

# BANKRUPTCY BRIEFS

NEWSLETTER OF THE BANKRUPTCY SECTION OF THE FEDERAL BAR ASSOCIATION

Marc Taubenfeld, Editor

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## CHAIR'S MESSAGE

Welcome to the revived *Bankruptcy Briefs*. The FBA Bankruptcy Law Section is revitalizing its newsletter and this edition is the Section's latest installment. The Bankruptcy Law Section is committed to engaging and highlighting law students and younger attorneys in our Section activities. As such, law students wrote all the articles for this edition. In addition, the Section is suggesting that law firms and judges participate in the "FBA Young Lawyers in the Court Initiative" by allowing less experienced lawyers the opportunity to practice in court with a bankruptcy judge's participation. The Section hopes that both the courts and the lawyers see this as an opportunity to educate and mentor newer attorneys in their career path.

As a member of the Bankruptcy Law Section, you should be receiving monthly Bankruptcy Circuit Updates and notice of conference calls regarding these updates. I would encourage you to reach out to law students and lawyers in your district to advise them regarding the opportunity to write bankruptcy circuit updates and participate in our Section. Our Section also has a regular column in *The Federal Lawyer* written for the non-bankruptcy lawyer. This is another opportunity to be published. Please feel free to contact me with any comments or suggestions you might have. It is a privilege serving as your Chair.

Regards,

**Judge Craig A. Gargotta**

Chair, Bankruptcy Section

[Judge\\_Craig\\_Gargotta@txwb.uscourts.gov](mailto:Judge_Craig_Gargotta@txwb.uscourts.gov)



# Lessons Learned



The Supreme Court Resolves Circuit Split  
Regarding § 523 Nondischargeability  
Actions in *Appling*

By: Zachary Levick  
Extern to the Honorable Harlin D. Hale  
United States Bankruptcy Court for the Northern District of Texas

At its heart, the Bankruptcy Code is meant to give the honest debtor a fresh start. *In re Appling*, 848 F.3d 953, 956 (11th Cir. 2017). But not all debtors are “honest” and the Bankruptcy Code is not an all-encompassing safe haven. When bad actors are involved and creditors may be subject to fraud, the Bankruptcy Code provides:

- (a) A discharge . . . does not discharge an individual debtor from any debt—
  - (2) for money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained by—
    - (A) false pretenses, a false representation, or actual fraud, *other than a statement respecting the debtor’s or an insider’s financial condition*;
    - (B) use of a statement in writing—
      - (i) that is materially false;
      - (ii) *respecting the debtor’s or an insider’s financial condition*
      - (iii) on which the creditor to whom the debtor is liable for such money . . . reasonably relied
      - (iv) that the debtor caused to be made or published with intent to deceive . . .

11 U.S.C. § 523(a)(2) (emphasis added). In effect, this statute creates mutually exclusive criteria for preventing discharges in cases of fraud. *Id.* If the fraud in question respects the debtor’s financial condition, it must be in writing and reasonably relied upon to prevent discharge—oral statements will not do. *Id.* In the case *Lamar, Archer, & Cofrin, LLP v. Appling (In re Appling)*, 2018 U.S. LEXIS 3384 (June 4, 2018), the United States Supreme Court considered whether an oral, false statement about a single asset is a “statement respecting the debtor’s . . . financial condition.”

This case started when Scott Appling (“Appling”) hired Lamar, Archer & Cofrin, LLP (“Lamar”) to represent him in miscellaneous business litigation. *In re Appling*, 848 F.3d 955. Per that litigation, as of March 2005, Appling owed Lamar upwards of \$60,000 in legal fees. *Id.* A meeting was held that same month at which Appling falsely claimed he was due to receive a \$100,000 tax refund, and that he would use that refund to pay his debt to Lamar. *Id.* Lamar, with that statement in mind, continued performing legal services for Appling. *Id.* In reality, Appling’s tax refund was nowhere near \$100,000, and once the funds were received by Appling, they were not used to pay the past due legal fees owing to Lamar. *Id.* Appling apparently lied again in a subsequent meeting, saying he had not yet received



The Court stated that it could not implement  
“such seemingly arbitrary distinctions”



the refund, and Lamar consequently continued with and completed the litigation despite the nonpayment. *Id.* Five years later, Lamar filed suit against Appling over the unpaid final invoice balance, obtaining a judgement against him for \$104,179.60. *Id.* at 956. Shortly thereafter Appling filed for bankruptcy. *Id.*

Lamar initiated a nondischargeability adversary proceeding against Appling in bankruptcy court. *Id.* Appling’s debt to Lamar was ruled nondischargeable; the court found that Lamar had reasonably relied on Appling’s fraudulent statements. *Id.* On appeal, the district court affirmed. *Id.* Appling’s argument—that his statement regarding a single asset “respect[ed] . . . [his] financial condition”—was expressly rejected by the district court, which instead held that “statements respecting the debtor’s financial condition involve the debtor’s net worth, overall financial health, or equation of assets and liabilities.” *Id.* On further appeal to the 11th Circuit, the lower courts’ rulings were reversed. *Id.*

The 11th Circuit focused on interpreting the language of the statute itself, determining that a statement pertaining to a single asset does respect the debtor’s financial condition. *Id.* at 957 (emphasis added). This ruling cemented a split on this issue among the circuit courts. See *Appling*, 848 F.3d 953; *Engler v. Van Steinberg*, 744 F.2d 1060, 1061 (4th Cir. 1984) (“[a] debtor’s statement that he owns certain property . . . is a statement reflecting his financial condition); but see *In Re Bandi*, 683 F.3d 671, 676 (5th Cir. 2012) (holding only statements about “general overall financial condition of entity” respect financial condition); *In re Joelson*, 427 F.3d 700, 714 (10th Cir. 2005) (“the strict reading of ‘respecting the debtor’s . . . financial condition’ is correct); *In re Lauer*, 371 F.3d 406, 413 (8th Cir. 2004) (statements about specific assets do not respect debtor’s financial condition).

The divisiveness, and relevance, of this narrow bankruptcy statute led to the Supreme Court granting certiorari on January 12, 2018. In affirming the 11th Circuit, the Supreme Court also relied on the language of the statute itself, while pointing out the illogical consequences that would stem from narrow construction of the statute and the statute’s legislative history. *Lamar v. Appling*, 584 U.S. \_\_\_ (2018) (slip op.). After noting the long judicial tradition of reading “respecting” to have a broadening effect on statutes, the Court focused on defining the word. *Id.* at 7. Keeping with the ordinary definition (as it often does), the Court found that a statement about a single asset necessarily has a relation to the speaker’s financial condition and therefore “respects” it. *Id.* at 8. Furthermore, the Court agreed with Appling that Lamar’s preferred narrow construction would “read ‘respecting’ out of the statute.” *Id.* at 9.

The Court then turned to the “incoherent results” that would stem from adopting Lamar’s narrow reading. *Id.* The Court noted that such a narrow construction would result in heightened dischargeability requirements for a misrepresentation about a single asset in a balance sheet, but not if the same misrepresentation was made alone. *Id.* at 10. The Court stated that it could not implement “such seemingly arbitrary distinctions” in lieu of Congressional intent. *Id.* The Court concluded the opinion with a discussion about why its ruling is consistent with the legislative history of the Bankruptcy Code before categorically stating “a statement about a single asset can be a ‘statement respecting the debtor’s financial condition’ under § 523(a)(2) of the Bankruptcy Code.” *Id.* at 15.

The Court’s ruling affirms a favorite principle of the law—get things in writing. By ultimately holding that an allegedly fraudulent remark regarding a single asset can be a “statement respecting the debtor’s financial condition,” and, as such, § 523(a)(2)(B) requires that type statement be made in writing to be the basis of a nondischargeability claim, the Court aptly reminded all potential creditors of that maxim. It is important to note that the Court did not find that a statement about a single asset would always be held to be a statement about a debtor’s financial condition, so exceptions may still be possible, but this ruling highlights the importance of obtaining written documentation of any representation even remotely related to a debtor’s financial condition. As they say—better safe than sorry. ■

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# THE INTERSECTION

BETWEEN

Preservation of the Estate

AND

Paying Debtor's Professional Fees

By: Taylor Calvert

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A conundrum arises at the intersection of preservation of the bankruptcy estate and allowing the debtor to equip itself with competent counsel and other professionals because of the concern “that payments to the debtor’s attorneys [and other professionals necessary to the administration of the estate] could jeopardize the relief accorded to creditors and could encourage overreaching by the debtor’s attorneys.”<sup>1</sup> To combat this concern, Congress enacted 11 U.S.C. § 330: “[a] professional employed by a debtor-in-possession may be awarded: (a) reasonable compensation for actual and necessary services performed by the professional; and (b) reimbursement for actual, necessary expenses.”<sup>2</sup> An award, however, cannot be made for “unnecessary duplication of services; or services that were not reasonably likely to benefit the debtor’s estate; or not necessary to the administration of the case.”<sup>3</sup>

The purpose of § 330 is to provide fair and reasonable compensation. Moreover, a “court should not allow compensation for . . . services that were not . . . reasonably likely to benefit the debtor’s estate; or . . . necessary to the administration of the case.” 11 U.S.C. § 330(a)(4)(ii). “[T]o not deter competent counsel from entering the bankruptcy area, attorneys should receive in bankruptcy matters what they would receive on the open market.”<sup>4</sup> “The amount of the estate, the complexity of the bankrupt’s affairs, the time reasonably devoted to the service, the

standing and experience of counsel . . . are all proper elements to be considered in estimating the reasonableness of attorney’s fees . . .”<sup>5</sup> Nevertheless, “[i]t would be unwise both for creditors and bankrupts to make the compensation so parsimonious that attorneys of standing and experience would be reluctant to act on behalf of bankrupts.”<sup>6</sup> Thus, basing approval of a fee application, or the amount of reasonable compensation, solely on the fact that multiple fee applications have been submitted, appears to be contradictory to the purpose of § 330, as it is likely to

deter competent attorneys from taking cases where the hiring of multiple professionals is necessary for case administration. The concern can be mitigated, however, if consideration of multiple fee applications is undertaken with an eye towards the benefit of the services to the estate.

**A. In some cases, the totality of administration expenses in relation to the size of the estate or benefit to the estate is examined when determining the reasonableness of fee application.**

“Determining the reasonableness of . . . [a professional’s] compensation is a difficult task which is not easily reduced to a mathematical formula.”<sup>7</sup> Courts typically make the determination on a case-by-case basis using a variety of factors. Bankruptcy courts in the Fifth Circuit use the lodestar method to calculate a reasonable amount, then use the factors provided by *Johnson v. Georgia Highway Express, Inc.*<sup>8</sup> to adjust that amount depending the circumstances of the case.<sup>9</sup> The factors specified in *Johnson* are:

- (1) The time and labor required;
- (2) The novelty and difficulty of the questions;
- (3) the skill requisite to perform the legal service properly.
- (4) The preclusion of other employment by the attorney due to acceptance of case;
- (5) The customary fee;
- (6) Whether the fee is fixed or contingent;
- (7) Time limitations imposed by the client or the circumstances;
- (8) The amount involved and the results obtained;
- (9) The experience, reputation, and ability of the attorneys;
- (10) The “undesirability” of the case;
- (11) The nature and length of the professional relationship with the client;
- (12) Awards in similar cases.<sup>10</sup>

Other courts outside of the Fifth Circuit also use the *Johnson* factors or a variation thereof as a blueprint for their analysis.<sup>11</sup> Some courts, including courts within the Fifth Circuit, have not expressly considered the presence of multiple fee applications when determining the reasonableness or amount of compensation afforded to a single fee applicant. They have considered, however, the total amount of administrative costs relative to the size of the estate or the benefit the services provided to the estate under the “amount involved and results obtained factor.”<sup>12</sup> Arguably, considering the totality of administrative costs in relation to the size of the estate is essentially considering the presence of multiple fee applications, because as more fee applications are submitted, the size of the estate diminishes upon their approvals.<sup>13</sup>

In *In re Warrior Drilling & Engineering Co., Inc.*, the court held that the two firms representing the debtor in a chapter 11 reorganization case were entitled to reasonable compensation of \$415,000 jointly, as well as expenses totaling \$12,485.<sup>14</sup> The objecting parties claimed that “services performed were of a routine nature,” the firms did not produce a purchaser for the debtor’s assets, and their fees should be limited to their hourly rate previously agreed.<sup>15</sup> The question before the court was “whether anything unusual or out of the ordinary occurred in the case by way of which attorneys would be entitled to claim a success premium for holding the case together when a breakdown was

. . . imminent.”<sup>16</sup> The *Warrior* court held “this case warrant[ed] a premium for ability, expertise and firmness of action under fire in a crisis, and . . . determined it has the authority to go beyond the mere matter of hours and reward success, considering the size of the estate.”<sup>17</sup> The court used the *Johnson* factors to determine the amount and reasonableness of compensation.<sup>18</sup> The size of the estate and the results obtained were most strongly considered under the “amount involved and the results obtained” factor.<sup>19</sup> Because of the reorganization, unsecured creditors and equity security holders were paid a total \$8,000,000.<sup>20</sup> The court found that the requested fee of \$440,000 was less than 6% of the amount paid to unsecured creditors and equity holders and “less than 1% of total assets and payments made to creditors and other interests.”<sup>21</sup>

The case of *In re Sapolin Paints, Inc.* involved a chapter 11 liquidating case in which the debtor’s attorneys were seeking compensation for services and reimbursement of expenses incurred.<sup>22</sup> Despite the fee request of \$423,848.62, the *Sapolin* court held that the debtor’s attorneys were only entitled to \$345,435.20 because, after paying priority claims, and other administrative expenses and claims, the balance of the estate was only \$2,228,000, and, according to the court, the legal fees needed to bear a reasonable relationship to that figure.<sup>23</sup> The attorney’s performance “was outstanding in all respects and was of the highest quality, [w]here a matter could be settled . . . it was [and] where it had to be brought before the court, it was done so in the most professional manner . . .”<sup>24</sup> Nonetheless, “[k]eeping in mind the comparatively modest estate, the court concluded that despite the excellence of work done by [the attorneys] it would be unfair to creditors to allow legal fees of this magnitude.”<sup>25</sup> Clearly, despite the excellent work cited by the courts that was exhibited by the professionals in each of these cases, courts determine these issues on a case by case basis.

**B. Other courts find it unnecessary to consider the size of the estate relative to the costs of estate administration when determining whether a fee application is reasonable.**

While some courts found it necessary to consider the size of the estate in relation to administrative costs when determining the reasonableness of the amount of compensation, other courts do not find the analysis relevant. In *In re Lane Lumber Co.*, an unsecured creditor and trustee petitioned for review of a court order allowing payment of the attorney’s claim for fees totaling \$2,750.<sup>26</sup> The court observed that there was a three-part question that the fee applicants had the burden of showing: “Was a service performed? Was such service reasonably necessary to enable the bankrupt to discharge its duties under the law? And what was it reasonably worth?”<sup>27</sup> The complained of order, allowing for payment of \$2,750 in attorney’s fees, was reversed with instructions allowing the fees to be paid at a reduced amount of \$385.<sup>28</sup> The fee applicants asserted that there was a “very material or direct relationship between the mere aggregate of assets and liabilities . . . and the compensation to be allowed to the bank-

rupt's attorney."<sup>29</sup> The court disagreed, finding that "[t]he value of the matter involved is generally taken into consideration as an important factor in determining what is a reasonable charge for legal advice or professional service; but . . . neither the assets nor the liabilities of the estate represent or measure the value of the estate."<sup>30</sup> Furthermore, while the "degree of solvency of estate" may be considered, it should only be considered to "the extent of the ability of a client to pay a reasonable fee."<sup>31</sup>

### C. It is improper to consider the presence of multiple fee applications as a standalone determinative factor when determining the amount or reasonableness of a single fee application.

There is no specific rule regarding whether adjustments to the amount of compensation awarded to an attorney should be based on the amount of administrative costs burdening the estate, essentially, the number of fee applications submitted. Some courts have correctly found that there is no automatic denial of compensation for overlapping professional attention to a chapter 11 debtor's problems, especially where it is necessary and reasonable for several professionals to work together: for example, coordination of services, delegation of responsibilities, development of strategies, and drafting of documents.<sup>32</sup> And, finding the presence of multiple fee applications as a standalone determinative factor would be contradictory to the purpose of 11 U.S.C. § 330 to provide fair and reasonable compensation to professionals employed by the debtor, and could infringe upon the debtor's right to competent counsel. A matter that requires the hiring of multiple professionals would be less attractive to competent or expert counsel, because the amount of compensation awarded to them will be at risk of being decreased simply because other professionals, necessary to the administration of the estate, were hired or will need to be hired. Furthermore, to keep fee applications at minimum, professionals might choose to perform tasks that they are not equipped to perform, which could possibly ultimately increase administrative costs, as it would likely take them longer to perform the tasks than the professional they should have hired. As such, it would be improper to consider the presence of multiple fee applications as a standalone determinative factor. It would be proper, however, to consider the amount of administrative costs in relation to the size of the estate, specifically considering the benefits the services provided to the estate. After taking all factors into consideration, there should be a reasonable relationship between the amount of administrative costs and the size of the estate. If there is not, adjustments should be made. ■

#### Footnotes

<sup>1</sup> *In re Smith*, 48 B.R. 375, 378 (C.D. Ill. 1984).

<sup>2</sup> *In re Palmaz Scientific, Inc.*, 556 B.R. 770, 784 (Bankr. W.D. Tex. 2016) (citing 11 U.S.C. § 330(a)(3): "[A]ll relevant factors, including: (A) the time spent on such services; (B) the rates charged for such services, (C) whether the services were necessary to the administration of, or beneficial at the time at which the service was rendered toward the completion of, a case under this title; (D) whether the services were performed within a reasonable amount of times commensurate with the complexity, importance, and nature of the problem, issue or task addressed; (E) with respect to a professional person, whether the person is board

certified or otherwise has demonstrated skill and experience in the bankruptcy field; and (F) whether the compensation is reasonable based on the customary compensation charged by comparably skilled practitioners in cases other than cases under this title.").

<sup>3</sup> 11 U.S.C. § 330(a)(4)(A)

<sup>4</sup> *In re Hunt's Health Care, Inc.*, 161 B.R. 971 (Bankr. N.D. Ind. 1993).

<sup>5</sup> *In re Christianson*, 175 F. 867, 868-69 (D.N.D. 1910).

<sup>6</sup> *Id.*

<sup>7</sup> *In re Smith*, 48 B.R. at 378 (citing *Citibank v. Multiponics, Inc.*, (*In re Multipontics Inc.*), 622 F.2d 731 (5th Cir. 1980)).

<sup>8</sup> *Johnson v. Georgia Highway Express, Inc.*, 488 F.2d 714 (5th Cir. 1974).

<sup>9</sup> *In re Palmaz Scientific, Inc.*, 556 B.R. at 784.

<sup>10</sup> *Id.* (citing *Johnson v. Georgia Highway Express, Inc.*, 488 F.2d at 717-19).

<sup>11</sup> See *Barron & Newburger v. Texas Skyline (In re Woerner)*, 783 F.3d 266, 275 (5th Cir. 2015) (noting that the Second, Third, and Ninth Circuits use a prospective standard in awarding fees).

<sup>12</sup> See cases cited *infra* notes 14-25 and accompanying text.

<sup>13</sup> See 11 U.S.C. § 507(a)(2) (prioritizing the payment of administrative expenses before the payment of secured and unsecured creditors) (citing 11 U.S.C. § 503(B)).

<sup>14</sup> *In re Warrior Drilling & Engineering Co.*, 9 B.R. 841, 844 (Bankr. N.D. Ala. 1981).

<sup>15</sup> *Id.* at 848.

<sup>16</sup> *Id.*

<sup>17</sup> *Id.*

<sup>18</sup> *Id.*

<sup>19</sup> *Id.* at 850.

<sup>20</sup> *Id.*

<sup>21</sup> *Id.*

<sup>22</sup> *In re Sapolin Paints, Inc.*, 38 B.R. 807, 809 (Bankr. E.D. N.Y. 1984).

<sup>23</sup> *Id.* at 811.

<sup>24</sup> *Id.* at 812.

<sup>25</sup> *Id.*

<sup>26</sup> *In re Lane Lumber Co.*, 206 F. 780, 781-82 (D.C. N.D. 1913).

<sup>27</sup> *Id.* at 783.

<sup>28</sup> *Id.* at 788.

<sup>29</sup> *Id.* at 785.

<sup>30</sup> *Id.* at 786.

<sup>31</sup> *Id.*

<sup>32</sup> *In re First River Energy*, Case No. 8-50085, 2018 WL 4403820 \*6 (Bankr. W.D. Tex. Sept. 13, 2018) (citing *In re Microwave Prod. of Am., Inc.*, 102 B.R. 661, 665 (Bankr. W.D. Tenn. 1989); *In re Aztec Co.*, 113 B.R. 414 (Bankr. M.D. Tenn. 1990)).



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## FEDERAL BAR ASSOCIATION / FBA BANKRUPTCY SECTION

The FBA Bankruptcy Section and the Dallas Chapter of the FBA jointly sponsored a 1 hour panel presentation entitled: “Bankruptcy: We’re From the Government, and We’re Here to Help” at the Dallas Bar Headquarters on November 28, 2018

*Pictured left to right:* Dawn Theiss (U.S. Attorney’s Office), Judge Harlin D. Hale (U.S. Bankruptcy Judge) (moderator), Lisa Lambert (U.S. Trustee’s Office), Ashley Carroll (State of Texas A.G.’s Office).



The panel discussed how often and when federal and state attorneys get involved in bankruptcy cases, how those cases can go more smoothly with communication with those government attorneys, what authority and ability to take actions the government attorneys typically have, and best practices those attorneys have witnessed in and out of bankruptcy court. An hour of CLE was available to attendees and approximately 35 people attended the panel presentation.

Members of the FBA Bankruptcy Section Board made a panel presentation on “The Litigation Trust and Theories of Recovery Regarding Director & Officer Insurance Policy Claims” at the NCBJ Conference in San Antonio on October 29, 2018.

*Pictured left to right:* Chris Sullivan, Elizabeth Gunn (moderator), Judge Harlin Hale, Judge Craig Gargotta.



The panel discussed theories of liability within the insurance or D&O policy area. The panel also discussed retention of jurisdiction under a confirmed plan and a bankruptcy court’s subject matter jurisdiction to adjudicate D&O claims post confirmation.

## UPCOMING EVENTS

**February 1-2, 2019**

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**March 22-23, 2019**

Leadership Training

**March 23, 2019**

Midyear & National Council Meeting

**September 5 - 7, 2019**

2019 Annual Meeting and Convention  
Hilton Tampa Downtown

# CASE STUDY:

## A Texas Chapter 13 Debtor's Community Property Interest In the Non-filing Spouse's Earnings



By: Joseph Reynolds  
Intern to the Honorable Craig A. Gargotta  
2L Texas Tech Law School

### **A DEBTOR'S COMMUNITY PROPERTY INTEREST** in the Non-filing Spouse's Community Property Earnings is a One-Half Undivided Interest Under Texas Law and Unaffected by a Chapter 13 Filing.

Texas Family Code § 3.002 defines community property as “property, other than separate property, acquired by either spouse during marriage.” In Texas, property acquired during marriage is presumed to be community property.<sup>1</sup> This presumption is rebuttable by clear and convincing evidence that the property is separate property.<sup>2</sup> Earnings, while still community property, have been characterized as “special community property.” Special community property is property that each spouse has sole management, control, and disposition of that the spouse would have owned if single; however, this classification does not affect a spouse's community property interest.<sup>3</sup> Since the Bankruptcy Code does not affect the community property interests of the debtor, a community property interest in a non-filing spouse's earnings is determined under state law.

While the Texas Family Code provides guidelines for community property, Texas case law addresses the rights of each spouse. “All property acquired during marriage is presumed to be community property, with each spouse owning an undivided one-half interest in all community asset.”<sup>4</sup> An undivided interest in funds cannot be severed or treated separately in the bankruptcy context.<sup>5</sup> The community property presumption is rebuttable by clear and convincing evidence.<sup>6</sup> Clear and convincing means the measure or degree of proof that will produce, in the mind of the trier of fact, a firm belief or conviction as to the truth of the allegations sought to be established.<sup>7</sup> Therefore, if a non-filing spouse wishes to characterize earnings as separate property, that spouse must present documentary evidence to trace and clearly identify the earnings as separate.<sup>8</sup> If the presumption is successfully rebutted, the debtor spouse has no interest in the non-filing spouse's separate earnings.<sup>9</sup>

State law determines whether the property is classified as separate or community for the purposes of a bankruptcy filing.<sup>10</sup>

While the community property may be included in a bankruptcy estate, the Bankruptcy Code does not contain express language to change a debtor's community property interest upon filing a chapter 13 bankruptcy. Therefore, the debtor's general community property interest is determined by the state law characterization only. In Texas, a debtor's community property interest in the debtor's non-filing spouse's earnings is a one-half undivided interest.

A Non-filing Spouse's Community Property Earnings May be Includible in a Chapter 13 Bankruptcy Estate Depending on the Management of the Property and Allowable Claims.

Section 541 of the Bankruptcy Code defines property of the estate to include:

All interests of the debtor and the debtor's spouse in community property as of the commencement of the case that is (A) under the sole, equal, or joint management and control of the debtor; or (B) liable for an allowable claim against the debtor or for both an allowable claim against the debtor and . . . the debtor's spouse, to the extent that such interest is liable.<sup>11</sup>

Section 1306(a)(1) of the Bankruptcy Code characterizes property of the estate to “include, in addition to the property specified in section 541 of this title – all property of the kind specified in such section that the debtor acquires after the commencement of the case but before the case is closed, dismissed, or converted.”<sup>12</sup> Thus, § 1306 brings in post-petition property acquired by the debtor that would have been includable in the estate upon filing under section 541.

Community Earnings May be Included in a Bankruptcy Estate Under § 541(a)(2)(A), however, it is Dependent on Whether the Earnings are Solely or Jointly Managed.

The inclusion of the non-filing spouse's earnings in the bankruptcy estate is dependent upon the characterization of the

property under state law and allowable claims on the non-filing spouse's earnings.<sup>13</sup> Texas law presumes earnings of each spouse to be under the sole management of the earner as special community property.<sup>14</sup> This characterization of a non-filing spouse's earnings would prevent inclusion in the bankruptcy estate under section 541(a)(2)(A).<sup>15</sup> If the sole managed earnings are mixed with property managed in some part by the other spouse, however, that property is no longer distinguishable or traceable to the earning spouse, and the property loses its special classification.<sup>16</sup> Thus, the separate and community property have been so comingled to defy differentiation, the statutory community property presumption prevails.<sup>17</sup> This change in identification of special community property to jointly managed community property would permit its inclusion in the estate through 11 U.S.C. §§ 541(a)(2)(A), 1306(a)(1) and Tex. Fam. Code §§ 3.102 & .202. Therefore, if the spouses were to pool earnings into a joint bank account, those comingled funds would be part of the community estate and includable in the debtor spouse's bankruptcy estate.

### **A NON-FILING SPOUSE'S EARNINGS ARE LIABLE FOR ALLOWABLE CLAIMS ON COMMUNITY DEBT AND INCLUDABLE IN THE BANKRUPTCY ESTATE UNDER § 541(A)(2)(B).**

Within community property states, each state has unique community property characteristics.<sup>18</sup> While Texas does not have a statutory presumption, Texas case law supports a presumption of community debt.<sup>19</sup> In *Newberry v. Newberry*, the El Paso Appellate Court explained that debt accrued during a marriage is presumed to be procured by community credit.<sup>20</sup> The presumption of community debt, procured by community credit, subjects the debtor and the debtor spouse's community property to an allowable claim.<sup>21</sup> This community property includes both special community property and normal community property.<sup>22</sup>

Therefore, a non-filing spouse's community earnings, whether solely managed or not, would be includable in a bankruptcy estate through 11 U.S.C. § 541(a)(2)(B), absent clear and convincing evidence that the earnings were separate property. Moreover, the post-petition earnings of the non-filing spouse would also be includable under § 1306(a)(2)(A) of the Bankruptcy Code.

The inclusion of community property earnings in the bankruptcy estate filed in a community property state is the result of the community debt presumption and is a reasonably fair exchange for the benefit of the co-debtor's stay. Section 1301 of the Bankruptcy Code protects both the debtor's and non-filing spouse's (as co-debtor's) community interests from collection without both spouses having to file for bankruptcy.

### **CONCLUSION**

While the filing of a bankruptcy does not itself determine the debtor's community property interests in the non-filing spouse's earnings, the characterization of the property and debt affects the bankruptcy estate. Texas community property presumptions associated with earnings and debt subject the full amount of the earnings to the bankruptcy estate, absent a clear and convincing showing of either separate property or separate debt. While a non-filing spouse's earnings are not explicitly addressed by the Bankruptcy Code, any community earnings would be includable in the estate both at the time of filing via 11 U.S.C. § 541(a)(2)(B), and post-petition under 11 U.S.C. § 1306(a)(1). ■

#### Footnotes

<sup>1</sup> Tex. Fam. Code Ann. § 3.003(a) (West 1997).

<sup>2</sup> *Id.* § 3.003(b) (West 1997).

<sup>3</sup> *Id.* § 3.102(a)(1) (West 1997); *Moss v. Gibbs*, 370 S.W.2d 452, 454 (Tex. 1963) (outlining the basic premise of special community property based on characteristics such as control).

<sup>4</sup> *In re Wald*, No. 11-53644, 2012 WL 2049429 at \*2 (Bankr. W.D. Tex. June 6, 2012) (quoting *United States v. Tischendorf*, No. 3-10-CV-2078-G-BD, 2011 WL 2413346 at \*2 (N.D. Tex. May 17, 2011) (citations omitted)).

<sup>5</sup> *In re Wald*, at \*5.

<sup>6</sup> Fam. § 3.003(a).

<sup>7</sup> *See Id.* § 101.007 (West 1995) (as applied to marriage relationships via Fam. § 1.001(c) (West 1997)).

<sup>8</sup> *In re Marriage of Stegall*, 519 S.W.3d 668, 674 (Tex. App. — Amarillo 2017, no pet.).

<sup>9</sup> *Barras v. Barras*, 396 S.W.3d 154, 163 (Tex. App. — Houston [14th Dist.] 2013, pet. denied).

<sup>10</sup> Fam. §§ 3.001 & .003.

<sup>11</sup> 11 U.S.C. §§ 541(a)(2)(A)-(B) (2016).

<sup>12</sup> 11 U.S.C. § 1306(a)(1).

<sup>13</sup> *Id.*

<sup>14</sup> Fam. § 3.102(b).

<sup>15</sup> Special community property is characterized by the sole control and management of the property. This characterization is not includable under 11 U.S.C. § 541(a)(2)(A).

<sup>16</sup> *Stegall*, 519 S.W.3d at 674.

<sup>17</sup> *Id.*

<sup>18</sup> *Compare In re Cluff*, No. 09-41244-JDP, 2012 WL 909551 at \*3 (Bankr. D. Idaho Mar. 15, 2002) (providing "both spouses, including the 'non-earning' spouse, are entitled to management and control of that community property, and community property is available to satisfy a spouse's antenuptial debts") and *In re Victor*, 341 B.R. 775, 781 (Bankr. D. N.M. 2006) (debts incurred during marriage are presumptively community debts, regardless of the other spouse's participation in accruing the debt).

<sup>19</sup> *Newberry v. Newberry*, 351 S.W.3d 552, 559 (Tex. App.—El Paso 2011 no pet).

<sup>20</sup> *Id.*

<sup>21</sup> *Id.*

<sup>22</sup> *Id.*

#### UPCOMING FEATURE:

### Chapter Spotlight

Many FBA Chapters around the country include bankruptcy judges and practitioners. Some have formal bankruptcy-focused subcommittees, and put on bankruptcy-related CLE events and programs.

**We want to hear more about you!** In future editions of *Bankruptcy Briefs*, look for our new **Chapter Spotlight** feature. If you would like us to feature your Chapter in an upcoming **Chapter Spotlight**, please send us a one-page article. Articles should highlight the bankruptcy-centric aspects of your Chapter's membership and activities.

Please submit articles and questions to editor Marc Taubenfeld at [mtaubenfeld@mcslaw.com](mailto:mtaubenfeld@mcslaw.com).



**To: Members of the FBA Bankruptcy Law Section**  
**From: Judge Craig A. Gargotta, Chair**  
**Re: FBA Young Lawyers in Court Initiative**



**Dear Members:** the FBA Bankruptcy Law Section is seeking support for an initiative that allows junior lawyers to argue matters to the bankruptcy court. **Judge Harlin D. Hale**, N.D. Texas, together with his fellow judges in the Northern District, and **Judge Alan S. Trust**, E.D.N.Y., have implemented a program that encourages senior lawyers to allow junior lawyers to argue matters to the court, even if uncontested. The Bankruptcy Section encourages bankruptcy judges and experienced lawyers to participate in the program. Like my colleagues, I will be implementing this program in my court in the W.D. Texas, and will encourage that less experienced lawyers be afforded the opportunity to have meaningful court time. Further, to the extent that time permits, I will hear uncontested matters and provide a critique of the lawyer’s presentation. A suggestion announcement on a bankruptcy court’s web site regarding is provided below. Should you have any questions, please contact Judges Hale, Trust, or myself.

The Bankruptcy Court for the \_\_\_\_\_ District of \_\_\_\_\_ recognizes the importance of providing opportunities for junior lawyers to gain experience and training in courtroom skills. Accordingly, it is the policy of this Court that, where junior lawyers are familiar with the matter before the court, but are not experienced in arguing in court, they should be encouraged to attend and participate. In such circumstances, where it creates an opportunity for a junior lawyer to argue, this Court is amenable to permitting more than one lawyer to argue for a party.

Other opportunities for junior lawyers include attending and participating in first day matters in chapter 11 cases and presenting some of the motions before the court, going over the agenda with the court for cases in which more than one hearing is scheduled, and attending to other uncontested matters. On the latter point, this Court does not consider it a waste of judicial time for a junior lawyer to handle in an efficient manner an uncontested matter. ■

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