2017 STATE BAR OF TEXAS BANKRUPTCY SECTION

TEXAS BANKRUPTCY BENCH BAR CONFERENCE

SAN ANTONIO, TEXAS

RECENT DEVELOPMENTS
CASE LAW UPDATE

Judge Ronald B. King
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A significant portion of the summaries in this paper were graciously provided by (i) Deborah D. Williamson, Aaron M. Kaufman and William J. Rochelle; (ii) Honorable Harlin D. "Cooter" Hale, Gerrit M. Pronske and Rakhee V. Patel; (iii) Deborah B. Langehennig, R. Byrn Bass Jr. and Brian T. Cumings; and (iv) Janet S. Northrup and Pamela Gale Johnson.

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The Fifth Circuit Court of Appeals found a debtor has standing to appeal a bankruptcy order when he or she is a "person aggrieved." Within the case, the bankruptcy court allowed certain claims, and, when the debtor appealed the ruling, the district court dismissed the claim allowance appeal as moot.

The Fifth Circuit reversed. To be a person aggrieved, the debtor must show he or she is directly and adversely affected by the order that he or she wishes to appeal. The court found the debtor to be a person aggrieved because he or she will be personally liable if the claim is not dischargeable and thereby could appeal the bankruptcy court's claim allowance order.

2. <u>AUTOMATIC STAY</u>

***In re Black Elk Energy Offshore Ops., LLC,* 2016 Bankr. LEXIS 2708 (Bankr. S.D. Tex. July 26, 2016) (Isgur, J.)**

Certain equity owners of the debtors moved for relief from the automatic stay to pursue derivative claims against non-debtor. In support of their motion, the equity holders argued that Tex. Bus. & Org. Code Ann. § 101.463 provides members of a closely held company the right to pursue derivative claims as direct actions and permits the court to provide payment directly to the members since the claims were not property of the estate.

The court was not persuaded. In general, all derivative claims belong to the estate and can only be pursued by a trustee for the benefit of all creditors. Otherwise, the derivative claims would violate 11 U.S.C.§ 362(a)(3). The court explained that the Texas statute provides a mere procedural benefit for members of a closely held company and ultimately concluded that "the statute does not convert derivate claims into direct claims such that they would not be included in a debtor LLC's bankruptcy estate."

3. <u>AVOIDANCE POWERS</u>

***Byman v. Lab. Corp. of Am. Holdings (In re Sadler Clinic, PLLC)*, 2016 Bankr. LEXIS 832 (Bankr. S.D. Tex. Mar. 9, 2016) (Isgur, J.)**

The chapter 7 trustee sought to avoid preferential transfers. After the trustee retained solvency experts, the debtors filed a motion to strike the solvency experts, arguing the trustee's experts used a liquidation methodology rather than a going-concern methodology. Both parties in turn filed a motion for summary judgment on the sole issue of insolvency.

The court denied the motion to strike, and found that the debtors' argument did not constitute a *Daubert* challenge. A *Daubert* challenge serves as a gatekeeping measure and focuses on whether the expert's testimony is scientifically valid. The court recognized that in evaluating the debtors' assets both the liquidation value method and the going concern value method could be appropriate, depending on the debtors' financial conditions. The final determination as to which methodology was appropriate would depend on the particular facts presented. On the merits, the court concluded that there was a genuine issue of fact as to solvency. Specifically, the court concluded that the defendant adduced sufficient evidence through its expert report to rebut the 90-day presumption of insolvency under § 547(f). However, the debtors used a going concern valuation method while the trustee used the liquidation value method. Since the trustee and debtors presented evidence that contradicted the actual image of the debtors' financial health, the court denied summary judgment.

***Janvey v. Golf Channel, Inc.*, 834 F.3d 570 (5th Cir. 2016) (per curiam) (affirming the district court's grant of summary judgment for Golf Channel upon receipt of answer to certified question, *Janvey v. Golf Channel Inc.*, 487 S.W.3d 560 (Tex. 2016) (Guzman, J.))**

The court-appointed receiver sued the Golf Channel to recover $5.9 million paid under a marketing agreement. The Fifth Circuit initially reversed the District Court's grant of summary judgment for the Golf Channel and rendered judgment in favor of the receiver. Months after its initial ruling, the Fifth Circuit vacated its ruling and certified the question on how to interpret "value" for purposes of the affirmative defense to fraudulent transfers under TUFTA to the Texas Supreme Court. In response, the Texas Supreme Court explained that "value" existed without regard to the potential fraud perpetrated by the transferor. The court concluded that value is viewed from an objective perspective at the time of the transaction, so long as the transaction is a legitimate enterprise. Moreover, the Texas Supreme Court explained that the absence of tangible goods or services was not dispositive of "value." The key inquiry was whether those goods or services had objective value in the market at the time of the transaction.

In the present case, the Texas Supreme Court concluded that the Golf Channel performed under a lawful, arm's-length agreement, charged a market rate for its services that had objective value at the time of the transaction, and provided such services in the ordinary course of its business. Under the circumstances, the Texas Court concluded that the Golf Channel did provide reasonably equivalent value to Stanford in exchange for the $5.9 million it received. After receiving the response to the certified question, the Fifth Circuit affirmed the district court's grant of summary judgment for Golf Channel.

4. <u>CLAIMS ALLOWANCE, LIEN DISPUTES</u>

***Banco Popular, N. Am. v. Kanning*, 638 F. App'x. 328 (5th Cir. 2016) (per curiam)**

On behalf of his company, the decedent executed a loan with a bank using his life insurance beneficiary interest as collateral. Both the decedent and his wife acknowledged the agreement, but the forms necessary to execute the lien were never properly completed despite several attempts to complete the assignment. When the decedent died, the life insurance company paid the proceeds to the wife. The wife later filed for bankruptcy, claiming the proceeds as exempt. After the wife obtained a discharge, the bank sued to recover the life insurance proceeds. The wife contended the assignment was unenforceable and that the bank was in contempt of her discharge.

The Fifth Circuit determined the assignment provision of the life insurance was enforceable and rejected the wife's argument that the bank had violated her discharge injunction. The bank's complaint demonstrated that it had a valid lien interest, as Texas law permits a lien to be created in monetary proceeds. Since the bank was attempting to collect on its lien, the claim constituted an *in rem* action and the discharge injunction did not bar the bank from bringing its suit.

***In re Hernandez*, 2016 Bankr. LEXIS 2758 (Bankr. S.D. Tex. July 29, 2016) (Rodriguez, J.)**

The court held that an oversecured creditor was entitled to interest accruing on its claim not only from the confirmation date forward, but also from the time between the petition date and the confirmation date as well.

***Hill v. Herring (In re Herring)*, 550 B.R. 119 (Bankr. S.D. Tex. 2016) (Paul, J.)**

The Bankruptcy Court for the Southern District of Texas held that title was not transferred when a deed was not delivered to the alleged transferee and, therefore, the property remained in the estate. In this case, joint debtors owned (by virtue of community property law) real property and attempted to execute a transfer of the property via general warranty deed to the debtor-wife's mother. The debtors never delivered the deed to the debtor-wife's mother. Thus, the court held that title did not transfer and the property was property of the debtors' estate.

***Prince v. IRS*, 2016 U.S. Dist. LEXIS 67128 (E.D. Tex. May 23, 2016) (Clark, J.)**

The debtor filed for chapter 7 bankruptcy. The IRS filed a proof of claim in the case and a lien was attached to the debtor's homestead. When the homestead was sold, the debtor and IRS both filed to have proceeds disbursed to them.

The court ruled that the proceeds would go to the IRS and the debtor appealed. The debtor stated that the IRS needed to object to the homestead exemption, levy the property, and file an adversary proceeding. The court disagreed stating that the IRS is not required to timely object because the exemption has no effect on a federal tax lien. In addition, the IRS did not need to levy the property to collect on its lien because simply filing the proof of claim is enough to enforce its lien.

***In re Solis*, 2016 Bankr. LEXIS 1708 (Bankr. W.D. Tex. Apr. 15, 2016) (Davis, J.)**

A chapter 13 debtor confirmed a plan that would be infeasible if the proposed value of the damaged vehicle was actually worth more than the debtor claimed. The secured creditor filed a proof of claim asserting a substantially greater value for the automobile, and the debtor objected. The court determined the burden for proving value is initially *prima facie* established by a creditor's proof of claim, but once the debtor rebuts the validity of such proof of claim, it is the secured creditor's burden to prove the value of the collateral based on a preponderance of the evidence standard.

The court noted that the NADA Clean Retail value generally overstated the replacement value of vehicles because it does not adjust for damage to the vehicle. Furthermore, the court noted how Edmunds may actually undervalue a vehicle since the valuation can include mechanical problems.

***In re Tavares*, 547 B.R. 204 (Bankr. S.D. Tex. 2016) (Rodriguez, J.)**

Upon completion of the debtor's plan payments, the trustee moved to declare the mortgage paid in full. The creditor disagreed, stating that the trustee's mortgage calculations were incorrect. The creditor had attributed the payments to the debtor's interest and ad valorem taxes before subtracting it from the principal. This caused issues because the principal remained untouched for the first part of the repayment plan, causing an inconsistency between the creditor and trustee's calculations. The court found that the creditor had violated the order confirming the plan because the plan included a clear scheme for how to apply the plan payments. By failing to apply the payments correctly, the creditor essentially waived the right to recover any deficiencies. Thus, the court found the debt fully cured.

5. <u>CREDITOR ABUSE</u>

***Bruner-Halteman v. Educ. Credit Mgmt. Corp. (In re Bruner Halteman)*, 2016 Bankr. LEXIS 1130 (Bankr. N.D. Tex. Apr. 8 2016) (Hale, J.)**

A creditor who received multiple notices of the debtor's chapter 13 bankruptcy, and had even participated in the bankruptcy, nevertheless continued to garnish the debtor's wages for two years post-petition. Despite numerous communications from the debtor's bankruptcy counsel demanding that the garnishments stop, and despite the fact that the creditor made fifteen manually processed refunds over the course of fourteen months, the creditor did not stop the garnishments until the debtor filed an adversary proceeding. The debtor claimed the creditor repetitively violated § 362(a)(3) and (a)(6) of the automatic stay. The creditor stipulated to the fact that it willfully violated the automatic stay.

The court held that the debtor had not established by preponderance of the evidence that the violations caused compensable emotional distress. Since the debtor had several personal challenges at the time of the garnishments, the court could not determine the creditor's actions were the sole cause of stress. Nevertheless, the court did award punitive damages of $2,000.00 per offense due to the callousness of the creditor's actions.

***In re Fauser,* 545 B.R. 907 (Bankr. S.D. Tex. 2016) (Isgur, J.)**

The court found that a creditor violates the chapter 7 discharge injunction by knowingly sending communication demanding payment. These communications willfully violated the discharge because the creditor knew of the injunction, but did not cease their collection efforts. The court awarded the debtor actual damages, punitive damages, and attorney fees.

To prevent future communication, the court also held the creditor would be subject to a $1,500.00 sanction, plus attorney fees, per each future communication.

6. <u>DISCHARGE AND DISCHARGEABILITY OF DEBT</u>

***Gnahoua v. Dep't of Educ. (In re Gnahoua)*, 2016 Bankr. LEXIS 974 (Bankr. N.D. Tex. Mar. 28 2016) (Jones, J.)**

A debtor failed to defend his doctoral thesis and was dismissed from school. Within the same month, the debtor filed for bankruptcy and sought to discharge his student loan debt. The court granted summary judgment against the debtor, holding that because the debtor had filed for bankruptcy the same month he was dismissed from school and had made no effort to repay the student loan debt or make payment arrangements he had failed to meet the good faith repayment test.

***Hinze v. Watkins (In re Hinze)*, 2016 Bankr. LEXIS 2700 (Bankr. S.D. Tex. July 25, 2016) (Paul, J.)**

The court was asked to decide whether the death of the debtor had an effect on the pending dischargeability proceeding. The court did not choose to answer and instead abstained under 11 U.S.C. § 1334(c) since the probate court was better situated to address whether the estate was liable for the debt.

***In re Klein*, 544 B.R. 587 (Bankr. W.D. Tex. 2016) (Gargottta, J.)**

A chapter 13 debtor received a discharge after successfully completing a five-year plan. One year after receiving that discharge, the debtor filed another chapter 13 case. The chapter 13 trustee requested the court to determine the debtor to be ineligible for a discharge pursuant to § 1328(f). The bankruptcy court denied the trustee's motion, holding that the appropriate meaning of § 1328(f)(2) is to prohibit debtors from receiving a second chapter 13 discharge in a case filed within two years of the filing date of the previous chapter 13 case in which the debtor received a discharge.

***Melchiorre v. Melchiorre (In re Melchiorre)*, 2016 Bankr. LEXIS 1800 (Bankr. E.D. Tex. April 20, 2016) (Parker, J.)**

The Bankruptcy Court for the Eastern District of Texas held attorney fees awarded under an order arising from a suit to modify terms of a parent-child relationship were nondischargeable pursuant to 11 U.S.C. § 523(a)(15). After finalizing a divorce, but prior to the debtor filing bankruptcy, the plaintiff sought a modification of a parent child relationship in state court and was awarded attorney fees within the case. The debtor then filed for bankruptcy and the plaintiff sought a determination that his claim against the debtor was nondischargeable.

The court found that the attorney fees awarded in state court were clearly assessed against the debtor. The court rejected the argument that the proceeding fell outside the purview of § 523(a)(15) simply because it was not an original proceeding to establish parental rights.

The court noted that the scope of family law debts that could not be affected by a bankruptcy discharge was significantly expanded by BAPCPA, and §523(a)(15) now encompasses any debt to a spouse, former spouse, or child of the debtor (other than a domestic support obligation) that is incurred by the debtor in the course of a divorce or separation or in connection with a separation agreement, divorce decree or other order of a court of record.

***Scarbrough v. Purser (In re Scarbrough),* 836 F.3d 447 (5th Cir. 2016) (Stewart, J.)**

Prior to the filing of bankruptcy, the debtor represented a client in a Texas state court lawsuit and the debtor wrongfully failed to disclose evidence to the court or the opposing side, for which the state court sanctioned the debtor. The other side to the litigation obtained several orders against the debtor for fraud, civil conspiracy, and defamation. The debtor then filed for bankruptcy. The other side sought nondischargeability of debts for money and property obtained by false pretenses, a false representation, or actual fraud and debts due to the attorney/debtor causing willful and malicious injury to them. The bankruptcy court concluded that the judgments against the attorney/debtor were nondischargeable because the debtor engaged in “scorched earth” tactics by intentionally concealing evidence; failing to disclose secret recordings; violating various court orders; making outrageous false allegations; and filing multiple frivolous motions, which ultimately affected litigation strategy and harmed other parties.

The debtor appealed the bankruptcy court decision. The district court affirmed and debtor appealed again. Several incidents lead the Fifth Circuit to affirm the judgment. Among them was debtor’s (1) false reporting to Adult Protective Services; (2) posting a video of a personal family conflict on YouTube in an attempt to hinder one of the litigant’s bid for a school board seat; and (3) conspiring to make false statements and reports that one of the litigants threatened to kill others and consumed illegal drugs. The court found these actions sufficient to find the debt non-dischargeable under § 523(a)(6).

7. <u>DISMISSAL, CONVERSION, AND BAD-FAITH FILING</u>

***In re Castro,* 2016 Bankr. LEXIS 411 (Bankr. S.D. Tex. Feb. 9, 2016) (Paul, J.)**

The court found that a case should be dismissed when a debtor uses the bankruptcy process for reasons other than his own need for financial rehabilitation. In this case, the debtor filed a petition, but failed to complete prepetition credit counseling and file certain necessary documents. The court found that the debtor filed bankruptcy with intentions of saving his brother-in-law and sister’s property. While his family paid the mortgage, the property was listed in the debtor’s name. The court determined that since the debtor did not have an equitable or possessory ownership in the property while he retained ownership for his family, the case should be dismissed.

***Krueger v. Torres (In re Krueger),* 812 F.3d 365 (5th Cir. 2016) (Jones, J.)**

Prior to filing bankruptcy, the debtor was restrained in state court from making nonordinary-course-of-business withdrawals from his company's account and from participating in the company's business. After the debtor violated the restraining order in a number of ways, the state district court ordered the debtor to show cause why he should not be held in contempt. The debtor filed for chapter 7 bankruptcy on the day before the hearing. After the bankruptcy filing and relief from the automatic stay, the state court held the debtor in criminal contempt in violation of the restraining order. The debtor then called for a meeting of the company's shareholders, despite the fact that the debtor's shares in the company had passed to the bankruptcy trustee. The debtor disregarded the trustee's ownership and voted his shares and caused the company's litigation against him to be dismissed. A shareholder then filed a motion to dismiss the bankruptcy case with prejudice for cause under § 707(a), and the bankruptcy court granted the motion with a two-year refiling bar. The debtor appealed.

With respect to the merits of the appeal, dismissal of the case under § 707(a), a "court may dismiss a case under this chapter only after notice and a hearing and only *for cause*." The statute lists three non-exclusive grounds for cause that courts use: 1) unreasonable delay by debtor causing prejudice to the creditors 2) "nonpayment of any fees or charges" required to file a case and 3) "failure of the debtor in a voluntary case to file" schedules and creditor lists. The Fifth Circuit joined those courts that have held a debtor's bad faith in the bankruptcy process can serve as the basis of a dismissal for cause. In judging whether there is cause to dismiss a case, a court may consider the debtor's entire course of conduct.

***Ogle v. Comcast Corp. (In re Houston Reg'l Sports Network, L.P.),* 547 B.R. 717 (Bankr. S.D. Tex. 2016) (Isgur, J.)**

In-fighting among the partners of the failed Houston Sports Network (HSN)—a 2003 partnership among Comcast and the media affiliates for the Houston Astros and Rockets—led to a messy involuntary bankruptcy process starting in 2013, followed by a rocky sale process, and ultimately the confirmation of a plan selling ownership of the network to Comcast's competitor AT&T/DirecTV. In this dispute, the liquidating trustee for the debtor network sued Comcast under a number of theories, arising from Comcast's alleged efforts to drive down the value of the debtor's business in order to buy the debtor inexpensively. The Comcast defendants moved to dismiss, arguing the complaint failed to state plausible facts giving rise to causes of action, contending that there was an "obvious alternative explanation" for Comcast's actions. Specifically, Comcast pointed out that if it truly wanted to buy the debtor "on the cheap," it would have done so when it was presented with the opportunity.

Under the facts alleged, the court concluded that Comcast's "alternative explanation" was neither obvious nor "so convincing that the plaintiff's explanation is rendered implausible" and therefore rejected the argument. Next, the Court considered whether its prior ruling on Comcast's "good faith" in filing the involuntary petition was preclusive of any fraud finding in Comcast's alleged actions during the bankruptcy case. Because the "good faith" ruling on the involuntary was a "close call" and premised on Comcast's statement at the outset of the case that it would purchase the debtor at a price sufficient to pay creditors in full and provide a meaningful dividend to equity, the court concluded that the current allegations concerned different claims. In the complaint, the trustee alleged that Comcast's actions during the bankruptcy were fraudulent, because they demonstrated a resolve to make no such offer. Because the claims were not identical, the court denied dismissal on preclusion grounds.

In re Karlinger–Smith, **544 B.R. 126 (Bankr. W.D. Tex. 2016) (Davis, J.)**

The Smith's filed a chapter 7 case after they could not find an amicable workout with their small business lender. The debtors were above-median and mostly lived within the budget outlined by the IRS. The lone exception was that the debtors paid for private Catholic schooling for their two teenage sons. Finding that the debtors had enough "disposable income" to pay more to their creditors, the U. S. Trustee moved to convert to chapter 11.

While noting the absence of binding authority on the ability to force a chapter 7 debtor into chapter 11, the court concluded that conversion could be proper if chapter 11 provided a meaningful benefit to creditors and the debtor. However, in this case, the court found no such benefit from conversion, noting that the primary business creditor was likely to litigate several issues in a chapter 11, making conversion more expensive and eating up the little bit of disposable income that the debtors have available. Thus, because the circumstances did not warrant conversion, the U.S. Trustee's motion was denied.

8. EXECUTORY CONTRACTS AND UNEXPIRED LEASES

In re Goodrich Petro. Corp, **554 B.R. 817 (Bankr. S.D. Tex. 2016) (Isgur, J.)**

Several months before the bankruptcy, the debtor entered into a settlement agreement with the movant to resolve Louisiana parish court litigation regarding the alleged termination of the debtor's oil and gas leases with the movants. But the debtor failed to complete the payments required under the settlement prior to bankruptcy. The movants asked the court to compel the assumption of the settlement agreement or, alternatively, allow them to dissolve the lease ratification recorded pursuant to the settlement agreement.

In this decision, the court rejected both theories. First, the court concluded the settlement was not executory because all material obligations (other than the bi-annual settlement payments) were completed. Specifically, the movants had already executed the releases, recorded the lease ratifications and accepted the promissory note from the debtor. Next, the court concluded that the movants could not dissolve the settlement (and, thus, the lease ratification recorded as a part of the settlement). The court concluded that any right to do so would have been an unrecorded right held by the movants that could be avoided by the debtor's strong-arm powers under § 544. As such, the court denied the movants' relief.

9. <u>EXEMPTIONS</u>

***In re Ayobami,* 2016 Bankr. LEXIS 645 (S.D. Tex. Mar. 1, 2016) (Isgur, J.)**

The court analyzed that the method a debtor used to measure their exemption of an asset, whether in value or percentage, decides whether an increase in value will go to the estate (by exempting a dollar amount) or to the debtor (by exempting a percentage). Within this case, the debtor used a percentage valuation on individual items within her schedules that exceeded the allowed exemption amount. The court found that debtor could not claim exemptions that exceed the statutory maximum because any excess violates the Code and belongs to the estate. The court ruled that the debtor needed to amend her schedules to claim the correct amount of the exemption.

***In re Harris,* 2016 WL 6127515 (Bankr. S.D. Tex. Oct. 20, 2016) (Isgur, J.)**

Prior to bankruptcy, debtor and his spouse owned real property, and the debtor transferred the property to his spouse pursuant to a divorce property settlement. Shortly after the property transfer, debtor filed for chapter 13 bankruptcy. As of the petition date, debtor continued to live at the transferred property, although he and his then ex-spouse stated that debtor lived in a garage apartment at the property rather than in the main portion of the home. The trustee alleged that the divorce was a sham and that the property transfer was done in actual fraud of creditors. The ex-spouse and the trustee settled by having the ex-spouse transfer the property to the estate. After the transfer, the debtor amended his schedules to claim the property as exempt by homestead. The trustee objected.

The court found that a debtor may only exempt property that was exempt on the petition date because the "snapshot rule" requires that all exemptions are determined at the time the bankruptcy petition is filed. In this case, the transfer was not avoided as a fraudulent transfer because it is was transferred pursuant to the settlement. Therefore, the property belonged to the estate post-petition, not on the date of the bankruptcy filing. Because the Estate owned a right of recovery—and not the real property itself—on the petition date, the court held that the debtor would not be able to exempt the property.

***Hawk v. Engelhart (In re Hawk),* 556 B.R. 788 (S.D. Tex. 2016) (Harmon, J.)**

After the debtor filed bankruptcy under chapter 7, the debtor elected exemption of his IRA accounts The debtor then withdrew all of the funds in the IRA account, but failed to reinvest or roll over funds into a new exempt IRA account. The Trustee then filed an expedited motion seeking a turnover order, arguing that the funds automatically reverted to the bankruptcy estate because the debtors failed to reinvest them in another exempt IRA account within sixty days. The debtor argued that the snapshot rule meant that the funds were permanently exempt. The bankruptcy court found that the funds reinvested into the estate since they were not reinvested.

In affirming, the district court held that an "essential element of the exemption must continue in effect even during the pendency of the bankruptcy." The court further held the debtor has a continuing duty to maintain the status quo of exempt property during the pendency of the bankruptcy case. If the debtor fails to do so, the trustee is entitled to the assets that the debtor claimed exempt as of the petition date. In the present case, the court found that the funds removed from an exempt IRA account during the pendency of the bankruptcy estate become property of the bankruptcy estate because they lost their exempt status when debtor failed to meet the state law's 60-day reinvestment requirement. The debtor appealed, and both parties have submitted briefs: Case No. 16:20641. The case is scheduled for oral arguments for Thursday, June 8, 2017.

***Romo v. Montemayor (In re Montemayor)*, 547 B.R. 684 (Bankr. S.D. Tex. 2016) (Rodriguez, J.)**

The chapter 7 debtor received the proceeds after the sale of his exempt homestead. The trustee sought to have the funds turned over, asserting they lost exemption status because the proceeds were not reinvested in a new homestead within the six-month statutory period. Distinguishing the present case from *In re Frost*, which held exemptions lose status if not reinvested in a chapter 13 case, the court held that the proceeds did not lose homestead protection in a chapter 7 case.

10. <u>ESTOPPEL</u>

***Sherman v. Wal-Mart Assocs., Inc.*, 550 B.R. 105 (N.D. Tex. 2016) (Godbey, J.)**

A chapter 13 debtor converted her case to chapter 7 after her employer terminated her. The debtor claimed she was wrongfully terminated and planned to file a lawsuit against her employer, but she did not include the lawsuit on her amended schedules. When the debtor filed a wrongful termination lawsuit, she reopened her bankruptcy case and amended her schedules to include the lawsuit. Her employer then moved to dismiss, asserting the debtor did not have standing under judicial estoppel.

The district court held that because the debtor had voluntarily converted her bankruptcy case, her post-petition claim no longer belonged to the bankruptcy estate and therefore she did not have an affirmative duty to disclose the lawsuit upon conversion.

***Smith v. Dallas Cty. Hosp. Dist.*, 651 F. App'x. 279 (5th Cir. 2016) (per curiam)**

Prior to bankruptcy, a debtor filed a *pro se* civil rights complaint seeking damages against her former employer. When she filed for bankruptcy, she failed to disclose her claim in her schedules. The district court found that the doctrine of judicial estoppel applied and dismissed the complaint. The debtor appealed. On appeal, the Fifth Circuit first found that a bankruptcy debtor is required to disclose all assets, including contingent claims or potential causes of action. The Fifth Circuit stated that judicial estoppel is particularly appropriate where a party fails to disclose an asset to a bankruptcy court, but then pursues a claim in a separate tribunal based on that undisclosed asset.

Second, The court found that a failure to disclose a claim in bankruptcy is considered inadvertent when, in general, the debtor either lacks knowledge of the undisclosed claims or has no motive for concealing the claim. In this case, the debtor was aware of her possible claim at the time of filing and the potential for a future recovery against the employer provided a motive for concealing the claim. Since the debtor presented no admissible evidence creating a genuine dispute regarding whether she inadvertently failed to disclose her claims in bankruptcy, the court dismissed the appeal as frivolous.

***Whitaker v. Moroney Farms Homeowners' Ass'n (In re Whitaker),* 642 F. App'x. 345 (5th Cir. 2016) (per curiam)**

A state court judgment for breach of fiduciary duty was entered against the former president and director of a HOA for self-dealing. When the debtor filed for chapter 7 bankruptcy, the HOA brought a dischargeability action and the bankruptcy court applied collateral estoppel to prevent the debtor from relitigating the facts, ultimately holding the debt to be nondischargeable under §523(a)(4). The Fifth Circuit Court affirmed, holding that federal law recognizes state laws that create a fiduciary relationship and that Tex. Bus. Org. Code Ann. §§ 22.221(a) and 22.235(a) creates a fiduciary duty on the part of directors and officers of non-profit corporations like HOAs.

11. JURISDICTION, REMOVAL AND CONSTITUTIONAL AUTHORITY

***Galaz v. Katona (In re Galaz),* 841 F.3d 316 (5th Cir. 2016) (Clement, J.)**

Galaz pursued claims against Katona, the debtor, and the claims were largely settled in an adversary proceeding. The settlement required the debtor to assign her interest in a company and any unliquidated claims against third parties to Vernon. Vernon assigned all of his rights related to the 2011 settlement to Galaz. The debtor then received a discharge, and the bankruptcy case was closed. Then, Galaz attempted to recover from the debtor in state court. In response, the debtor filed with the bankruptcy court a motion to enjoin Galaz from attempting to recover, claiming the state court suit violated the debtor's discharge rights. Galaz, argued that the bankruptcy court did not have jurisdiction to bar him, as successor-in-interest to Oshita, from pursuing claims against the debtor.

The Fifth Circuit disagreed with Galaz and concluded that post-confirmation jurisdiction existed and that the 2011 settlement order barred Galaz from pursuing pre-discharge claims against the debtor. First, the state court litigation related primarily to pre-confirmation claims that are subject to the bankruptcy court's discharge order because bankruptcy courts maintain jurisdiction to interpret and enforce their own orders. Second, a violation or of the debtor's discharge rights is within the bankruptcy court's "arising under" jurisdiction. The court further concluded that Galaz's claims were barred by the 2011 settlement for res judicata, as the 2011 settlement barred claims by Vernon against the debtor.

***Hornbeck Offshore Servs., LLC v. ATP Oil & Gas Corp. (In re ATP Oil & Gas Corp.)*, 550 B.R. 325 (Bankr. S.D. Tex. 2016) (Isgur, J.)**

A claimant commenced an adversary proceeding to request a declaratory judgment holding that the creditor held perfected liens. The court determined it had subject matter jurisdiction over the declaratory judgment action between the statutory lien claimant and the purchaser of the debtor's assets to determine the relative priority of the lien claimant's liens. However, because the dispute was only "related to" the bankruptcy case, concerned only issues of state law, was among non-debtor parties, and could not be fully resolved in the context of a claim objection, the court concluded that lacked constitutional authority to issue final orders without the parties' consent. Therefore, the court concluded that it could grant partial summary judgment, which was merely interlocutory, and not a final order.

***Kingdom Fresh Produce v. Stokes Law Office, L.L.P. (In re Delta Produce, L.P*), 845 F.3d 609 (5th Cir. 2016) (Costa, J.)**

In the present case, various unpaid sellers of perishable produce sued the debtor, a "repacker" that purchased produce from farmers to sell to grocers, under PACA. After the debtor filed for chapter 11, special PACA counsel was thereby deputized to take those steps reasonably necessary to preserve and collect the PACA trust assets and to facilitate the distribution of the collected PACA trust assets. Counsels' fees and costs would be paid from the PACA trust funds.

After Special PACA Counsel collected over $4 million in PACA assets and filed a fee application to be paid from the trust assets, various claimants objected to the fee application, arguing that the bankruptcy court lacked jurisdiction to disburse PACA trust assets that were not part of the bankruptcy estate and therefore Special Counsel could not be paid out of the PACA trust. At the hearing on the first application, the bankruptcy court concluded that it had proper jurisdiction over the PACA claims and awarded fees. On appeal to the district court, the court agreed that the bankruptcy court had proper jurisdiction over the PACA trust but held that the Special Counsel was not entitled to attorney's fees paid out of the trust unless and until the trust beneficiaries were paid in full. The court held that it need not resolve doubts about the bankruptcy court's constitutional authority to adjudicate PACA claims because there was consent for it to act. In regards to whether fees can be paid from the trust, the court found the trust's unequivocal language to require a PACA trustee—or in this case, its functional equivalent— to pay all funds due to claimants before it could be paid from the trust assets.

***In re Odin Demolition & Asset Recovery, LLC,* 544 B.R. 615 (Bankr. S.D. Tex. 2016) (Bohm, J.)**

Defendants filed a motion to reopen a bankruptcy case to have the bankruptcy court interpret the plan and determine that the claims asserted against them were barred. The court concluded that it had jurisdiction and authority to consider and enter final orders on the motion to reopen because the ruling was critical to the administration of the bankruptcy case and would adjust the debtor-client relationship. Further, the court found that the parties consented by appearing in person and through pleadings on the motion to reopen, and never once raised an objection to the bankruptcy court's constitutional authority. Thus, under *Wellness International*, the court concluded that it could enter final orders by consent as well.

12. PLANS, CONFIRMATION, AND MODIFICATION

***In re Chapter 13 Plan Admin. in the Brownsville, Corpus Christi & McAllen Divs.*, 2016 Bankr. LEXIS 1938 (Bankr. S.D. Tex. May 5, 2016) (Jones, J.)**

Bankruptcy judges within the Southern District of Texas initiated a proceeding related to the chapter 13 trustee administering plans in reference to mortgage payment change notices. The chapter 13 trustee claimed she had administered chapter 13 plans in accordance with the interpretation of the standard plan enforced by a recently retired bankruptcy judge. The retired judge submitted an affidavit confirming that the chapter 13 trustee's administration had been in accordance with his interpretation of the standard plan. Nevertheless, the court ruled that the chapter 13 trustee had violated her duties and ordered her to take remedial actions, including repaying out of her own funds debtors who paid more than they would have under the standard plan for the district.

***In re Crawford*, 2016 Bankr. LEXIS 2695 (Bankr. W.D. Tex. July 21, 2016) (Gargotta, J.)**

The chapter 13 trustee objected to a debtors' plan that would pay all claims over five years, arguing that all of debtors' income should be used to pay creditors in order to receive their discharge. The bankruptcy court noted that debtors could either propose full payment of unsecured claims or propose payment of all disposable income over 60 months, but that they are not required to do both. But, the court continued to hold that it can impose conditions on confirmation of a plan that otherwise meet the requirement of § 1325(b)(1). Therefore, the court required the debtors to resubmit the plan with language stating that the debtors cannot modify the plan to less than 100% distribution to creditors.

***In re House Nursery, Ltd.*, 2016 Bankr. LEXIS 409 (Bankr. E.D. Tex. Feb. 9, 2016) (Parker, J.)**

This decision addressed the contractual interpretation of a plan provision stating that the secured lender "may foreclose" on its collateral after an agreed-upon date. When that date passed without the lender's foreclosure, the debtor moved to enforce the plan to compel foreclosure, arguing that "may" in context was not discretionary.

In this opinion, without finding ambiguity in the provision, the court found that "the factual background derived from the public record as outlined in the proceeding section . . . is not forbidden extrinsic evidence"—the court concluded that "may" in the present context was not discretionary. Rather, the court held that "may foreclose" meant that the lender had negotiated to use this foreclosure right after the agreed-upon deadline, if the debtor was unable to sell the property before then. Given the background and the remaining provisions of the plan, the court concluded that the parties did not intend for that right to be used with discretion. While the market did not produce the results the parties had hoped for, the court explained that "the Bank cannot simply isolate chosen words now from the context from which they arose and thereby achieve a different result from that contemplated by the parties at the time of the confirmation of the plan."

***Kessler v. Wilson (In re Kessler)*, 655 F. App'x. 242 (5th Cir. 2016) (per curiam)**

The chapter 13 debtors completed their bankruptcy plan and requested a discharge. The bankruptcy court denied discharge because the debtors did not make direct payments on their mortgage debt and therefore had not complied with § 1328(a). The Fifth Circuit affirmed, holding that post-petition direct mortgage payments fall under a chapter 13 plan when pre-petition defaults are also provided for in the plan.

***In re Shea, Ltd.*, 545 B.R. 529 (Bankr. S.D. Tex. 2016) (Rodriguez, J.)**

Under § 1121(e), a debtor has 180 days of exclusivity to propose a plan, but no more than 300 days to obtain confirmation of that plan. When that time runs out, the case will be subject to conversion or dismissal. Within this case, the time ran out and a creditor filed a motion to dismiss, but other creditors objected, requesting to purpose their own plan.

The court concluded that Congress did not intend for the 300-day deadline to apply to creditors. "Certainly, if Congress wished to provision a drop dead deadline for all plans filed in a small business chapter 11, it absolutely knew how to say so in 1994 and likely did not forget how to say so in 2005." Accordingly, the motion to convert was denied, and the creditors were allowed to file a plan.

***In re Univ. Gen. Hosp. Sys.*, 2016 Bankr. LEXIS 1783 (Bankr. S.D. Tex. Apr. 20, 2016) (Paul, J.)**

Certain principals of the debtor sought to enforce the plan injunctions when a creditor obtained a judgment against the debtor's directors for the debtor's. Under the plan, creditors were enjoined from pursuing derivative actions of the debtor, including "any type of successor liability based on acts or omissions of the Debtors." The directors argued that claims stemming from corporate forfeiture were such "successor liability" claims.

The court disagreed. Under of the Tex. Tax Code Ann. § 171.255(a) "each director or officer of the corporation is liable for each debt of the corporation that is created or incurred in this state after the date on which the report, tax, or penalty is due and before the corporate privileges are revived." Relying on a case from the Northern District of Texas, the Court concluded that these claims were *direct*, not derivative, because the plan did not bar a creditor's direct claims against non-debtors and denied the movants' motion.

***In re Odin Demolition & Asset Recovery, LLC,* 544 B.R. 615 (Bankr. S.D. Tex. 2016) (Bohm, J.)**

Defendants filed a motion to reopen a bankruptcy case to have the bankruptcy court interpret the plan and determine that the claims asserted against them were barred.

The court denied the motion for several reasons. First, the court concluded that the defendants lacked standing to reopen the case. Under § 350, only a debtor, creditor or trustee can seek to reopen a case, and the defendants failed to demonstrate that they fell into any of those categories. Likewise, the defendants failed to demonstrate that they were a "party in interest" under § 1109(b), because there was no evidence of any threat of imminent injury to their businesses or property from the state court litigation. Second, the court denied the motion to reopen on the merits, because it concluded that there was no relief available to the defendants. The court recognized that the plan and disclosure statement failed to make "specific and unequivocal" reservations of these claims. However, as a matter of first impression, the court concluded that the debtor was not barred from pursuing the claims because the defendants were not creditors with rights to vote on the plan.

***In re Ward*, 546 B.R. 667 (Bankr. N.D. Tex. 2016) (Jernigan, J.)**

After the debtor's chapter 13 case was confirmed, the debtor filed a motion to incur debt to borrow money to purchase a new car. The debtor needed to purchase a car with an exorbitant interest rate after her vehicle was repossessed due to her inability to maintain insurance. The court found that the car dealership was targeting debtors by sending several hundred advertisements in mail and by helping to pay debtor's attorney fees in association with the motion to incur debt. Additionally, the dealership allowed the debtor to use the car for three months before the approval of the motion. The court denied the motion. It ordered that both the car and the attorney's fees to be returned to dealership.

13. PROCEDURE

***In re Adilace Holdings, Inc.*, 548 B.R. 458 (Bankr. W.D. Tex. 2016) (Davis, J.)**

A chapter 7 trustee filed a motion to establish a deadline for a counterparty to make an election under § 365(n). Subsequently, a creditor filed an objection to intervene, asserting that an adverse ruling on the could impair her rights in a separate action pending in an unrelated state court action. The trustee moved to deny intervention efforts because the objecting creditor had no real stake in the outcome of the potential deadline under § 365(n).

In denying intervention, the court concluded that the trustee was adequately representing the creditor's interest by seeking to maximize distributions. The court also concluded that the creditor would not be prejudiced in state court if intervention was denied because estoppel would not bar the action. Finally, the court concluded that intervention would unnecessarily complicate the § 365(n) issue, because it would require the trustee to litigate several additional issues. For those reasons, the court concluded that the objecting creditor failed to demonstrate grounds for intervention and, thus, denied her motion to intervene.

***In re Bascus*, 548 B.R. 742 (Bankr. S.D. Tex. 2016) (Isgur, J.)**

Several law firms and bankruptcy petitioner preparers were ordered to show cause why they should not be sanctioned for acting in concert with others to violate §§110, 526, 527, and 528 of the Bankruptcy Code by offering mortgage relief services that involved filing bad faith chapter 13 bankruptcy cases in order to delay foreclosures. The respondents asserted that they had a Seventh Amendment right to a jury trial. The bankruptcy court found that no Seventh Amendment right to a jury trial existed for claims brought against a person based on §§ 110, 526, 527, and 528 of the Bankruptcy Code, holding that the claims arose only in bankruptcy law and had no analogous common law equivalents, and that the statutory provisions involved fell within the public rights exception.

***In re DeRosa-Grund*, 544 B.R. 339 (Bankr. S.D. Tex. 2016) (Bohm, J.)**

The chapter 7 trustee released all claims for injunctive relief against a movie company relating to certain film ideas. The debtor had not disclosed the film treatment in his bankruptcy. But, before completion of the bankruptcy, the debtor began to sue the movie company in state court, alleging claims relating to the film treatment the movie company purportedly used. After losing in arbitration, the debtor's attorney sent a settlement demand letter to the movie company suggesting that unless the film company met the debtor's demands, the debtor would move to reopen the bankruptcy case and amend his schedules so that the chapter 7 trustee would be able to administer the film treatment. The movie company declined, so the debtor moved to reopen his case. The movie company objected, arguing that an arbitrator had already ruled the debtor did not own the treatment and that judicial estoppel precluded the debtor from receiving any proceeds.

After a detailed explanation of the improper litigation tactics that the debtor and his attorneys employed during their dispute with the movie company, the bankruptcy court held that the film treatment was property of the estate and that the trustee's release of claims for injunctive relief was not a release of the trustee's claims to the underlying film treatment. The court reopened the case, but *sua sponte* held that the debtor was judicially estopped from receiving any proceeds from the sale of the film treatment.

***Foster v. Holder (In re Foster)*, 644 F. App'x. 328 (5th Cir. 2016) (per curiam)**

A debtor filed a claim against her bankruptcy estate as the next friend of her children and moved under § 324(a) to remove the trustee. The bankruptcy court disallowed the claim and separately denied the motion to remove the trustee. The debtor and her children moved to appeal the order denying the removal of the trustee and the bankruptcy court denied the motion as to the children because their claim had been disallowed and granted it as to the debtor. The court determined that the debtor had standing because the debtor was making assertions that, if correct, would have resulted in the estate not being insolvent. Ultimately, the appeal was dismissed as being frivolous because the debtor failed to present any arguments as to how the order denying the motion to remove the trustee had been an abuse of discretion by the bankruptcy court.

***Prince v. Chow et al (In re Prince),* 2016 Bankr. LEXIS 2702 (Bankr. E.D. Tex. 2016) (Rhoades, J.)**

Plaintiff moved for recusal of the bankruptcy judge, arguing that the judge showed bias in previous rulings against the plaintiff. The court denied the motion because prior adverse decisions cannot form the basis for recusal and because the plaintiff failed to produce any other evidence of bias.

14. PROFESSIONAL REPRESENTATION, EMPLOYMENT, AND COMPENSATION

***In re King*, 546 B.R. 682 (Bankr. S.D. Tex. 2016) (Bohm, J.)**

A chapter 7 trustee hired his own firm to represent the estate, and the firm filed a fee application requesting 66.93% of the total proceeds. The bankruptcy court held that the fee application inappropriately billed the estate for duties that the chapter 7 trustee should have carried out in the trustee capacity, included multiple time entries that constituted non-legal and non-compensable work, and included multiple entries that were vague and/or lumped tasks. The court approved roughly one-third of the fees requested.

***In re Palacios,* 2016 Bankr. LEXIS 249 (Bankr. S.D. Tex. Jan. 27, 2016) (Rodriguez, J.)**

The debtor had a class action cause of action that went undisclosed until one year after the bankruptcy case was closed. When the chapter 7 debtor's class action counsel notified the trustee of a settlement, the trustee moved to reopen the case and seek approval of the compromise. The court was willing to do so for the compromise, but the payment of counsel's fees presented a separate issue. Years before the debtor's bankruptcy case, the debtor engaged counsel at a 40% contingency, but never filed an application to employ with the bankruptcy court. At a preliminary hearing on the compromise, the court instructed counsel to file the appropriate applications. However, the application to employ did not comply with the Southern District's Local Rule requiring all retroactive applicants to explain why the application was not filed sooner, why retroactive employment is necessary, and how retroactive employment might prejudice other parties.

In this thorough decision denying fees of the chapter 7 debtor's class action counsel, the court lists a litany of counsel's deficiencies in following the court's clear instructions to seek retroactive employment. The application failed to comply with local rules. The application to employ was denied and, thus, the court struck the fee application as moot, reminding counsel that "no good deed goes unpunished."

15. PROPERTY OF THE ESTATE

***In re Sanjel (USA) Inc.*, 2016 Bankr. LEXIS 2771 (Bankr. W.D. Tex. July 28, 2016) (Gargotta, J.)**

After the bankruptcy court entered an order recognizing the foreign main proceeding in Canada and enforcing the terms of the "Initial Order" of the Canadian Court (which insulated various D&Os from liability), certain plaintiffs filed a motion for relief from the automatic stay under § 362 to pursue Fair Labor Standard Act claims against the debtors' D&Os within the United States. The debtors opposed for several reasons, including the prejudice litigation would pose to the debtors by straining the limited resources of the debtors' existing staff.

As a threshold matter, the bankruptcy court concluded that relief from the automatic stay was insufficient to provide the relief the plaintiffs were seeking. The automatic stay under § 362(a) did not apply to the debtors' D&Os. What the plaintiffs really wanted was a modification to the recognition order, which had incorporated the D&O stay from the Canadian Court's "Initial Order." Exercising its broad discretion, the court considered the stay relief motion as a motion to modify the recognition order under § 1522(c).

In this case, the plaintiffs persuasively argued that many class members would lose their rights to pursue the debtors' D&Os because the D&Os would not enter into tolling agreements, and the limitations would likely expire while the D&O Stay remained in effect. On the other hand, the court was not persuaded by the potential strain on the debtors' resources if the debtors were forced to participate in discovery related to the FLSA claims against certain of the debtors' D&Os. Accordingly, the court modified the recognition order to allow the plaintiffs to conduct limited discovery and obtain the necessary consents from other class members to preserve causes of action.

16. SANCTIONS, DEBTORS, AND COUNSEL BEHAVING BADLY

***In re Bascus*, 548 B.R. 742 (Bankr. S.D. Tex. 2016) (Isgur, J.)**

A debtor filed a second case after his first was dismissed for various filing deficiencies. In the second case, it became known that a bankruptcy preparer filed his first "pro se" case. The court issued a show cause order, and the preparer's demanded a jury.

In this opinion, Judge Isgur explains that the Seventh Amendment does not extend to the specific rights asserted against the petition preparers. Finding no 18th century claims that would be analogous to the statutory claims pursued by the United States Trustee, the court concluded that they were equitable in nature, even though the United States Trustee sought civil sanctions as part as incidental to the request, and therefore determined the claims do not carry with them a right to a jury trial.

***Freeman Saxton, P.C. v. United States. Tr. (In re Bascus),* 2016 U.S. Dist. LEXIS 111971, Case No. 4:15-cv-869 (E.D. Tex. Aug. 22, 2016) (Schneider, J.)**

This lengthy decision, which incorporated substantial portions of a prior decision from Judge Rhoades, detailed the actions of a law firm based out of Atlanta. As evident from three different "victims," the law firm's modus operandi was the same for all cases. When a debtor received a foreclosure notice from its mortgage lender, the law firm would send out marketing materials offering to save the debtor's house. When the debtor called, a non-lawyer individual from the firm's Atlanta office would offer a "loan modification program" at a cost of $4,500. The debtors were never told they were speaking with a non-lawyer, nor did they realize the firm was not licensed to practice in Texas.

The firm would take an "upfront" payment, despite receiving no modification offer from the debtor's lender, and then instruct the debtor to contact a "petition preparer" to help the debtor file a *pro se* chapter 13 case. In one instance, the debtor was already in bankruptcy, so the law firm instructed the debtor to transfer the house to someone else and have that person file a bankruptcy petition.

In this detailed decision, the district court dismissed the appeal, concluding that the bankruptcy court did not err in its rulings. Specifically, the court concluded that the initial dismissal hearings (where the court first learned about the law firm's involvement) were not *ex parte* communications merely; they were public hearings that were duly noticed. That the law firm chose not to be involved in those bankruptcy cases was not a valid ground to invalidate the proceedings. Further, the show cause hearings were duly noticed. The court affirmed the bankruptcy court's award of the debtors' legal fees associated with any subsequent bankruptcy filing, concluding that those subsequent filings (and the additional work required to file them) would not have been necessary but for law firm's actions.

The court further concluded that the law firm and petition preparer were given ample due process as required by Rule 9011 and that there was no requirement under Rule 26 to hold a pre-trial conference or require parties to provide disclosures. The court also concluded that Freeman and Bascus were not entitled to a jury in this proceeding.

***In re Netoche Bringham Fair,* 2016 Bankr. LEXIS 2043 (Bankr. N.D. Tex. May 18, 2016) (Jernigan, J.)**

In this debtor's second chapter 13 case, the court was concerned that the debtor purchased a new car days before her prior case was dismissed. During the stay extension hearings, the court discovered that the debtor's prior law firm had counseled the debtor to abandon her old vehicle (i.e., the only item still being paid under her prior chapter 13 plan), and convert the case to chapter 7 so that she could get a discharge and then purchase a new vehicle. The counsel then referred the debtor to a car dealership that would approve her credit and pay her legal fees associated with converting the case or financing a new vehicle. Concerned about this newly-discovered (and previously undisclosed) relationship, and also having concerns about the way prior counsel drew down on the debtor's debit card to make monthly plan payments, the court issued a show cause to prior counsel.

First, the court concluded that the practice of running a client's debit card every month violated Texas Disciplinary Rules, because it entailed the law firm to hold the funds in an unsegregated, non-interest bearing account. The court explained that the practice was wholly unnecessary to ensure timely payments—the chapter 13 trustee accepted e-payments and online payments. However, no sanctions were issued for these actions because the evidence presented indicated that the firm had stopped this practice.

Second, the court found that the law firm had received over $77,000 in fees from the dealership over the prior 18 months. The court found that none of these fee payments were disclosed. While noting that § 504 applied, the court concluded that there was no violation because the compensation did not come from the estate. On the other hand, the court concluded that the arrangement violated § 329 and Rule 2016, which required this arrangement to be disclosed, and further violated Rule 3.03 of the Texas Disciplinary Rules. As such, the court felt "compelled to take remedial measures." Because there was no disclosure, the court concluded that disgorgement was the proper remedy.

Accordingly, the court required the law firm (and the two lawyers responsible for the arrangement) to pay $77,175 into the registry of the court. The U.S. Trustee and chapter 13 trustee were instructed to file fee applications for their time and expense incurred in bringing this issue to the court's attention. Any funds left over after payment of allowed fees and expenses would be donated to the Texas Access to Justice Foundation.

***In re Skyport Global Commc'n, Inc.*, 642 F. App'x. (5th Cir. Mar. 14, 2016) (per curiam)**

The Fifth Circuit affirmed sanctions awarded, when it held that a bankruptcy court has inherent authority to police practitioners who act in direct contravention of its orders. Within this case, minority shareholders filed a state court action after confirmation. The bankruptcy court determined that the state court action contravened the plan confirmation order because the claims asserted were enjoined under the plan.

17. SUPREME COURT CASES

***Puerto Rico v. Franklin Cal. Tax-Free Tr.*, 136 S. Ct. 1938 (2016) (Thomas, J.)**

In response to an ongoing fiscal crisis, Puerto Rico enacted the Puerto Rico Public Corporation Debt Enforcement and Recovery Act. Portions of the Recovery Act mirror chapters 9 and 11 of the Federal Bankruptcy Code and enable Puerto Rico's public utility corporations to restructure their debt. Respondents, a group of investment funds and utility bondholders, sought to enjoin the Act. They contended, among other things, that § 903(1) of the Bankruptcy Code explicitly pre-empts the Recovery Act. The District Court enjoined the Act's enforcement, and the First Circuit affirmed, concluding that the Bankruptcy Code's definition of "State" to include Puerto Rico, except for purposes of defining who may be a debtor under chapter 9, § 101(52), did not remove Puerto Rico from the scope of the pre-emption provision.

The Supreme Court found that three federal municipal bankruptcy provisions were relevant here. First, the "gateway" provision, § 109(c), requires a chapter 9 debtor to be an insolvent municipality that is "specifically authorized" by a State "to be a debtor." Second, the pre-emption provision, § 903(1), expressly bars States from enacting municipal bankruptcy laws. Third, the definition of "State," § 101(52), as amended in 1984, includes Puerto Rico, except for the purpose of defining who may be a debtor under chapter 9. The Court found that if petitioners were correct, that the amended definition of "State" excluded Puerto Rico altogether from chapter 9, then the pre-emption provision would not apply. But if respondents' narrower reading were correct and the definition only precluded Puerto Rico from authorizing its municipalities to seek chapter 9 relief, then Puerto Rico would be barred from implementing its Recovery Act.

The Court found that the Bankruptcy Code's plain text supported respondents' reading. The unambiguous language of the preemption provision contains an express preemption clause, the plain wording of which necessarily contains the best evidence of Congress' pre-emptive intent. The definition provision excludes Puerto Rico for the single purpose of defining who may be a chapter 9 debtor, an unmistakable reference to the § 109 gateway provision. This conclusion is reinforced by the definition's use of the phrase defining who may be a debtor under Chapter 9, § 101(52), which is tantamount to barring Puerto Rico from "specifically authorizing" which municipalities may file Chapter 9 petitions under the gateway provision, § 903(1). The text of the exclusion thus extends no further. Had Congress intended to exclude Puerto Rico from chapter 9 altogether, including chapter 9's pre-emption provision, Congress would have said so.

The Court further found that the amended definition of "State" did not exclude Puerto Rico from all of chapter 9's provisions. First, Puerto Rico's exclusion as a "State" for purposes of the gateway provision does not also remove Puerto Rico from chapter 9's separate pre-emption provision. A State that chooses under the gateway provision not to authorize a municipality to file is still bound by the preemption provision. Likewise, Puerto Rico is bound by the pre-emption provision, even though Congress has removed its authority under the gateway provision to authorize its municipalities to seek chapter 9 relief. Second, because Puerto Rico was not "by definition" excluded from chapter 9, both § 903's introductory clause and its proviso, the preemption provision, continue to apply in Puerto Rico. Finally, the argument that the Recovery Act is not a "State law" that can be pre-empted is based on technical amendments to the terms "creditor" and "debtor" that are too "subtle" to support such a "[f]undamental chang[e] in the scope" of chapter 9's pre-emption provision.

***Husky Int'l Elecs., Inc. v. Ritz*, 136 S. Ct. 1581 (2016) (Sotomayor, J.)**

A company of which the debtor was director and part owner incurred a debt to a creditor/supplier of nearly $164,000. The debtor drained the company of assets available to pay the debt by transferring large sums of money to other entities the debtor controlled. Creditor sued the debtor to recover on the debt, and debtor then filed for chapter 7 bankruptcy. In the bankruptcy case, creditor filed a complaint, seeking to hold the debtor personally liable and contending that the debt was not dischargeable because the debtor's intercompany-transfer scheme constituted "actual fraud" under § 523(a)(2)(A) of the Bankruptcy Code.

The district court affirmed the bankruptcy court holding that the debtor was personally liable under state law but that the debt was not obtained by actual fraud under § 523(a)(2)(A), and therefore could be discharged in bankruptcy. The Fifth Circuit affirmed, holding that a misrepresentation from a debtor to a creditor is a necessary element of "actual fraud" and was lacking in this case, because the debtor made no false representations to the creditor regarding the transfer of the company's assets.

The Supreme Court reversed, holding that the term "actual fraud" in § 523(a)(2)(A) encompasses fraudulent conveyance schemes, even when those schemes do not involve a false representation. The Court presumed that when Congress amended the Bankruptcy Code in 1978 and added to debts obtained by "false pretenses or false representations" an additional bankruptcy discharge exception for debts obtained by "actual fraud," it did not intend the term "actual fraud" to mean the same thing as the already existing term "false representations." Further, at common law, "actual fraud" meant fraud committed with wrongful intent, and the term "fraud" has, since the beginning of bankruptcy practice, been used to describe asset transfers that, like the debtor's scheme, impair a creditor's ability to collect a debt. Overall, the common-law term "actual fraud" is broad enough to incorporate fraudulent conveyances. The common law also indicates that fraudulent conveyances do not require a misrepresentation from a debtor to a creditor, as they lie not in dishonestly inducing a creditor to extend a debt but in the acts of concealment and hindrance.

The Court further found that interpreting "actual fraud" in § 523(a)(2)(A) to encompass fraudulent conveyances would not render duplicative two of § 523's other discharge exceptions, (a)(4) and (a)(6), given that "actual fraud" captures much conduct not covered by those other provisions. The Court further found that was also not incompatible with § 523(a)(2)(A)'s "obtained by" requirement. Even though the transferor of a fraudulent conveyance does not obtain assets or debts through the fraudulent conveyance, the transferee—who, with the requisite intent, also commits fraud—does. At minimum, those debts would not be dischargeable under § 523(a)(2)(A). Finally, reading the phrase "actual fraud" to restrict, rather than expand, the discharge exception's reach would untenably require reading the disjunctive "or" in the phrase "false pretenses, a false representation, or actual fraud" to mean "by."

In a dissenting opinion, Justice Thomas found that the Bankruptcy Code exempts from discharge any debt for money, property, or services "*to the extent obtained by*" false pretenses, a false representation, or actual fraud. Justice Thomas found that the Court had incorrectly held that "actual fraud" encompasses fraudulent transfer schemes effectuated without any false representation to a creditor and had concluded that a debt for goods may "sometimes" be "obtained by" a fraudulent transfer scheme.

In his view, "actual fraud" within the meaning of § 523(a)(2) does not encompass fraudulent transfer schemes. Section 523(a)(2)(A) covers only situations in which "money, property, [or] services" are "obtained by ... actual fraud," and results in a debt. The statutory phrase “obtained by” is an important limitation on the reach of the provision. Section 523(a)(2)(A) applies only when the fraudulent conduct occurs at the *inception of the debt, i.e.*, when the debtor commits a fraudulent act to induce the creditor to part with his money, property, services, or credit. The logical conclusion then is that “actual fraud”—as it is used in the statute—covers only those situations in which some sort of fraudulent conduct caused the creditor to enter into a transaction with the debtor. But the fraudulent transfer in this case did not trick the creditor into selling his goods to the buyer. It follows that the goods that resulted in the debt here were not “obtained by” actual fraud. Bankruptcy treatises confirm that the phrase “to the extent obtained by” is properly read as meaning obtained from the creditor. It would be nonsensical in this case to say that a fraudulent transfer created the debt at issue.

Justice Thomas found that the majority had reached the conclusion that § 523(a)(2)(A) may prevent an individual debtor from obtaining a discharge even if (1) the debtor makes no false representation to the creditor, (2) the creditor does not rely on any of the debtor’s actions or inactions, and (3) there was no actual fraudulent conveyance at the inception of the credit transaction between the creditor and the debtor.