *forecloses* any possible set of facts for the Supreme Court to re-consider *Dewsnup*.[274]

## IX. HOMESTEAD[275]

### A. Non-Debtor Spouse Homestead Interest—*In re Odes Ho Kim*

In *In re Odes Ho Kim*, the U.S. Court of Appeals for the Fifth Circuit considered the issue of a non-debtor spouse's separate homestead interest and determined that (i) the bankruptcy court had the authority to order a sale of the debtor's residence pursuant to 11 U.S.C. § 363 generally, despite the non-debtor spouse's homestead interests; and (ii) the non-debtor spouse failed to show that a constitutional taking would occur unless she received compensation for her homestead interests in excess of the capped exemption under 11 U.S.C. § 522(p).[276]

The case involved a creditor that obtained a judgment against the debtor in California for more than $5,000,000.00.[277] This creditor then commenced an involuntary bankruptcy against the debtor in Texas, where he and his spouse had purchased a homestead less than 1,215 days prior. After conversion to Chapter 11, the debtor claimed the homestead as exempt. The creditor objected to the exemption to the extent that it was limited by § 522(p) and tried to force the sale of the homestead to satisfy its judgment. As a result, the debtor filed an adversary proceeding to determine the bankruptcy estate and his spouse's interest in the homestead.[278] In that adversary proceeding, the bankruptcy court determined that the spouse had no separate, vested interest that would prevent a forced sale of the homestead or require compensation to the spouse from the sale proceeds, aside from her interest in the capped homestead exemption under § 522(p).[279] The district court and the Fifth Circuit af-

270. *Id.*
271. *See id.*
272. *See id.* at 1999–20.
273. *See id.* at 2001.
274. *See id.*
275. The two Fifth Circuit cases that follow were not covered by the prior survey, although decided in 2014. The authors thought that they were worthy of mention as a substantial amount of litigation has occurred in their wake.
276. Odes Ho Kim v. Dome Entm't Ctr., Inc. (*In re* Odes Ho Kim), 748 F.3d 647, 656, 663 (5th Cir. 2014).
277. *Id.* at 650.
278. *Id.*
279. *Id.* at 651.

firmed, although the Fifth Circuit distinguished its opinion by holding that the spouse did hold a separate, vested property interest in the homestead apart from the debtor.[280]

Precedent from both the U.S. Supreme Court and Texas Supreme Court supported the Fifth Circuit's holding that a sale of the residence could be forced.[281] The Fifth Circuit looked to *United States v. Rodgers* for the proposition that a forced sale could occur where federal law expressly permitted it, despite a third party's interests in the property.[282] There, the tax code's authorization of a forced sale of a debtor's homestead trumped any non-debtor's homestead rights in preventing sale because the tax law was "the exercise of a sovereign prerogative" grounded in the U.S. Constitution.[283] The Bankruptcy Code similarly contained express authority to sell property of the estate and, similar to *Rodgers*, this authority trumped a non-debtor's homestead rights.[284] The Fifth Circuit recounted that the Texas Supreme Court recognized this conclusion in *Benchmark Bank v. Crowder*, where it held that the Supremacy Clause allowed the IRS to enforce a federal tax lien against a Texas homestead, although not permitted by the Texas Constitution.[285]

The Fifth Circuit next considered whether the spouse was entitled under the Takings Clause to compensation for loss of her homestead interest in excess of the capped exemption of § 522(p).[286] This question, the Fifth Circuit noted, would only arise where a debtor purchased his house prior to BAPCPA because a taking could not occur where a property interest came into existence after the enactment of a law subjecting it to creditors' reach.[287] Here, however, the debtor and his spouse purchased the Residence before Congress enacted § 522(p).[288]

The most remarkable point, and a cause of possible confusion in the Fifth Circuit's opinion, was its holding that the homestead interest of the debtor's spouse had "some value . . . separate and apart from an ownership interest in the real property on which homestead rights [we]re impressed."[289] Yet, the Fifth Circuit refused to subscribe a value or formula to this interest.[290] Instead, the Fifth Circuit placed the burden upon the spouse to show that she was not adequately compensated by the capped exemption afforded to her and the debtor under § 522(p).[291] This ambiguity left open a door for non-debtor spouses to argue for compensation

280. *Id.* at 657.
281. *Id.* at 654–56.
282. *Id.* at 654–55 (citing United States v. Rodgers, 461 U.S. 677, 697 (1983)).
283. *Id.* at 654 (citing *Rodgers*, 461 U.S. at 687).
284. *Id.* at 654–55.
285. *Id.* at 655–56 (citing Benchmark Bank v. Crowder, 919 S.W. 2d 657, 659–60 (Tex. 1996)).
286. *Id.* at 656–63.
287. *Id.* at 657.
288. *Id.*
289. *Id.* at 661.
290. *Id.* at 663.
291. *Id.*

for loss of some homestead interest due to BAPCPA provisions but left bankruptcy courts with little guidance as to the method for valuation.

### B. Constitutional Takings and Homesteads after BAPCPA—*In re Thaw*

After its ruling in *In re Odes Ho Kim*, the U.S. Court of Appeals for the Fifth Circuit decided the case of *In re Thaw* on similar facts and solidified its position that a constitutional taking of a property interest could not occur where a statute subjecting that interest to creditor liability was created prior to the property interest.[292] This meant that the debtor and his non-debtor spouse, who had acquired their homestead after the passage of § 522(p) that limited their homestead exemption in bankruptcy, could not prevail on a constitutional takings claim.[293] The Fifth Circuit referenced its reasoning in *In re Odes Ho Kim*, which was dicta because that case involved a homestead purchased pre-BAPCPA, and noted that the *Kim* opinion had issued only after the parties in *Thaw* had appealed.[294] The factual distinction between *Kim* and *Thaw* turned the Fifth Circuit's discussion in *Kim* from dicta into precedent, and therefore, significantly limited takings clause arguments by non-debtor spouses to that time period prior to 2005.[295]

### C. Homestead Exemptions and the Texas Proceeds Rule in Chapter 7—*In re Smith*; *In re D'Avila*; *In re DeBerry*

In *In re Smith*, the U.S. Bankruptcy Court for the Southern District of Texas considered whether a Chapter 7 trustee could seize and distribute proceeds from a debtor's homestead sale where the proceeds had lost their exempt status under Texas law after the debtor received his discharge.[296] Under Texas law, the proceeds of a homestead sale maintained their exempt status if reinvested in another homestead within six months of closing (the Texas Proceeds Rule).[297] The debtor in this case failed to reinvest within the timeframe required under the Texas Proceeds Rule.[298] Applying Fifth Circuit precedent in *In re Frost* on the issue in the context of a Chapter 13 bankruptcy case, the bankruptcy court permitted the trustee's collection of the proceeds.[299] Despite the distinction that the Chapter 7 case did not include post-petition property in the bankruptcy estate as opposed to a Chapter 13 case, the bankruptcy court applied *In re Frost*, relying upon the "snapshot rule."[300] According to the snapshot rule, initially established by the U.S. Supreme Court in *White v. Stump*, a court

292. Thaw v. Moser (*In re* Thaw), 769 F.3d 366, 367 (5th Cir. 2014).
293. *Id.* at 367–68.
294. *Id.* at 369–70.
295. *See id.*
296. Cage v. Smith (*In re* Smith), 514 B.R. 838, 840 (Bankr. S.D. Tex. 2014).
297. *Id.* at 843–44 (citing Tex. Prop. Code Ann. § 41.001 (West 2001)).
298. *Id.* at 841.
299. *Id.* at 850 (citing *In re* Frost, 744 F.3d 384 (5th Cir. 2014)).
300. *Id.* at 845–46.

should look to the exemption statute as of the day of the bankruptcy filing, as opposed to the exempt or non-exempt character of the asset on that day to determine whether the property was subject to creditor claims.[301] The bankruptcy court noted that its ruling did not permit a trustee to wait-and-see if a debtor would sell his homestead and fail to reinvest in perpetuity.[302] Instead, the bankruptcy court set the deadline as the closing date of a bankruptcy case, not the discharge date.[303]

Whether a debtor could lose or keep his home to the trustee in a Chapter 7 bankruptcy under the Texas Proceeds Rule became an increasingly hot topic during this Survey period and shows no signs of slowing down. In similar factual scenarios, bankruptcy courts across Texas have both agreed and disagreed with the holding in *Smith* and applied the snapshot rule differently. In *In re D'Avila*, the U.S. Bankruptcy Court for the Western District of Texas disagreed with *Smith*'s conclusion that the holding and reasoning in *In re Frost* applied in Chapter 7 bankruptcy cases.[304] In that case, the bankruptcy court refused to prevent a debtor from selling her homestead during bankruptcy unless the deadline for objection to exemptions was extended beyond the six months provided by the Texas Proceeds Rule.[305] Similarly, in *In re DeBerry*, the same bankruptcy court rejected the reasoning of *Smith* and agreed with *In re D'Avila*, in a case where a Chapter 7 trustee sought to avoid and recover the transfer of homestead sale proceeds that became exempt post-petition under the Texas Proceeds Rule.[306] With the disarray of opinions that have emerged within the Fifth Circuit's lower courts, it seems certain that this issue will continue to rise in significance and have a great effect upon Texas homeowners until resolved by the Fifth Circuit.

## X. CHAPTER 7

### A. Bankruptcy Without Purpose as "Cause" for Dismissal of a Chapter 7 Business Bankruptcy Case—*In re Cypress Fin. Trading Co., L.P.*

"When a bankruptcy serves no purpose, results in no benefit for its creditors or the debtor, and only delays litigation already pending against the debtor, there is 'cause' to dismiss the case."[307] This is the rule announced by the U.S. Court of Appeals for the Fifth Circuit in *In re Cypress*, a case that defined the scope of 11 U.S.C. § 707(a) in corporate

301. *Id.* (citing White v. Stump, 266 U.S. 310, 313 (1924)).

302. *Id.* at 850–51.

303. *Id.*

304. *Compare In re* D'Avila, 498 B.R. 150, 158 (Bankr. W.D. Tex. 2013), *with In re Smith*, 514 B.R. at 840.

305. *In re D'Avila*, 498 B.R. at 159.

306. *See* Lowe v. DeBerry (*In re* DeBerry), No. 14-50406, 2015 Bankr. LEXIS 3694 (Bankr. W.D. Tex. Oct. 28, 2015).

307. Trading Co., L.P. v. Cypress Fin. Trading Co. (*In re* Cypress Fin. Trading Co., L.P.), 620 F. App'x 287, 289 (5th Cir. 2015).

Chapter 7 cases.[308] During avoidance litigation in Minnesota, the corporate entity (the debtor) in *In re Cypress* filed for Chapter 7 bankruptcy.[309] By its own admission, the debtor had zero assets, no viable claims or causes of action, and only listed two creditors (one of which was an inside partner and had an interest in the entity). When the debtor filed a "Report of No Distribution" certifying that it had no assets or claims, its only non-insider creditor sought dismissal of the bankruptcy proceedings under 11 U.S.C. § 707(a). The bankruptcy court denied the motion for lack of bad faith, but the district court reversed, reasoning that the Chapter 7 proceedings at issue had no benefit for the corporate debtor and only harmed the one non-insider creditor.[310] To the district court, this amounted to "cause" under § 707(a).[311] The debtor appealed.[312]

In a theme consistently illustrated by the cases discussed in this Survey, the Fifth Circuit noted that § 707(a), which allowed dismissal for "cause," did not define the term.[313] The Fifth Circuit declined to create a uniform meaning of the term based on policies underlying the Bankruptcy Code, and instead declared that the term was intentionally broad and flexible.[314] Under Fifth Circuit precedent, bankruptcy courts' equitable roots required them to weigh the benefits and prejudices of dismissal to the debtors, creditors, and the bankruptcy system when deciding a § 707(a) motion.[315] Viewing the equities of this particular case, the Fifth Circuit upheld the district court's ruling, declaring that neither the corporate debtor nor its two creditors received a benefit and the Chapter 7 bankruptcy was only sought to "unreasonably and unjustifiably" delay the ongoing recovery litigation in Minnesota.[316] Dismissal for cause was the appropriate action.[317]

*In re Cypress* has sizable consequences, as the Fifth Circuit has solidified its broad approach to § 707(a) cases, at least in the corporate debtor context. The effects of *In re Cypress* have reached even beyond the realm of Chapter 7 corporate debtors, with at least one court applying the rational of *In re Cypress* to an individual's Chapter 7 bankruptcy.[318] It will be interesting to see if this broadened understanding of cause under § 707(a) is a continuing trend. Future litigation will shine light on this issue, but now, *In re Cypress* affords bankruptcy judges the necessary freedom to decide when a corporate debtor does not deserve the benefits of bankruptcy.

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308. *Id.*
309. *Id.* at 288.
310. *Id.*
311. *Id.*
312. *Id.*
313. *Id.* at 289.
314. *Id.* (citing *In re* Little Creek Dev. Co., 779 F.2d 1068, 1072 (5th Cir. 1986)).
315. *Id.*; *see In re Little Creek*, 779 F.2d at 1073.
316. *In re* Cypress Fin. Trading Co., L.P., 620 F. App'x at 289.
317. *Id.*
318. *See In re* Wilcox, 539 B.R. 137, 154 (Bankr. S.D. Tex. 2015).

### B. Dismissal Of An Individual Bankruptcy Case for "Cause" Under § 707(a)—*In re Wilcox*, Case 539

The holding in *In re Wilcox* is best summarized as a cautionary tale for debtors: do not approach Chapter 7 bankruptcy with a cavalier attitude.[319] Considering a motion for dismissal under 11 U.S.C. § 707(a), the U.S. Bankruptcy Court for the Southern District of Texas had to determine what actions constituted "cause" under this provision.[320] In a rather rare grant of dismissal, the bankruptcy court held that an individual debtor who demonstrates no "hint of belt tightening" when approaching Chapter 7 bankruptcy may not deserve the benefits of the bankruptcy system.[321]

Under § 707(a), a court may dismiss a Chapter 7 case "only after notice and hearing and only for *cause*."[322] Section 707(a)(1)–(3) goes on to list actions that illustrate cause.[323] Relying on this provision generally, the U.S. Trustee (the UST) sought dismissal of a debtor's Chapter 7 petition.[324] Here, although the debtor filed his Schedules and Statement of Financial Affairs, cooperated with the Chapter 7 trustee, and fulfilled all other fundamental Chapter 7 duties the UST exposed the debtor's extravagant lifestyle that he maintained despite having $4,603.32 in secured claims and $16,920,102.09 in unsecured claims against him.[325]

To say the debtor's lifestyle was irresponsible stands as an understatement. Although employed and handsomely rewarded for his status as vice president of Atwell LLC, the debtor claimed only $2.68 in net monthly income (a UST analysis demonstrated that the debtor could have up to $9,016.19 in monthly net income if he cut his spending).[326] In 2013, heeding the advice of his bankruptcy counsel not to pay back his debt, the debtor stopped making payments on his credit card bills.[327] That same year, he received an IRS refund check for $204,576.[328] Instead of attempting to pay off his credit card debt with the newly received funds, the debtor decided to continue living large. His more lavish expenditures included a $22,591 pre-paid lease on a Mercedes-Benz for his wife, a $16,813 trip to Peru and Nepal for his stepson, $18,504 in airfare and housing expenses for him and his wife in London, San Francisco, Phoenix, and Michigan, and close to $24,000 for goods and services at luxury retail-

319. *See id.* at 153 ("Debtor has exhibited an incredibly cavalier attitude towards the bankruptcy system in general").

320. *Id.* at 151.

321. *Id.* at 151–52.

322. 11 U.S.C. § 707(a) (2012) (emphasis added).

323. *See id.* § 707(a)(1)–(3).

324. *In re Wilcox*, 539 B.R. at 145–46.

325. *Id.* at 138–39 (noting the unsecured claims included business debt and personal credit card debt).

326. *Id.* at 139–41 (noting that the debtor was receiving $23,193.33 a month in salary as well as other company benefits).

327. *Id.* at 141–42.

328. *Id.* at 141.

ers like Nordstrom and Bloomingdales.[329]

The debtor not only continued to spend, he actively managed and positioned his funds in an almost deceitful manner. To avoid garnishment but still be able to use his salary, the debtor placed his bi-weekly paycheck from Atwell, LLC in his wife's bank account, which was separately maintained.[330] The debtor sheltered other funds by making regular and voluntary contributions to his 401(k), an amount that totaled over $37,000. Just three months before his bankruptcy filing, the debtor still managed to spend over $10,000 on shoes, clothing, spas, fine dining, and assorted vacations. These egregious facts led the court to state that oft-cited adage from the Fifth Circuit—"when a pig becomes a hog it gets slaughtered."[331]

In determining whether the facts in *In re Wilcox* constituted cause for dismissal under § 707(a), the bankruptcy court was fully cognizant of a circuit split on which the Fifth Circuit had not yet sided.[332] In handling two separate corporate Chapter 7 cases, the Fifth Circuit had stated that cause under § 707(a) was meant to be construed broadly.[333] The bankruptcy court reasoned that § 707(a)(1)–(3) was an illustrative, not exhaustive list of actions that amounted to cause.[334] Therefore, when considering dismissal under § 707(a), a court should weigh the benefits and prejudices in an equitable manner.[335]

This test derived by the bankruptcy court appeared to be most influenced by the Seventh Circuit's approach, which fell in line with the ideology behind Fifth Court precedent.[336] The Seventh Circuit approach to dismissal for cause under § 707(a) harped on policy, reasoning that a debtor who made no effort to retire his debt and continued to live an over-the-top lifestyle did not deserve to remain in Chapter 7, as that would be a "misuse of the protections granted by the Bankruptcy Code."[337] This test did not require a finding of bad faith like the approaches adopted in the Third, Sixth, and Eleventh Circuits,[338] but instead analyzed the circumstances of the case to fish out any deliberately selfish behavior on behalf of the debtor.[339] Even if a debtor was timely and punctual in filing his Chapter 7 petition, the bankruptcy court determined, dismissal for cause was still appropriate if the debtor reflected "an

329. *Id.* at 143.
330. *Id.* at 142.
331. *Id.* at 153; *see In re* Swift, 3 F.3d 929, 931 (5th Cir. 1993) ("There is a principle of too much; phrased colloquially, when a pig becomes a hog it is slaughtered.").
332. *See In re Wilcox*, 539 B.R. at 147.
333. *Id.*
334. *Id.* at 150.
335. *Id.*; *see In re* Cypress Fin. Trading Co., L.P., 2015 U.S. App. LEXIS 14347, at *2 (5th Cir. 2015); *In re* Atlas Supply Corp., 857 F.2d 1061, 1063 (5th Cir. 1988).
336. *See In re Wilcox*, 539 B.R. at 150.
337. *See In re* Schwartz, 532 B.R. 710, 716 (Bankr. N.D. Ill. 2015), *aff'd*, 799 F.3d 760 (7th Cir. 2015).
338. *See In re* Tamecki, 229 F.3d 205, 207 (3rd Cir. 2000); *In re* Zick, 931 F.2d 1124, 1127 (6th Cir. 1991); *In re* Piazza, 719 F.3d 1253, 1260–61 (11th Cir. 2013).
339. *In re Wilcox*, 539 B.R. at 151.

attitude that [was] repugnant to the 'fresh start' principle of the Code."[340] A selfish and "I come first" bankruptcy approach was the prototypical type of behavior the bankruptcy court did not want rewarded; dismissing the case was necessary to maintain the integrity of the bankruptcy process.[341]

It is curious to note that the debtor's Chapter 7 petition was "dismissed without prejudice to the [d]ebtor refiling under a Chapter 11 petition."[342] At the on-set of the Chapter 7 case, the UST had derived a 60-month reorganization plan under Chapter 11 that would discharge 97% of the debtor's total debt when the debtor completed all the payments.[343] The debtor, however, ignored this alternative.

*In re Wilcox* proposes that a broad definition of cause aligns with Fifth Circuit precedent and is necessary in the context of § 707(a) to afford a court flexibility to judge the debtor's position on a case-by-case basis.[344] This flexibility allows bankruptcy courts to protect the integrity of the bankruptcy system while promoting its two fundamental objectives: a fresh start for the debtor and maximum distribution to creditors.[345] Certainly the conclusion does not ring unfair in light of the debtor's lavish lifestyle. On the other hand, does dismissal for cause based on a debtor's spending, add new dimensions for eligibility established by the Bankruptcy Code?

Although outside the timeframe of this Survey period, the authors thought it important to note that the U.S. Court of Appeals for the Fifth Circuit in 2016 ruled on § 707(a) in the context of an individual debtor in the case, *In re Krueger*.[346] Consistent with the reasoning in *In re Wilcox*, the Fifth Circuit adopted a broad and flexible approach to define cause, noting that the three grounds explicitly stated in the statute were "illustrative, not exclusive."[347] The debtor filed Chapter 7 bankruptcy while a criminal contempt proceeding was pending against him and after his state court litigation had taken a turn for the worse. Further, the bankruptcy court found that the debtor had perjured himself in his court documents and testimony and threatened witnesses during the bankruptcy case to the end of avoiding personal liability and threats to his pecuniary interests.[348] The Fifth Circuit determined these were the type of "'non-economic motives' [that] [we]re 'unworthy of bankruptcy protection.'"[349] This ruling endorsed the reasoning in *In re Wilcox* that bankruptcy courts have broad discretion to determine "cause," including taking into account

340. *Id.* at 150.
341. *Id.* at 152–53.
342. *Id.* at 154.
343. *Id.* at 153.
344. *See id.* at 147.
345. *See In re* T-H New Orleans Ltd. P'ship, 188 B.R. 799, 807 (E.D. La. 1995), *aff'd*, 116 F.3d 790 (5th Cir. 1997).
346. 812 F.3d 365, 366–67 (5th Cir. 2016).
347. *Id.* at 370; *see also In re Wilcox*, 539 B.R. at 150.
348. *In re Krueger*, 812 F.3d at 375.
349. *Id.* (quoting *In re* Huckfeldt, 39 F.3d 829, 833 (6th Cir. 1994)).

a debtor's pre and post-petition bad faith conduct.[350]

### C. Trustee Removal Under § 324(a)—*In re IFS*

When can a trustee be removed from a Chapter 7 bankruptcy proceeding? The answer seems to be at least when he uses too much of the cookie jar, or perhaps, when he fails to disclose his mess. The holding in *In re IFS* broadened the scope of § 324(a) of the Bankruptcy Code, which allowed removal of a trustee for cause and "after notice and a hearing."[351] The trustee in the case made several critical mistakes. Appointed in 2003 for IFS Financial Corporation, the trustee subsequently hired his law firm to represent him personally in his capacity as trustee and appointed his wife, an appellate attorney at the law firm, as lead appellate counsel.[352] Because the case was administered with other related cases, the trustee "initiated over 100 adversary proceedings to recover assets of several bankruptcy estates."[353] But, the retention of his own law firm came back to haunt him when one of those adversary proceedings required oral argument before the U.S. Court of Appeals for the Fifth Circuit in New Orleans.[354]

The trustee turned the New Orleans trip to the Fifth Circuit into a family affair. Not only did he and his wife attend, but their two children attended as well.[355] The couple's arrival on Saturday amounted to a free day and moderate preparation on Sunday (albeit their children were in the room) before oral argument on Tuesday.[356] This preparation involved a $359 a night rate for the hotel room, as well as various expenses for room service and restaurants. At the end of the trip, the trustee submitted a large, un-itemized bill for his law firm's work that included a request to distribute $3,486.37 in estate funds as reimbursement.[357] IFS's largest creditor objected to the proposed distribution and the bankruptcy court agreed, deeming the trustee's trip as an extended stay that should have only lasted one day and amounted to $275 of reimbursement.[358] The bankruptcy court, which had already scrutinized the trustee's hiring of his own law firm for the bankruptcy estate, issued a show cause order as to why the trustee "should not be removed under 11 U.S.C. § 324(a)."[359] The bankruptcy court took the trustee's behavior in prior cases into consideration and emphasized the trustee's willingness "to put the interest of his personal law firm ahead of the interest of the estate."[360] His actions,

350. *See id.* at 370–73.
351. *In re* IFS, 803 F.3d 195, 205 (5th Cir. 2015); *see* 11 U.S.C. § 324(a) (2012).
352. *In re IFS*, 803 F.3d at 198.
353. *Id.*
354. *See id.* at 199.
355. *Id.*
356. *Id.*
357. *Id.* at 197.
358. *Id.* at 199.
359. *Id.* at 200.
360. *Id.*

the bankruptcy court held, constituted a breach of a fiduciary duty.[361] Applying the statute, the bankruptcy court removed the trustee not only from the current bankruptcy case but from *all* of the cases for which he was acting as trustee in the district.[362] The trustee appealed the scope of the bankruptcy court's removal, arguing that the bankruptcy court's show cause order had provided insufficient cause for the sanction and that the bankruptcy court erred in considering the trustee's actions in other cases.

After the district court affirmed the bankruptcy court, the Fifth Circuit was left to analyze the trustee's removal under § 324(a) of the Bankruptcy Code.[363] Elaborating on what constituted "notice" under the statute, the Fifth Circuit reasoned that removal, and its extreme consequences, required notice to be "specific enough to allow the parties to prepare and respond to the noticed issue."[364] Specifically, reasonable notice needed to include "the conduct immediately at issue as well as the extrinsic conduct to be visited."[365] The trustee argued that "the bankruptcy court's consideration of 'contextual matters,'" like his conduct in other cases and proceedings before the bankruptcy court, violated due process.[366] Here, the show cause order had specifically identified two different instances sufficient to put the trustee on notice that the bankruptcy court would have questions.[367] As to a third instance, the Fifth Circuit construed its own definition of notice broadly, finding it sufficient that the show cause order had informed the trustee he would be questioned about "his observance of fiduciary duties."[368] Additionally, the trustee himself provided testimony and argument at the show cause hearing regarding all the cases and proceedings about which the bankruptcy court then questioned him.[369] Regardless, the Fifth Circuit fell back on the conclusion that the bankruptcy court had not relied upon these contextual matters in removing the trustee from pending cases in the district.[370]

It is noteworthy that the bankruptcy court's ruling also withstood a constitutional challenge, with the Fifth Circuit declaring § 324(a) constitutional both on its face and as applied.[371] By operation of the statute, removal for cause under § 324(a) removed the trustee from *all* cases in which they were acting as trustee unless otherwise stipulated by the court.[372] The Fifth Circuit did not have to go far to uphold this provision and quickly dismantled the trustee's argument that he was denied due process as to his automatic removal for all cases, because constitutionally

361. *Id.* at 202.
362. *Id.*; *see* 11 U.S.C. § 324(b) (2012).
363. *In re IFS*, 803 F.3d at 203; *see* 11 U.S.C. § 324(a).
364. *In re IFS*, 803 F.3d at 203–04.
365. *Id.* at 204.
366. *Id.*
367. *Id.*
368. *Id.*
369. *Id.* at 205.
370. *Id.*
371. *Id.* at 208–09.
372. *See* 11 U.S.C. § 324(b) (2012).

acceptable notice and notice provided under § 324(a) were one in the same.[373]

After dispensing with the issue of notice, the Fifth Circuit turned to the issue of cause and what actions could justify removal under § 324(a).[374] Rationalizing that cause was undefined in the Bankruptcy Code to afford judges greater flexibility, the Fifth Circuit declined to create a uniform definition.[375] In light of prior precedent regarding removal for cause, the Fifth Circuit ruled that consistently acting to advance a firm's interest to the detriment of the estate was legally acceptable grounds for removing a trustee.[376] Therefore, the Fifth Circuit upheld the bankruptcy court's ruling.[377]

In *In re IFS*, the Fifth Circuit illustrated the expansive discretion provided by § 324 and the grim consequences for not adhering to legally acceptable modes of conduct. The Fifth Circuit's insistence on maintaining flexibility in construing cause under the Bankruptcy Code is a consistent theme throughout its precedent, as noted above in *In re Wilcox*.[378]

Just as *In re IFS*'s interpretation of cause as fact-specific is not remarkable, the Fifth Circuit's definition of notice under § 324(a) is not precedential.[379] But, the Fifth Circuit's application of this definition of notice in *In re IFS* does warrant remark and should serve as a cautionary tale for a trustee whose fiduciary duties have been called into question. The outcome of *In re IFS*, however, may be limited in effect to facts strikingly similar to those in the case. Altogether, it took a highly-involved creditor, a potentially dangerous conflict of interest, and more than three circumstances in which the same bankruptcy court expressed concern over the trustee's behavior to lead to the trustee's district-wide removal. This trifecta is unlikely to recur frequently. Still, the fact that a bankruptcy court could eliminate a trustee's district-wide business should cause a trustee to approach his role with a certain amount of discretion.

## XI. CHAPTER 11

### A. When a Cause of Action Becomes Property of the Estate Pre-Conversion—*In re Cantu*

When a Chapter 11 debtor is an individual, the property of the estate includes "all property of the kind specified in § 541 that the debtor acquires after the commencement of the case but before the case is . . . converted to a case under [C]hapter 7."[380] Per § 541, that includes all

373. *In re IFS*, 803 F.3d at 209.
374. *Id.* at 205.
375. *Id.* at 206–07.
376. *Id.* at 208.
377. *Id.*
378. *See In re* Wilcox, 539 B.R. 137, 147 (Bankr. S.D. Tex. 2015); *see also In re* Cypress Fin. Trading Co., L.P., 620 F. App'x 287, 289 (5th Cir. 2015) (noting "cause" is construed broadly to give flexibility to bankruptcy courts).
379. *See In re IFS*, 803 F.3d at 203–04.
380. 11 U.S.C. § 1115(a)(1) (2012).

legal rights—that is, any causes of actions belonging to the debtor.[381] It has been well-established under Fifth Circuit precedent that causes of actions belonging to the debtor prior to conversion were property of the bankruptcy estate, "[b]ut if a cause of action [wa]s acquired at or after the time of conversion, it belong[ed] to the individual debtor."[382]

In *In re Cantu*, the U.S. Court of Appeals for the Fifth Circuit clarified how to "determin[e] whether a claim that a debtor [sought] to assert constitute[d] property of the estate."[383] The Fifth Circuit held that the "accrual approach" was the appropriate test when making this determination.[384] Under the accrual test, an injury did not occur, and therefore, a cause of action did not accrue for purposes of inclusion in the bankruptcy estate, until an injured party (the debtor) could institute a cause of action.[385] The Fifth Circuit noted that the focus of the accrual test was the harm that the alleged wrongful conduct caused to the bankruptcy estate, and conversely, the benefit that any recovery would bring to the bankruptcy estate.[386]

Under the facts of the case, the debtors filed their original bankruptcy petition under Chapter 11 but could not receive approval of their plan and their case was converted to Chapter 7. The debtors alleged that this forced conversion occurred due to attorney malpractice. They "argue[d] . . . that necessary injury occurred only after conversion when their assets were liquidated and the bankruptcy court denied them discharge."[387] The debtors wanted the settlement from their state law claim against their attorney to fall outside of the bankruptcy estate. The Chapter 7 trustee argued, however, that "the estate also suffered injuries from [the attorney's] misconduct, and those injuries arose earlier, prior to the conversion."[388]

Reviewing the trustee's argument, the Fifth Circuit "focus[ed] on whether the allegations and causes of action in the Cantus' petition injured the estate in a manner that would have enabled the trustee to file the lawsuit prior to conversion."[389] The creditors, the Fifth Circuit decided, were injured in numerous ways "during the pendency of the [C]hapter 11 bankruptcy that would have allowed the estate to file suit prior to conversion."[390] First, the Fifth Circuit found that the misconduct of the debtors' attorney directly "led to the depletion of assets that could have otherwise gone to pay creditors."[391] Even though the debtors argued that their attorney's failure to file a motion for authorization to use

381. *Id.* § 541 (a)(1).
382. *See In re* Cantu, 784 F.3d 253, 257–58 (5th Cir. 2015).
383. *Id.* at 259.
384. *Id.* at 259–60.
385. *Id.* at 260.
386. *Id.*
387. *Id.*
388. *Id.*
389. *Id.* at 261.
390. *Id.*
391. *Id.*

cash collateral harmed them because it led to their unauthorized use of cash collateral, which contributed to conversion, the Fifth Circuit found that the impact of the attorney's misconduct more directly harmed creditors who were deprived of the cash collateral that the debtors used.[392] Second, the attorney's failure to include valuable assets in the debtors' schedules diverted these assets away from the bankruptcy estate.[393] Third, the Fifth Circuit held that that the attorneys' submission of an unconfirmable plan harmed not only the Cantus, but also the estate, because a confirmable plan that could reorganize the debtors would have given creditors the benefit of the debtors' going concern.[394] If a confirmable plan was not possible, as the bankruptcy court suggested, then the attorney should have never filed the case under Chapter 11 because the costs to creditors would have significantly decreased in a Chapter 7 case.[395] Finally, the Fifth Circuit found that the attorneys' fees and costs of reorganization approved by the bankruptcy court injured the bankruptcy estate by subtracting those avoidable costs from the estates corpus.[396]

While there was previous confusion on whether courts should apply the "prepetition relationship," "middle ground" or "accrual" test when a debtor *asserted* a cause of action, following *In re Cantu*, the Fifth Circuit has definitively answered that question in favor of the accrual test.[397] Applying the accrual test, rather than the alternative tests, will arguably bring fewer cases into the bankruptcy estate, but the Fifth Circuit's logic makes sense. As the Fifth Circuit reasoned, a distinction exists between determining when a claim occurs to provide a creditor with due process to pursue a cause of action against a debtor, and when a claim occurs to include within the bankruptcy estate.[398] The former requires a court to consider the pre-petition relationship between a debtor and creditor; the latter does not.[399] Additionally, the accrual test most closely aligns property interests in bankruptcy to those under state law because it looks to substantive state law to determine when an injury occurs.[400]

### B. Valuation of a Secured Claim—*In re Age Ref., Inc.*

In *In re Age Ref., Inc.*, the U.S. Court of Appeals for the Fifth Circuit addressed four combined matters in a rather complicated fact pattern.[401] The matters included an approved settlement under Bankruptcy Rule 9019, a denied motion to value a secured claim, a denied objection to an

392. *Id.*
393. *Id.*
394. *Id.* at 261–62.
395. *Id.* at 262.
396. *Id.*
397. *See id.* at 259–60.
398. *See id.* at 259.
399. *See id.*
400. *See id.* at 258.
401. *In re* Age Ref., Inc., 801 F.3d 530, 532 (5th Cir. 2015).

allowed claim, and an approved Chapter 11 plan.[402] Under the settlement agreement, secured lender Chase Bank (Chase) settled its claim for post-petition attorneys' fees and interest. Chase argued it was entitled to the post-petition interest because it was oversecured. Alternatively, under an administrative expense theory, Chase argued that it was entitled to adequate protection if a court found that Chase was undersecured. The unsecured creditors' committee (Committee) objected to Chase's claim for post-petition interest or alternatively, adequate protection, and moved for a valuation of its collateral on the basis that it was in fact, undersecured.[403] The district court affirmed the bankruptcy court on all four rulings against the Committee.[404] On appeal, the Committee designated eight issues; however, in a rare procedural step, the Fifth Circuit only considered two, claiming that the remaining six issues challenged only the district court and not the bankruptcy court's findings and conclusions.[405] The two issues considered on appeal were "(1) whether the bankruptcy court abused its discretion in approving the settlement agreement; and (2) whether the bankruptcy court erred in denying the motion to value and claim objection."[406]

The Fifth Circuit analyzed the bankruptcy court's approval of the settlement agreement under the requirements of Bankruptcy Rule 9019, which provided that a settlement must be "fair and equitable and in the best interest of the estate."[407] Whether a settlement met these requirements was determined by a three-part test: (1) the probability that the bankruptcy estate would succeed in litigating the claim that was settled; (2) the complexity, potential duration, inconvenience, expense, and delay of litigating the claim; and (3) all other factors that might bear on the prudence of the settlement.[408] The Fifth Circuit was satisfied that the bankruptcy court had undertaken an analysis of these three considerations, including the *Foster Mortgage* factors that included the creditors' best interests and the extent to which the settlement was an arms-length, good faith bargain.[409] The Committee's argument against this conclusion hinged on valuation and priority of payments: How could the bankruptcy court determine that the settlement of the post-petition claim for interest and fees, which relied upon oversecured status, satisfied the *Jackson Brewing* test when it did not value the collateral to verify oversecured status?[410] Ultimately, the Fifth Circuit determined, the "record provide[d] support for the [t]rustee's conclusion that the estate faced some

402. *Id.*
403. *Id.* at 536.
404. *Id.* at 538.
405. *Id.* at 538–39.
406. *Id.* at 539.
407. *Id.*; *see In re* Foster Mortg., 68 F.3d 914, 917 (5th Cir. 1995).
408. *In re Age Ref., Inc.*, 801 F.3d at 540 (citing *In re* Jackson Brewing Co., 624 F.2d 599, 602 (5th Cir. 1980)).
409. *Id.* (citing *In re Foster Mortg.*, 68 F.3d at 917).
410. *See id.* at 542.

probability of failure in litigating Chase's post-petition claim."[411] The Committee also tried to challenge the Fifth Circuit's conclusion with a creative argument that Chase would have been undersecured, and unsecured creditors a bit wealthier, had the trustee elected to distribute funds from various sales and working interest adjustments in a different order.[412] But the Fifth Circuit rejected this argument, first by deferring to the trustee's discretion and second by noting that the timing in the case would not have allowed the payment schedule advocated by the Committee.[413]

In perhaps a stronger argument, the Committee asserted that the bankruptcy court should have valued Chase's collateral and considered the Committee's objection to its post-petition claim under §§ 502(b) and 506(a).[414] Section 506(a) provides that Chase was entitled to post-petition interest to the extent the value of its collateral exceeded its "allowed claim."[415] The Committee argued that its objection triggered § 502(b) that required the bankruptcy court to determine the amount of Chase's allowed claim.[416] Despite agreeing with the Committee, the Fifth Circuit determined that the bankruptcy court implicitly overruled the objection to claim when the bankruptcy court approved the settlement agreement and therefore, concluded that the error was harmless.[417] On the other hand, the Fifth Circuit easily determined that the Committee had not been entitled to a valuation of Chase's collateral based on its motion for valuation, because Bankruptcy Rule 3012 contains permissive language that grants a bankruptcy court the discretion to value a claim upon a party's motion or objection.[418]

The bankruptcy court avoided what could have been a costly, time-consuming, and inconvenient process in this bankruptcy case. And the Fifth Circuit's opinion preserved discretion in the bankruptcy courts. In *In re Age Refining*, the Fifth Circuit's deference to the bankruptcy court in foregoing the cumbersome process of valuation, even determining that the failure to do so was harmless under § 506(a),[419] is important. As noted by the dissent, valuing Chase's claim and determining its over-secured or undersecured status could have had a great effect on the settlement agreement.[420] According to the dissent, it was most likely for this reason that the bankruptcy court elected not to require this valuation, but at the same time, likely that the failure to do so was not harmless.[421]

411. *Id.*
412. *See id.* at 541–42.
413. *Id.* at 542.
414. *Id.* at 542–43.
415. *Id.* at 543; *see* 11 U.S.C. § 506(b) (2012).
416. *In re Age Ref., Inc.*, 801 F.3d at 543.
417. *Id.*
418. *Id.* at 544; *see* FED. R. BANKR. P. 3012 (West 2013).
419. *In re Age Ref., Inc.*, 801 F.3d at 539–45.
420. *Id.* at 545–46 (Owen, J., dissenting).
421. *Id.*

### C. Cramdown Interest Rate in Chapter 11 Plans—*In re Couture Hotel, Corp.*

Conflicts often arise regarding interest rates in Chapter 11 reorganizations, but not always to the extent that parties argue over basic methodology. Thus, when debtor Couture Hotel Corporation and creditor Mansa disputed the proper cramdown interest rate in *In re Coutoure Hotel Corp.*, the confirmation hearing before the U.S. Bankruptcy Court for the Northern District of Texas became more contentious than most.[422] Both the debtor and Mansa relied on the U.S. Supreme Court's ruling in *Till v. SCS Credit Corp*[423] and the Fifth Circuit's analysis in *Wells Fargo Bank, N.A. v. Texas Grand Prairie Hotel Realty, L.L.C. (In re Texas Grand Prairie Hotel Realty, L.L.C.)*[424] to support their proposed methodologies for determining interest rates. Under *Till*'s holding, a debtor in Chapter 13 had to use the prime-plus approach to determine an appropriate cramdown interest rate.[425] In *Texas Grand Prairie*, the U.S. Court of Appeals for the Fifth Circuit applied the prime-plus approach of *Till* based on the parties' stipulation, but explicitly refused to *require* this approach in the Chapter 11 context.[426] Here, neither the debtor nor Mansa "stipulated that a strict, prime-plus formula should be used."[427] Although "[b]oth parties agree[d] that a formula-based approach [wa]s the proper method to determine the appropriate Cramdown Interest Rate," the parties adjusted for risk from different starting points—the debtor from a "market-based rate of interest" and Mansa from the prime.[428] The two approaches produced very different rates for purposes of cramming down Mansa's secured claim; the debtor proposed a 4.25% interest rate, and Mansa proposed a 10.38% interest rate. The bankruptcy court, rejecting the argument that it was bound by *Till*'s prime-plus rate, exercised its discretion to uphold or require modification of the proposed cramdown interest rate in piecemeal for each type of Mansa's collateral.[429]

Before analyzing the dueling cramdown interest rates for purposes of a fair and equitable analysis, the bankruptcy court concluded that the debtor proposed its methodology for cramdown in good faith.[430] Additionally, the bankruptcy court quickly dispensed with a challenge to the proposed plan's separate classification and lower interest rate for the Mansa claim than other secured claims, concluding that the differing collateral underlying the secured claims justified disparate treatment.[431]

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422. *In re* Couture Hotel Corp., 536 B.R. 712, 719–21 (Bankr. N.D. Tex. 2015).
423. 541 U.S. 465, 465 (2004).
424. 710 F.3d 324, 326 (5th Cir. 2013).
425. *See Till*, 541 U.S. at 479–80.
426. *In re Texas Grand Prairie Hotel Realty, L.L.C.*, 710 F.3d at 337.
427. *In re Couture Hotel Corp.*, 536 B.R. at 721.
428. *Id.* at 744.
429. *Id.* at 744–49.
430. *Id.* at 734–35.
431. *Id.* at 733–34.

Turning to the issue of fair and equitable treatment, the bankruptcy court was not ultimately impressed with either party's proposed interest rate.[432] The debtor's proposed interest rate was "based upon a range of interest rates that [it] felt accounted for the industry risk associated with hotel-based lending."[433] In determining these base rates, the debtor used the "websites for Commercial Loans Direct and United Financial Group to view the currently-offered rates on hotel loans with loan-to-value ratios similar to the proposed Mansa restructuring."[434] Using these rates, the debtor began its risk assessment under the *Texas Grand Prairie* factors.[435] Each factor had a low and a high range, and in the end, the Debtor took the middle ground and settled on a rate of 4.25%.[436]

Unlike the debtor, Mansa "followed a strict *Till* analysis, beginning with the prime rate of 3.25%."[437] From there, Mansa "adjusted the prime rate for each of the factors discussed in *Till*, giving both a low and high range adjustment for each factor" and then settled on a mid-range of 10.38%.[438]

According to the bankruptcy court, the debtor's proposal was too lenient, while Mansa's proposal was too harsh.[439] Addressing the debtor's leniency, the bankruptcy court was not pleased that the debtor gave "a downward to neutral adjustment based on the quality of [its] management."[440] Based on testimony about the hotel manager's previous struggles, the bankruptcy court felt that the debtor needed to adjust upwards for some risk regarding management, and settled upon 1.0%.[441] The bankruptcy court also recognized the risk that the debtor may not be capable of making a balloon payment at the end of a five year period and "assign[ed] an upward risk adjustment of .75%."[442]

The bankruptcy court was similarly disturbed by Mansa's cramdown interest rate.[443] First, Mansa gave a 1.0%–2.0% increase for "circumstances of the estate," based on, what the bankruptcy court called, "blind reliance on the [receiver's] report without any independent investigation."[444] The bankruptcy court criticized this blind reliance based on testimony at trial that directly dispensed with some of the problems and inconsistencies stated within the report.[445] Mansa, the bankruptcy court held, also overstated a risk adjustment due to feasibility issues.[446] In fact,

432. *See id.* at 747.
433. *Id.* at 745.
434. *Id.*
435. *Id.*
436. *Id.*
437. *Id.*
438. *Id.*
439. *Id.* at 746.
440. *Id.*
441. *Id.* at 746–47.
442. *Id.*
443. *See id.* at 747.
444. *Id.*
445. *Id.*
446. *Id.*

the bankruptcy court rejected Mansa's risk adjustment, relying on the debtor's cash flow projections, which one expert for Mansa testified as "reasonable and supportable."[447]

Although the bankruptcy court believed that many of the problems with the plan had been corrected when the debtor adjusted the payment period from seven to five years, the bankruptcy court ultimately found that the debtor's cramdown interest rate was "insufficient to provide Mansa with the deferred cash payments it [wa]s entitled to receive under 11 U.S.C. § 1129(b)(2)(A)(II) in light of its election under § 1111(b)."[448] Thus, the bankruptcy court denied the debtor's plan but gave the debtor an opportunity to correct and propose a reasonable cramdown interest rate.[449]

The bankruptcy court's ruling in *In re Couture* is not simple, but the ruling leaves practitioners with a general takeaway: the prime-plus rate established in *Till* is not necessarily the appropriate formula to apply in the Chapter 11 context, and this application should be reviewed for each different type of collateral.[450] As to what formula is necessarily appropriate, or even how to measure risk factors, practitioners gain some general considerations. In a case that harkens to the story of Goldilocks, here, the debtor hit the mark too low, the creditor too high, and the bankruptcy court provided parameters for the debtor and an opportunity to modify and get the cramdown interest rate just right.[451]

## XII. CHAPTER 13

### A. Condominium Fees Not "Security Interests" Under § 1322(b)—*In re Green*

"[A] Louisiana privilege is not a 'security interest.'"[452] Addressing a matter of first impression under Louisiana law, the U.S. Court of Appeals for the Fifth Circuit determined that a condominium association's lien against a debtor's condominium unit was not a consensual security interest, but a statutory lien, and thus, the anti-modification provision of 11 U.S.C § 1322(b) did not apply.[453] The debtor, as owner of a condominium unit, was subject to both the Louisiana Condominium Act (the Act) and his community's Condominium Declaration (the Declaration).[454] Both the Act and the Declaration granted condominium associations the privilege to file a lien against a condominium owner when the owner fails to pay dues assessed by the association. When the debtor fell behind on assessment payments, his condominium association properly filed a lien af-

447. *Id.*
448. *Id.*
449. *Id.*
450. *See id.* at 721.
451. *See id.* at 746–47.
452. *In re* Green, 793 F.3d 463, 469–70 (5th Cir. 2015) (quoting First Nat'l Bank of Bos. v. Beckwith Mach. Co., 650 So. 2d 1148, 1151 (La. 1995)).
453. *Id.* at 466–67.
454. *Id.* at 466.

fidavit and "obtained a default judgment against the [d]ebtor" for over $23,000.[455]

After the condominium association obtained the judgment, the debtor filed for Chapter 13 bankruptcy and moved to avoid his condominium association's lien, reasoning that "after deducting the balance of his first mortgage and the Louisiana homestead exemption, there was only $8,000 left to which the association's lien could attach."[456] Granting the debtor's motion, the bankruptcy court bifurcated the association's claim into an $8,000 secured claim and an unsecured claim for the remaining amount. Contesting the bifurcation, the condominium association argued that its lien on the condominium was a security interest and, therefore, bifurcation was inappropriate pursuant to 11 U.S.C. § 1322(b)(2),[457] which provides that "a bankruptcy plan may 'modify the rights of holders of secured claims, other than a claim secured only by a security interest in real property that is the debtor's principal residence.'"[458] Because the condominium was the debtor's principal residence, any security interest attached to it could not be "bifurcated pursuant to the anti-modification provision of 11 U.S.C. § 1322."[459] By declaring the association's lien on the debtor's condominium a statutory lien and not a consensual security interest, the bankruptcy court rendered the prohibition on bifurcation inapplicable.[460]

On appeal, the Fifth Circuit was left to classify the type of lien that attached to a condominium and what was meant by privilege under applicable Louisiana state law.[461] The Fifth Circuit analyzed the only "two types of security devices that pertain to immovable property: privileges and mortgages."[462] Even though Louisiana is the only state that uses the term *privilege*, the court found that privilege retained the same meaning as "statutory lien," a term used by other states.[463] For this reason, the Fifth Circuit found the Act's privilege language granted a statutory lien to the association on the debtor's condominium.[464] Additionally, the Fifth Circuit held that "[a] privilege [arose] only by law and . . . [could] never be created by the consent of the parties."[465] Thus, the inclusion of the privilege language in the Declaration was ineffective to create a security interest between the parties.[466]

Having dispensed with the meaning of a privilege, the Fifth Circuit then disposed of the idea that the association could have a mortgage, the

455. *Id.*
456. *Id.*
457. *Id.*
458. *See* 11 U.S.C. § 1322(b)(2) (2012).
459. *In re Green*, 793 F.3d at 466; *see also* 11 U.S.C. § 1322(b).
460. *In re Green*, 793 F.3d at 466–67.
461. *Id.* at 467.
462. *Id.* at 468.
463. *Id.*
464. *Id.* at 469.
465. *Id.*
466. *Id.*

other security interest in immovable property.[467] A conventional mortgage requires the parties to execute a written contract that includes three things: (1) the mortgagor's signature; (2) the amount secured; and (3) a description of the immovable property.[468] Because the condominium association did not submit any evidence of these basic requirements, the Fifth Circuit rejected the argument that the condominium association held a mortgage.[469]

The effects of *In re Green* may not appear far-reaching, because the Fifth Circuit's answer to the dispositive issue relies upon Louisiana state law. As a byproduct of its answer, however, the Fifth Circuit solidified the breadth and power of 11 U.S.C. § 1322(b). Though the language of § 1322(b)(2) is relatively straight forward, *In re Green* shows the *only* interest that may not be modified under a Chapter 13 bankruptcy plan is a secured interest in real property that is the debtor's primary residence, almost conclusively limiting this provision to mortgages.[470] To this end, all other secured interests, as well as unsecured interests, may be subject to modification under § 1322(b). By declaring the condominium association's lien statutory and not secured by the debtor's primary residence, the Fifth Circuit subjected the condominium association's claim to bifurcation under § 1322.[471] As a practical effect, this rendered nearly $15,000 of the $23,303.72 judgment against the debtor an unsecured claim—a rather bleak outcome.[472] Moreover, although the term, privilege, was unique to Louisiana, the Fifth Circuit analogized the term, statutory liens, in other states and analyzed generic, conventional mortgages—an analysis that could apply to any state.[473] The implications for condominium and homeowners associations may be great, as courts interpreting the laws of other states are likely to follow *In re Green* and reserve § 1322(b)(2) protection to mortgagees.

### B. Plan Modification to Account for Homestead Surrender—*In re Ramos*

Can a debtor modify his Chapter 13 plan to provide for the surrender of a mortgaged property at the end of the case? *In re Ramos* answered this question in the negative, because the specific facts of the case led the U.S. Bankruptcy Court for the Northern District of Texas to strictly construe 11 U.S.C § 1329(a) with a small window for the opposite outcome.[474]

Here, the debtors faced several peculiar issues. At the end of their

467. *Id.*
468. *Id.*
469. *Id.*
470. *See id.* at 466–67.
471. *See id.* at 467.
472. *See, e.g.*, *id.* at 466–67 (noting the difference between the judgment obtained against the creditor and the amount deemed a security interest is roughly around $15,000).
473. *See id.* at 468–69.
474. *In re* Ramos, 540 B.R. 580, 594 (Bankr. N.D. Tex. 2015).

Chapter 13 case, the Ramos (debtors) found themselves in a bind.[475] Earlier on, the debtors obtained confirmation of a 60-month payment plan in accordance with § 1322(b)(5) of the Bankruptcy Code. The plan allowed them to retain their homestead, cure prepetition default arrearages, and resume regular postpetition payments to their home mortgage company. The debtors partially complied with the aptly named "cure and maintain" plan, making all of their payments to the Chapter 13 trustee (curing the prepetition default arrears on their home loan) but failing to make numerous postpetition mortgage payments directly to their home mortgage lender (failing to maintain).[476] Neither the Chapter 13 trustee nor the bankruptcy court discovered these direct payments until the end of the 60-month term of the plan, because the home mortgage company never attempted to lift the automatic stay against the homestead and the debtors never spoke up about missing payments.[477]

With the debtors stuck at the finish line, the bankruptcy court first had to answer whether or not a discharge was appropriate for a Chapter 13 debtor who faithfully made all plan payments to the Chapter 13 trustee but failed to make direct postpetition mortgage payments to their mortgage lender as described in his plan.[478] The bankruptcy court decisively answered no, relying on two other bankruptcy court decisions that held that a debtor was not entitled to a discharge under the above-mentioned circumstances.[479] Section 1328(a) of the Bankruptcy Code entitled a debtor to a discharge after "all payments under the plan."[480] In the bankruptcy court's eyes, "all payments" included the direct postpetition payments to the home mortgage lender, and thus, failure to make three years' worth of required postpetition payments rendered a discharge for the debtors inappropriate.[481]

The fact that the debtors' failure to make postpetition direct payments equaled a failure to make all payments under the plan was just as much good news as bad news for the debtors, because § 1329(a) permitted a debtor who had not finished making "all payments under the plan" to modify the plan, subject to certain qualifications.[482] Under the plain language of the statute, modification of a Chapter 13 plan was appropriate "at any time after confirmation of the plan, but before completion of payments under such plan."[483] Qualifications included the prohibition on a modification that "provide[d] for payments over a period that expire[d] after the applicable commitment period . . . unless the court, for cause, approve[d] a longer period, but the court may not approve a period that

475. *Id.* at 582.
476. *Id.*
477. *Id.*
478. *Id.*
479. *Id.* at 582–83; *see In re* Kessler, No. 09-60247, 2015 WL 4726794, at *3 (Bankr. N.D. Tex. Jun. 9, 2015); *see In re* Heinzle, 511 B.R. 69, 78 (Bankr. W.D. Tex. 2014).
480. *See* 11 U.S.C. § 1328(a) (2012).
481. *In re Ramos*, 540 B.R. at 589.
482. *Id.* at 583.
483. *See* 11 U.S.C. § 1329(a).

expire[d] after five years after such time."[484] The bankruptcy court acknowledged that "there [may] be a way to 'fix' an end-of-case problem . . . so long as the 'fix' did not involve modifying a plan to extend plan payments . . . over a period of more than five years."[485] Noting the split of authority as to "whether a debtor may modify a [C]hapter 13 plan . . . to surrender collateral to a secured creditor," the bankruptcy court refused to agree with the courts that had determined that "surrender" could never satisfy this requirement and the other qualifications under § 1329.[486] Nevertheless, the specific facts of the case, especially the timing, precluded the debtors from effecting the proposed modification.[487]

In determining that the facts of this case did not allow modification to surrender, the bankruptcy court looked to § 1329(a)(1)–(4).[488] Under these provisions, one of which included the five year limitation noted above, the bankruptcy court found no mechanism through which the debtors could modify their plan to surrender at the late date.[489] No party had raised an issue about the missed postpetition mortgage payments until the expiration of the 60-month plan. Generally, when a debtor misses one of these payments, the home mortgage lender will take affirmative action by filing a motion to lift stay at some point during the Chapter 13 case.[490] The stay is often lifted; the mortgage lender will foreclose, and subsequently, file an unsecured deficiency proof of claim.[491] Under these circumstances, the bankruptcy court held a debtor could likely modify his plan under § 1329(a)(3).[492] Section 1329(a)(3) stated that a plan may be modified post-confirmation to "alter the amount of the distribution to a creditor whose claim is provided for by the plan *to the extent necessary* to take account of any payment of such claim *other than under the plan*."[493] Here, however, the mortgage lender had not taken such affirmative actions.[494] Even if the mortgage lender had taken action that made modification to surrender necessary, the bankruptcy court cautioned that this modification could not violate § 1322(b)(2) and (5) of the Bankruptcy Code, which prevented "modification of the rights of a home mortgage lender in any plan."[495] In effect, these provisions prevented any plan modification from denying a home mortgage lender the right to assert "an unsecured deficiency claim against the debtor after stay relief and foreclosure."[496] Under the specific facts of the case, due to the conclusion of the 60-month plan and the fact that the home mortgage lender was

484. *See id.* § 1329(c).
485. *In re Ramos*, 540 B.R. at 583 (emphasis removed).
486. *Id.* at 583–84.
487. *Id.* at 583.
488. *See* 11 U.S.C. § 1329(a)(1)–(4).
489. *In re Ramos*, 540 B.R. at 583.
490. *Id.* at 585.
491. *Id.*
492. *Id.*; *see* 11 U.S.C. § 1329(a)(3).
493. 11 U.S.C. § 1329(a)(3) (emphasis added).
494. *In re Ramos*, 540 B.R. at 585.
495. *Id.*; *see* 11 U.S.C. § 1322(b)(2), (5).
496. *In re Ramos*, 540 B.R. at 585–86.

undersecured, there was no mechanism by which the home mortgage lender could file an unsecured deficiency claim.[497] Any modification to the Chapter 13 plan at this point was therefore, an inappropriate modification to the "lender's right to assert a deficiency" under § 1322(b)(2) and (5) of the Bankruptcy Code.[498]

Altogether, the bankruptcy court denied the debtor's proposed plan modification, although slightly different facts may have led to a different result.[499] It is noteworthy that the bankruptcy court refused to establish a *per se* rule that modification to surrender was impermissible.[500] The Fifth Circuit has not addressed whether surrendering a residence to a mortgage lender as full payment of a secured claim is an appropriate modification of a plan under 11 U.S.C. § 1329(a).[501]

As to the split of authority on the issue, there are two trains of thought. One holds that a combination of certain Bankruptcy Code provisions permit modification to surrender collateral:

> (a) [S]ection 1329(a)(1), since the debtor, through surrender, is . . . reducing the amount of payments of the secured creditor down to $0;[502] (b) section 1329(a)(3), because a debtor's surrender of collateral to a creditor is a form of payment made to that creditor other than under the plan[503]; [and] (c) section 502(j) . . . since the modification, essentially, involves the court reconsidering the secured claim and reclassifying and reducing it.[504]

The other adheres to the literal wording of § 1329(a) and does not permit surrender of collateral, "as the word 'surrender' is simply not used in the statute."[505] Today, the authors know of no appeal pending on this issue in the Fifth Circuit, but it will be interesting to see if a set of facts arises, similar to those prescribed in *In re Ramos*, that would set the stage for the Fifth Circuit to weigh in on modification to surrender.

### C. Undisbursed Post-petition Wages upon Conversion to Chapter 7—*Harris v. Viegelahn*

With the passage of the Bankruptcy Reform Act of 1994, Congress addressed the previously unsettled question of whether a debtor's postpetition earnings became a part of the new Chapter 7 estate upon conversion from a Chapter 13 case. Unless a debtor converted in bad faith, these

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497. *Id.* at 586.
498. *Id.*
499. *Id.*
500. *Id.* at 592–94.
501. *Id.* at 590.
502. *See* 11 U.S.C. § 1329(a)(1) (2012); *see, e.g.*, *In re* Leuellen, 322 B.R. 648, 658 (S.D. Ind. 2005) (applying § 1329(a)(1)).
503. *See* 11 U.S.C. § 1329(a)(3); *see, e.g.*, *In re* Tucker, 500 B.R. 457, 462 (Bankr. N.D. Miss. 2013) (applying § 1329(a)(3)).
504. *In re Ramos*, 540 B.R. at 584; *see* 11 U.S.C. § 502(j); *see, e.g.*, *In re* Davis, 404 B.R. 183, 195 (Bankr. S.D. Tex. 2009) (applying § 502(j)).
505. *In re Ramos*, 540 B.R. at 584; *see, e.g.*, *In re* Nolan, 232 F.3d 528, 535 (6th Cir. 2000).

earnings did not become part of the new Chapter 7 estate under § 348(f).[506] Instead, the earnings remained the property of the debtor—as if the debtor had filed a Chapter 7 case initially.[507] The Act also made clear that, upon conversion, the debtor did not have a right to a return of any postpetition earnings already distributed to creditors as part of the debtor's Chapter 13 plan prior to conversion.[508] But upon conversion, what happens to the debtor's postpetition earnings that are in limbo—funds that had already been remitted to the Chapter 13 trustee but not yet disbursed to creditors? This was the question the U.S. Supreme Court answered in *Harris v. Viegelahn*.[509]

In this case, the Chapter 13 trustee did not distribute a portion of the debtor's payments under his Chapter 13 plan to his mortgagee post-foreclosure. As a result, this portion of the debtor's postpetition wages accumulated in the Chapter 13 trustee's possession.[510] A year after the funds began accumulating, the debtor converted his case to a Chapter 7 case, and the Chapter 13 trustee subsequently used the accumulated wages to pay her fees, the debtor's attorneys' fees, and unsecured creditors. Claiming the Chapter 13 trustee lacked authority to distribute these funds to his creditors, the debtor successfully filed a motion directing a refund of the wages distributed post-conversion.[511] The Fifth Circuit, however, disagreed and reversed, concluding that the creditors' claim to the accumulated funds were superior to the debtor's claim.[512] The Fifth Circuit reasoned that the debtor's receipt of these funds would constitute a windfall, and these funds rightfully belonged to creditors.[513]

The Supreme Court unanimously disagreed with the Fifth Circuit, holding that a debtor was entitled to the return of any postpetition wages not yet distributed by the Chapter 13 trustee upon conversion to Chapter 7.[514] Although acknowledging that the Bankruptcy Code did not explicitly answer this question,[515] the Supreme Court concluded that allowing a terminated chapter 13 trustee to distribute accumulated wages post-conversion would be "incompatible with [the] statutory design."[516] Because § 348(f)(1)(A) allowed good faith debtors to remove postpetition wages from the converted Chapter 7 bankruptcy estate while bad faith creditors were penalized under § 348(f)(2) by making these wages available for creditors, the most sensible reading of the statute was to refrain from imposing a similar penalty upon good faith debtors by allowing accumu-

506. *See* 11 U.S.C. § 348(f)(1)(A).
507. *See id.*
508. *See* § 1326(a)(2).
509. 135 S. Ct. 1829 (2015).
510. *Id.* at 1836.
511. *Id.*
512. *Id.*
513. *Id.* at 1839.
514. *Id.* at 1835.
515. *Id.* at 1838.
516. *Id.* at 1837.

lated wages to return to the debtor upon conversion.[517] The Supreme Court additionally reasoned that "payment to creditors" was a core service provided by the Chapter 13 trustee under § 1326(c)—a service that the Chapter 13 trustee could not provide when the case was converted to a Chapter 7 case.[518] By contrast, merely returning undistributed funds to the debtor was not a Chapter 13 service.[519] Thus, the Chapter 13 trustee had no authority to distribute the funds to creditors upon conversion and instead, should have returned the funds to the debtor.[520]

While there is merit to the Fifth Circuit's observation that the debtor's ability to obtain receipt of undisbursed wages upon conversion was completely dependent upon the trustee's ability to make timely distributions to creditors,[521] the Supreme Court's holding seems most consistent with Congress' statutory goal of giving a fresh start to debtors by not over-penalizing them for attempting to complete a Chapter 13 plan before converting to a Chapter 7.[522] At first glance, this case seems to be a big win for debtors. The impact of the case, however, will almost certainly be mitigated—if not eliminated completely—by the response of Chapter 13 trustees and perhaps interested creditors, who will likely seek to include a regular disbursement schedule of all collected funds within the Chapter 13 plan.

## XIII. LEGISLATIVE UPDATE

A number of changes to statutes and rules affecting debtor and creditor relations went into effect during this past Survey period, including a big increase in the Texas personal property exemptions and changes to the Federal Rules of Civil Procedure. In addition, at least at the Commission level, changes are being introduced to the Uniform Fraudulent Transfer Act. Below is a brief summary of the highlights.

### A. Changes to the Federal Rules of Civil Procedure

Amendments to the Federal Rules of Civil Procedure (the Rules) that took effect on December 1, 2015, are projected to influence numerous aspects of civil litigation, most notably service of process, discovery, default judgments, and possibly pleadings requirements in patent cases.[523] Some of these changes are of significant importance and should be noted for their practical implications.

Some rules have been amended in what appears to be an effort to reduce delay and improve cooperation in early case management. Rule 4(m) has changed the time to serve a defendant from 120 days to 90

517. *Id.* at 1837–38.
518. *Id.* at 1838.
519. *Id.*
520. *Id.*
521. *See id.* at 1839.
522. *See id.* at 1837.
523. Fed. R. Civ. P. 1, 4, 16, 26, 30, 31, 33, 34, 37, 55, 84, http://www.supremecourt.gov/orders/courtorders/frcv15_5h25.pdf [https://perma.cc/8AFG-54H6].

days.[524] Rule 16 no longer provides for scheduling conferences by "telephone, mail, or other means" and the time for a court to issue a scheduling order is now the earlier of 90 days (down from 120 days) after any defendant has been served, or 60 days (down from 90 days) after any defendant has appeared.[525] The amended Rule 16 also allows scheduling orders to address the preservation of electronically stored information (ESI) and incorporates the parties' agreements for asserting claims of privilege and work-product protection.[526] These amendments encourage direct communication between the parties involved. And the reduced time for entry of a scheduling order and discovery conference will likely enable the parties to set the tone and expectations at the onset of litigation.

Rule 26 has been narrowed, now mandating that discovery be relevant to any party's claim or defense and proportional to the needs of the case.[527] Proportionality considerations under Rule 26 are not new, but Rule 26(b)(1) now makes proportionality considerations part of the definition of the scope of discovery and reinforces the parties' obligations to consider proportionality in making discovery requests, responses, and objections.[528] Relating to requests for production of documents and reflecting a new streamlined approach to discovery, the amended Rule 26 allows requests for production to be sent before the Rule 26(f) conference;[529] the amended Rule 34 requires objections "with specificity," requires responses to state whether documents are being withheld, and provides a reasonable time for production;[530] and the amended Rule 37 permits a party to move for an order compelling production if another party fails to produce documents.[531]

Further, Rule 37(e) adopts a uniform standard, now providing broad discretion for courts to cure prejudice caused by loss of ESI, a solution that resolves a circuit split concerning when courts may impose more severe sanctions for failures to preserve ESI.[532] The last change worth mentioning deals with Rule 55, which now clarifies that a default judgment that does not dispose of all of the claims among all parties is not a final judgment, unless so directed by the court.[533] Thus, a court may revise a default judgment until final judgment is entered.[534]

If appropriately enforced, these amendments to the Federal Rules alter the discovery landscape. Proper adherence will expedite the resolution of the issues, decrease discovery costs, and focus parties and courts more on

524. *See* Fed. R. Civ. P. 4(m).
525. *See* Fed. R. Civ. P. 16.
526. *See id.*
527. *See* Fed. R. Civ. P. 26.
528. *See id.*
529. *See* Fed. R. Civ. P. 26(d)(2).
530. *See* Fed. R. Civ. P. 34(b)(2).
531. *See* Fed. R. Civ. P. 37(a)(3)(B)(iv).
532. *See* Fed. R. Civ. P. 37(e).
533. *See* Fed. R. Civ. P. 55.
534. *See id.*

the claims and defenses at bar. Attorneys would be wise to memorize and leverage these new amendments.

### B. Increase In Texas Personal Property Exemptions—§ 42.001 of the Texas Property Code

Texas has long been known for its generous exemption laws, and with the passage of a recent amendment to the Texas Property Code, the Lone Star State has become even more debtor-friendly. Section 42.001(a) now allows families to exempt up to $100,000 of personal property and allows individuals to exempt up to $50,000—a substantial increase from the former amounts of $60,000 and $30,000 for families and individuals, respectively.[535] Texas also allows a wide variety of personal items to be exempted, including jewelry, home furnishings, tools, and two firearms.[536] They say everything is bigger in Texas and, with this amendment, it clear that the adage certainly applies to protections for the personal property of debtors.

### C. Uniform Law Commission Amendments to the Uniform Fraudulent Transfer Act

On July 16, 2014, the Uniform Law Commission renamed the Uniform Fraudulent Transfer Act as the Uniform Voidable Transactions Act (UVTA) and made a number of amendments to the Act, for the first time since its promulgation.

The high points of these amendments included changing the term "fraudulent" transfer to "voidable" to clear up the confusion surrounding the intent or *bad act* aura that surrounded targets of the Act. The UVTA altered and clarified the burden of proof for a cause of action under the Act, expressly placing a preponderance of the evidence burden upon the creditor-claimant as to each element, with one caveat.[537] This caveat referred to the long-standing rebuttable presumption under the Act that a debtor was insolvent if it failed to pay its debts as they became due.[538] As amended, the UVTA now qualifies this rebuttable presumption in two ways: (i) debts that are subject to a bona fide dispute do not count towards the rebuttable presumption; and (ii) the debtor bears the burden to prove the rebuttable presumption by a preponderance of evidence.[539]

In an amendment unfavorable to secured creditors, the UVTA eliminated protection for "strict foreclosures," which will now be subject to fraudulent transfer claims under the Act.[540] Strict foreclosures occur where a debtor voluntarily agrees to surrender property in full or partial

535. Tex. Prop. Code § 42.001(a) (West 2014).
536. *Id.* § 42.002(a).
537. *See* Uniform Voidable Transfer Act § 4(c) (2014), http://www.uniformlaws.org/shared/docs/Fraudulent%20Transfer/2014_AUVTA_Final%20Act_2016mar8.pdf [https://perma.cc/585C-P866].
538. *See id.* § 2(b).
539. *See id.* § 8 cmt. 5.
540. *See id.* § 10(a).

payment of a debt secured by the property after the debtor has defaulted.[541]

Finally, in a move that eases the burden of courts addressing claims under the Act and possibly prevents forum-shopping, the UVTA now eliminates any choice-of-law ambiguity by establishing that the substantive law of the place of the debtor's location at the time of the transfer applies.[542] The location of an individual debtor is considered to be his primary residence.[543] Similarly, the location of an entity is its primary place of business, unless it has multiple places of business, in which case the location is the entity's chief executive office.[544]

So far, it seems that these amendments have been introduced in legislatures in Massachusetts and Indiana.[545] Whether Texas follows is unclear at the time of this Survey. In the past, however, the adoption of uniform statutes regarding transfers has only taken a matter of time, and the authors include this in the Survey for your information.

## XIV. CONCLUSION

During this Survey period, bankruptcy judges and practitioners gained clarity on the authority of the bankruptcy courts. In addition, lawyers who are paid by the bankruptcy estate won a big victory in the Fifth Circuit, with the overruling of the problematic *Pro-Snax* decision. Finally, as the authors point out, some of the decisions covered in this Survey are not over, but are on their way up the appellate ladder, hopefully ripe for coverage next year. As for changes to statutes and rules, amendments to the Federal Rules of Civil Procedure seem geared towards eliminating or at least minimizing the burden of discovery and disputes. The authors hope these changes prove useful to those parties and attorneys putting forward a good faith effort towards discovery compliance and case resolution. Finally, once again highlighting Texas' reputation as a debtor-friendly state, debtors have cause to celebrate the increase in what were already robust personal property exemptions.

541. *See id.*
542. *See id.* § 10 cmt. 1.
543. *See id.* § 10.
544. *See id.*
545. *See id.* § 10(b).