Bankruptcy Circuit Update

Featuring cases from December 2015

First Circuit

Fonseca v. Gov't Emples. Ass'n (AEELA), (In re Fonseca),
__ B.R. __, 2015 WL 9450911, (1st Circuit B.A.P., December 24, 2015)

Bankruptcy Appellate Panel for the First Circuit affirmed the bankruptcy court's denial of summary judgment to the debtor and affirmed the grant of summary judgment to the defendant, which meant the defendant savings and loan association did not violate the discharge injunction of 11 U.S.C. Section 524(a) by sending out certain letters. The two letters at issue were not an attempt to collect a debt from the debtor personally but rather to collect against its collateral as the defendant possessed a valid statutory lien in the debtor's pre-petition accumulated leave wages.

Ortega v. LSREF2 Island Holdings, LTD., (In re Ortega),
2015 WL 8270775, (1st Circuit B.A.P., December 4, 2015)
(Not for Publication).

Bankruptcy Appellate Panel for the First Circuit affirmed the bankruptcy court's finding that it lacked jurisdiction to impose or lift the automatic stay of 11 U.S.C. Section 362 over assets that were not property of the bankruptcy estate. The property at issue was a rental property of the debtor's parents' probate estate for which the debtor had no right to use or possess same. While the debtor may have had an interest in the probate estate as a whole, she had none in any of the individual assets of the probate estate.

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Second Circuit

***Beneficiaries v. Amr Corp. (In re Amr Corp.)*,**
622 Fed. Appx. 64 (December 7, 2015)

The Second Circuit affirmed the judgment of the district court affirming three bankruptcy court orders that (1) granted the debtor aviation company's motion to reject a collective bargaining agreement ("CBA") with its pilots, (2) eliminated the option for lump-sum payouts at

retirement held by the Supplement B Pilot Beneficiaries (the "Supp. B Pilots"), and (3) extinguished grievances filed pursuant to the rejected CBA.

On appeal in the Second Circuit, the Supp. B Pilots presented four arguments, all of which were rejected by the Court. First, the Supp. B Pilots argued that the bankruptcy court's rejection of the CBA violated both 11 U.S.C. § 1113, which they claimed required good faith negotiation with the Supp. B Pilots, and their rights under the CBA. However, the Second Circuit found that the debtor complied with § 1113, which requires only that the debtor negotiate with the "authorized representative" of the employees, which was the union in this case, and not with subgroups of members represented by the union, such as the Supp. B Pilots. The Second Circuit also found that there was no violation of the Supp. B Pilots' rights under the CBA because, having permissibly rejected the CBA under § 1113, the debtor was no longer required to comply with its terms.

Second, the Second Circuit rejected the Supp. B Pilots' argument that the Bankruptcy Court committed error in eliminating an option for lump-sum retirement benefits that was guaranteed in perpetuity by the CBA, and committed clear error in finding that the elimination of lump-sum benefits was necessary to avoid a failure of the retirement plan post-bankruptcy. The Second Circuit was not persuaded by this argument because it deemed that the CBA was properly rejected and held that the bankruptcy court's factual finding was supported by the record, including statistics showing that a lump-sum option was associated with higher retirement rates and thus likely to cause financial strain on the already underfunded retirement plan.

Third, the Second Circuit rejected the Supp. B Pilots' argument that the bankruptcy court erred in extinguishing their grievances filed under the rejected CBA. The Second Circuit held that, under the circumstances, the decision was necessary to allow the court to conduct core bankruptcy proceedings and fell within its equitable power to "issue any order . . . necessary or appropriate to carry out the provisions of [the Bankruptcy Code]" pursuant to 11 U.S.C. § 105(a).

Finally, the Second Circuit rejected the Supp. B Pilots' argument that all disputes growing out of grievances or relating to interpretations of the CBA were subject to mandatory arbitration under the Railway Labor Act, 45 U.S.C. § 151 et seq. (the "RLA"). In light of the CBA's arbitration requirement, the Supp. B Pilots argued that the bankruptcy court lacked jurisdiction to decide CBA-related issues such as the rejection of the CBA or the extinguishment of claims against the debtor based on grievances filed under the CBA. The Second Circuit, however, held that whether the CBA or grievances filed under the CBA could be rejected in bankruptcy were issues to be resolved under the Bankruptcy Code and not under the CBA or the RLA, and that the bankruptcy court therefore did not exceed its jurisdiction in deciding them.

ANZ Sec., Inc. v. James W. Giddens (In re: Lehman Bros. Inc.),
2015 WL 9488200 (December 14, 2015)

The Second Circuit affirmed the judgment of the district court and denied the challenge put forward by the junior underwriters (the "Junior Underwriters") of debtor Lehman Brothers Inc. (the "Debtor") to the judgment affirming a bankruptcy court order subordinating the Junior Underwriters' contribution claims pursuant to 11 U.S.C. § 510(b) to the claims of the Debtor's general unsecured creditors.

In order to ensure that claims corresponding to ownership of debt or equity securities are confined to their "proper tier of the waterfall," Section 510(b) of the Bankruptcy Code provides generally that "a claim arising from rescission of a purchase or sale of a security of the debtor or…for damages arising from the purchase or sale of such a security…shall be subordinated to all claims or interests that are senior to or equal the claim or interest represented by such security…" 11 U.S.C. § 510(b). The provision treats the security of an "affiliate" as a security of the debtor for this purpose.

Following the bankruptcy of both the Lehman entity that issued the notes and the Lehman entity that was lead underwriter on the issuances, the Junior Underwriters were held to account for the noteholders' losses and incurred further costs for defense and settlements. The Junior Underwriters filed general creditor proofs of claim against the Debtor in its Securities Investor Protection Act of 1970 ("SIPA") liquidation proceeding, asserting rights to contribution for their losses. The SIPA Trustee objected on the ground that the claims were subject to mandatory subordination pursuant to 11 U.S.C. § 510(b).

The Junior Underwriters argued that § 510(b) could not be used to subordinate their claims in the Debtor's SIPA proceeding because the securities were issued by the Debtor's parent, rather than the Debtor itself. However, the bankruptcy judge rejected the Junior Underwriters' arguments and ordered that their claims be subordinated to the claims of general unsecured creditors, reasoning that, when considering affiliate securities, the "claim[s] . . . represented by" the parent securities were the claims for contribution themselves, and, as such, were general unsecured claims.

The district court affirmed the bankruptcy court's order, but on another ground; to determine the level of subordination, the district judge focused on the type of security rather than on the type of claim, reasoning that "any ambiguity in the statute lies not in whether claims based on securities of an affiliate are to be subordinated but how that subordination is to occur," and that, in this instance, "[a] straightforward and practical application of section 510(b) recognizes that unsecured, non-equity securities," such as the notes at issue, "represent unsecured claims, meaning that claims involving such securities must be subordinated to general unsecured claims."

The Second Circuit adopted the district court's analysis, holding that in the affiliate securities context, "the claim or interest represented by such security" means a claim or interest of the same type as the affiliate security. As such, claims arising from securities of a debtor's affiliate should be subordinated in that debtor's bankruptcy proceeding to all claims or interests

senior or equal to claims in the bankruptcy proceeding that are of the same type as the underlying securities. The Second Circuit found that the Junior Underwriters had proposed no convincing rationale for their alternative construction, under which the affiliate securities provision would operate only in two hypothetical instances: when a debtor's and its affiliate's estates are substantively consolidated in bankruptcy, and when a debtor has guaranteed payment on the securities of its affiliate. The Second Circuit explained that nothing in the text of § 510(b) suggests the affiliate provision is so limited, and in the absence of any textual hook, the Second Circuit declined to adopt a narrow construction of a section that its precedent suggests should be read broadly. The Second Circuit also held that the legislative history supports a construction that reaches affiliate securities in the ordinary case, because, in the drafting process, Congress expressly included claims based on affiliate securities. Furthermore, the Second Circuit noted that every other court that has applied § 510(b) to claims based on affiliate securities when the debtor was a corporate entity has required subordination. Therefore, the Second Circuit affirmed the judgment of the district court.

***Sec. & Exch. Comm'n v. Miller*, 2015 WL 9259045 (December 18, 2015)**

The Second Circuit affirmed the order of the district court temporarily freezing assets adjudged to be ill-gotten gains from a securities fraud scheme perpetrated by defendants Samuel and Charles Wyly (the "Wyly Brothers"), holding that the asset freeze order obtained by the Securities and Exchange Commission (the "SEC") did not constitute an action to collect on an anticipated money judgment and therefore did not violate the automatic stay provision of either 11 U.S.C. § 362 or the Second Circuit's precedent in *SEC v. Brennan*, 230 F.3d 65 (2d Cir. 2000).

After a jury found the Wyly Brothers liable for multiple claims of securities fraud, the district court ordered payment of approximately $300 million in disgorgement. Fearing the dissipation of ill-gotten gains among the Wyly Brothers' family members, the SEC requested that the district court enter a temporary asset freeze. While that request was pending, Samuel Wyly and the widow of Charles Wyly filed petitions for Chapter 11 protection, triggering the automatic stay provision of 11 U.S.C. § 362. Shortly thereafter, the district court entered the requested order freezing the Wyly Brothers' ill-gotten gains, including assets transferred to multiple Wyly family members who had been named as relief defendants (the "Relief Defendants").

Bankruptcy Code § 362 automatically stays virtually all proceedings against a debtor, including "any act to obtain possession of property of the estate or of property from the estate or to exercise control over property of the estate." The Bankruptcy Code also contains an exception to § 362 known as the "governmental unit" exception, which provides that the automatic stay provision does not extend to the commencement or continuation of an action or proceeding by a governmental unit "to enforce such governmental unit's or organization's police and regulatory power, including the enforcement of a judgment other than a money judgment, obtained in an action or proceeding by the governmental unit to enforce such governmental unit's or organization's police or regulatory power."

As explained by the Second Circuit in *Brennan*, the purpose of the governmental unit exception is to prevent a debtor from "frustrating necessary governmental functions by seeking refuge in bankruptcy court." As the legislative history makes plain, when a governmental unit seeks to stop a debtor from committing fraud or attempts to fix damages for the violation of such a law, the action or proceeding is not stayed under the automatic stay. Though all parties here agreed that the SEC's regulatory enforcement action against the Wyly Brothers fell within the governmental unit exception, the Relief Defendants asserted that this case fell under an exception to the governmental unit exception. This "exception to the exception" provides that actions to enforce money judgments are subject to the automatic stay, even if they were otherwise pursued by a governmental unit in furtherance of the government's police or regulatory powers. The critical question before the Second Circuit was thus whether the asset freeze order at issue was a permissible use of the government's regulatory power under the "governmental unit exception," or whether, like its analogue in *Brennan*, it was an impermissible action to enforce a money judgment under the "exception to the exception."

Like the district court below, the Second Circuit held that factual, procedural, and policy considerations distinguished this case from *Brennan*, thus allowing for the holding that the asset freeze order fell within the "governmental unit exception" but not within the "exception to the exception" for actions to enforce a money judgment. Factually, the order at issue here differed significantly from the order in *Brennan*; in that case, the Second Circuit vacated an order directing the debtor to repatriate assets held abroad and deposit them in a court registry, whereas here the applicable order was merely an asset freeze, which, unlike the order in *Brennan*, did not transfers ownership, vest control over assets in the courts, or entirely deprive the Relief Defendants of their use.

Procedurally, the posture of this case also significantly differed from that of *Brennan*. In that case, the repatriation and deposit order arose as part of the SEC's post-judgment collection procedures, whereas here, the November 2014 asset freeze order was imposed before the entry of final judgment on February 26, 2015. In *Brennan,* the Second Circuit noted that "the line between [unstayed] police or regulatory power on the one hand, and [stayed] enforcement of a money judgment on the other, [must] be drawn at entry of judgment." The pre-judgment asset freeze at issue here thus did not implicate the same concerns as did the post-judgment repatriation and deposit order in *Brennan.* Moreover, the Second Circuit found that the SEC had persuasively argued that the relevant judgment was not the one entered in February 2015 against the Wyly Brothers, but rather, the judgment which has yet to be entered against the Relief Defendants, who only answered the complaint against them in April 2015.

Finally, the Second Circuit held that the policy concerns underlying the disposition in *Brennan* weighed in favor of the opposite outcome here. In *Brennan*, the Second Circuit cited two specific policies when concluding that the automatic stay should be applied: (1) the general purpose of the automatic stay "to allow the bankruptcy court to centralize all disputes concerning property of the debtor's estate so that reorganization can proceed efficiently, unimpeded by uncoordinated proceedings in other arenas," and (2) the general purpose of the governmental unit exception "to prevent a debtor from frustrating necessary governmental functions by seeking refuge in bankruptcy court." Here, the asset freeze order did not jeopardize either of these policy objectives because the order was narrowly framed to exclude assets in the bankruptcy proceeding

and to be lifted as soon as the assets were clearly under the control of the bankruptcy court. Having thus affirmed the application of the automatic stay, the Second Circuit remanded the case in part for the limited purpose of determining which of the Relief Defendants received the ill-gotten gains from the Wyly Brothers.

Statek Corp. v. Dev. Specialists, Inc. (In re Coudert Bros. LLP),
2015 WL 9466455 (December 29, 2015)

The Second Circuit reversed and remanded a district court order denying the motion of claimant Statek Corp. ("Statek") for reconsideration of an order disallowing a claim, because the Second Circuit concluded that the bankruptcy court did not give full effect to its mandate in an earlier appeal in this case which impliedly foreclosed the bankruptcy court from relying on its prior alternative holding.

This dispute arose out of Statek's claim in bankruptcy against Coudert Brothers LLP ("Coudert"), a now-defunct New York law firm and debtor in bankruptcy. From 1984 until 1996, Statek was controlled by Hans Frederick Johnston, who looted its treasury. In 1990, Johnston caused Statek to retain Coudert as counsel, and thereafter Coudert helped him hide his pilfered assets. Coudert's malpractice caused Statek to undergo a prolonged, global search for its assets, at a cost of $85 million.

In 2005, Statek sued Coudert for malpractice in Connecticut state court. Coudert soon went bankrupt, and its 2006 petition for Chapter 11 bankruptcy in the Southern District of New York automatically stayed Statek's Connecticut action. In bankruptcy, the plan administrator moved to disallow Statek's claim as time-barred. On July 21, 2009, the bankruptcy court granted that motion, reasoning that New York choice-of-law rules applied under the Erie doctrine, and New York's "borrowing statute" requires claims to satisfy both the relevant New York statute of limitations and the limitations period of the state where the cause of action accrued. The bankruptcy court found that Statek did not satisfy those requirements.

Statek moved for reconsideration, arguing that the bankruptcy court had erroneously applied the Erie doctrine by not treating the bankruptcy court as the transferee court for the Connecticut action. The bankruptcy court reasoned that the "transferee court" argument was "never raised" before and therefore was a new argument that could not be considered on reconsideration. Moreover, the bankruptcy court held, "the argument [was] mistaken" because Statek's claim was filed in New York and so there was no transfer. In *Statek Corp. v. Development Specialists, Inc. (In re Coudert Bros. LLP)* ("*Coudert I*"), 673 F.3d 180 (2d Cir. 2012), the Second Circuit reversed, vacating the denial of Statek's motion for reconsideration and agreeing with Statek's "transferee court" reconsideration argument. The Second Circuit held, on this "question of first impression," that for practical purposes the bankruptcy court was to be treated as the transferee court of the Connecticut action and that, therefore, Connecticut choice-of-law rules applied to Statek's bankruptcy claim. The Second Circuit did not, however, specifically address the alternative holding that the "transferee court" argument had been raised for the first time on the motion for reconsideration.

On remand, the bankruptcy court determined that it could still adhere to that alternative holding, holding that its alternative basis for denying reconsideration, i.e. that Statek's "transferee court" argument was a new argument, continued to apply. In so concluding, the bankruptcy court determined that relying on its prior alternative holding complied with the Second Circuit's mandate in *Coudert I*. Statek then asked for reconsideration once again, requesting that the bankruptcy court reconsider its new holding and lift the stay of the Connecticut action so that Statek could amend its claim to plead additional facts relevant to the "continuing course of conduct" doctrine; the bankruptcy court denied that motion, and the district court affirmed both denials of reconsideration for substantially the same reasons relied on by the bankruptcy court.

In this second appeal, the Second Circuit began its analysis by considering the "mandate rule," which requires that a lower court follow any mandate issued by an appellate court so as to give it its full legal effect. Here, the Second Circuit held that the bankruptcy court essentially gave its mandate from *Coudert I* no legal effect. In *Coudert I*, the Second Circuit instructed the bankruptcy court "to apply Connecticut's choice of law rules in deciding Statek's motion to reconsider." The bankruptcy court did not follow that instruction, as the Connecticut choice-of-law rules did not bear on the bankruptcy court's ultimate decision. Instead, the bankruptcy court ordered further briefing on whether it could adhere to its prior alternative holding that Statek's argument was a new argument not available on reconsideration. The bankruptcy court concluded that it could, and disposed of the case on that basis.

The Second Circuit then considered whether the scope of the mandate was so narrow as to permit the bankruptcy court to dispose of the case by relying on a prior alternative holding. The Second Circuit had not previously expressly addressed whether Statek's "transferee court" argument was a new argument cognizable on reconsideration. Nonetheless, the Second Circuit impliedly foreclosed that ground of decision in *Coudert I*. The Second Circuit noted that, as a general matter, it is an uncompromising rule that lower courts may not hear "arguments . . . that could have been raised prior to the entry of judgment." The Second Circuit also noted that it generally "will not consider an argument on appeal that was raised for the first time below in a motion for reconsideration." But this rule is not absolute in the Second Circuit; it exists as a matter of "prudence." It follows that when the Second Circuit does consider on appeal arguments raised for the first time below in a motion for reconsideration and remands on the basis of those arguments, the lower court must follow such a mandate. In other words, if the Second Circuit elects to consider a new argument on appeal, on remand the lower court may not ignore that ruling on the basis that the appellate court relied on a non-cognizable "new argument." By remanding in this case, the Second Circuit necessarily implied that Statek's "transferee court" argument should not be disregarded as a "new argument."

The Second Circuit thus reversed the district court's order affirming the orders of the bankruptcy court and remanded the case to the district court with directions to remand to the bankruptcy court with instructions to: (1) reverse its orders denying reconsideration, (2) vacate the claim disallowance order, (3) reinstate Statek's claim, and (4) permit further proceedings in a manner consistent with the Second Circuit's opinion.

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Third Circuit

***In re Radnor Holdings Corporation*, 2015 WL 8479679 (3rd Cir. Dec. 10, 2015)**

The Third Circuit affirmed the decision of the United States District Court for the District of Delaware, approving the final fee application of the Debtors' attorneys. After filing for bankruptcy protection in 2006, the Debtors applied to the Court for an order authorizing the retention of Skadden, Arps, Slate Meagher & Flom ("Skadden") as its lead counsel. In the application, Skadden disclosed that it represented Tennenbaum Capital, an equity holder of the Debtors, in matters wholly unrelated to the bankruptcy cases. The Bankruptcy Court considered the application and found that Skadden's relationship with Tennenbaum Capital was not a disabling conflict of interest. Shortly thereafter, Tennenbaum Capital purchased all of the Debtors' assets. Six years later, Skadden filed its final fee application, to which the appellant objected on the basis that Skadden's prior Tennenbaum-related disclosures failed to comply with Bankruptcy Rule 2014. The Bankruptcy Court disagreed and approved the fee application, finding that Skadden had not misrepresented its relationship with Tennenbaum. The District Court and the Third Circuit affirmed.

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Fifth Circuit

***In re KSRP, Ltd.*,**
2015 WL 9022040 (5th Cir. Dec. 15, 2015)

The Fifth Circuit, applying the "conceivable effect" test, examined whether a bankruptcy court had "related to" jurisdiction under 28 U.S.C. § 1334 in this matter.

The plaintiff had filed claims in state court against KSRP and Sidharthan, whom plaintiff claimed held himself out as having the personal authority to bind KSRP to agreements. Plaintiffs' claims against KSRP were nonsuited, and KSRP subsequently filed for bankruptcy. Sidharthan removed the case against him to bankruptcy court, asserting for the first time a cross-claim for indemnity against KSRP. The bankruptcy court asserted jurisdiction on the basis that due to Sidharthan's indemnity claims, any damages awarded to plaintiff could potentially have been collected against KSRP's estate. Following a two-day bench trial, the bankruptcy court declined to grand Sidharthan's indemnity cross-claim.

Plaintiff challenged the bankruptcy court's exercise of "related to" jurisdiction, claiming it was based on Sidharthan's illusory indemnity and contribution claims. Courts apply a broad "conceivable effect" test to determine whether they have "related to" jurisdiction. While plaintiff did not challenge whether the claims would have any conceivable effect on the bankruptcy estate if they succeeded; rather, he argued that Sidharthan's indemnity claims could not possibly have any conceivable effect because they lacked merit and had no chance of succeeding.

The court invoked the general rule that questions of jurisdictions should be analyzed separately from questions of merits, with the caveat that a claim invoking federal jurisdiction must not be "immaterial and made solely for the purpose of obtaining jurisdiction." The court found that Sidharthan's indemnity claims against KSRP were sufficient to support "related to" jurisdiction; not only had Sidharthan claimed he was acting on behalf of KSRP for the transactions at issue, but also, plaintiff had alleged that Sidharthan had held himself out as an agent or principal of KSRP. Because Texas law allows for a principal to contractually indemnify its agent, including for negligent acts, and because Sidharthan was alleged to be KSRP's agent, Sidharthan's claims was not "immaterial and made solely for the purpose of obtaining jurisdiction." Accordingly, the Fifth Circuit affirmed the bankruptcy court's exercise of "related to" jurisdiction under 28 U.S.C. 1334, even though Sidharthan's claims for indemnity had been unsuccessful at trial.

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***In re Domistyle, Inc.*,**
2015 WL 9487732 (5th Cir. Dec. 29, 2015).

The Fifth Circuit held a bankruptcy trustee can surcharge pre-abandonment expenses pursuant to 11 U.S.C. § 506(c), rejecting the notion that such expenses were not primarily for the creditor's benefit. After unsuccessfully attempting to sell a secured parcel, the trustee moved to abandon it and sought surcharge from the secured creditor for preservation and maintenance costs incurred during the prior 10 months. The creditor opposed, arguing (i) it did not benefit

from the trustee's expenditures relating to the property and (ii) even if it had, there was insufficient evidence of benefit received.

In finding in favor of the trustee, the Court rejected the notion that only expenditures made for the "specific and exclusive" benefit of the creditor are reimbursable, pointing to the fact that the statutory language contains no such requirement. Further, it noted the creditor clearly benefited from the surcharged funds, having inherited a property that was maintained rather than run down and vandalized. The Court further found the bankruptcy court had properly quantified that benefit, concluding each dollar of expense preserved at least one dollar of value based on testimony from the trustee's broker.

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Allen v. C & H Distributors, L.L.C.,
2015 WL 9461591, (5th Cir. Dec. 23, 2015)

The Fifth Circuit, in affirming the district court, found that plaintiffs who consistently failed to disclose a personal injury claim in their bankruptcy were judicially estopped from pursuing that personal injury claim in a separate suit. Although the injury occurred post-confirmation, plaintiffs failed to include the claim in three later plan modifications. Defendants moved for summary judgment in the personal injury suit, arguing that the plaintiffs' personal injury claim was barred by judicial estoppel.

The Fifth Circuit determined that each element of judicial estoppel was met in this case: (1) the party against whom it is sought has asserted a legal position that is plainly inconsistent with a prior position; (2) a court accepted the prior position; and (3) the party did not act inadvertently. Importantly, the Fifth Circuit found that because the plaintiffs had a duty to disclose their personal injury suit and never did, the plaintiffs' omission from their mandatory bankruptcy filings is a plainly inconsistent assertion. Because the bankruptcy court accepted this position, in accepting the plan that did not provide for the claim, and the plaintiffs did not act inadvertently, the Fifth Circuit affirmed the district court's dismissal of the plaintiffs' personal injury claim.

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NOVEMBER:
***In re Brown*,**
807 F.3d 701 (5th Cir. Nov. 24, 2015)

In this matter, the debtor died during the pendency of his Chapter 11 bankruptcy. Debtor had been living in Florida for less than two years at the time of his death, but had previously lived in Texas. The court applied two differing notions of domicile in determining whether Texas or Florida law applied to exemptions sought by debtor's personal representative and surviving spouse.

Debtor's personal representative attempted to claim exemptions on debtor's behalf pursuant to § 522 of the Bankruptcy Code and Texas law. The court, applying choice of law rules under § 522(b)(3)(A), held that Texas, rather than Florida law applied; where the debtor had not lived in Florida for two years at the time of his death, he had spend more time in Texas than Florida during the 910 days before filing up to 730 days after filing (the relevant time period under § 522(b)(3)(A)).

The debtor's representative sought a cash allowance in lieu of a homestead under Texas Estates Code § 353.053. Noting that the plain language of § 353.053 applies only if the debtor is deceased, the court applied the "snapshot rule," which holds that all exemptions are determined at the time the bankruptcy petition is filed, and reasoned that a debtor who dies during then pendency of his bankruptcy proceedings cannot become eligible for exemptions that were unavailable to him as of the filing date. Thus, the cash allowance under Texas Estates Code § 353.053 was not available to debtor, because he was alive at the time the bankruptcy petition was filed.

Finally, the court examined whether debtor's surviving spouse could claim the cash-in-lieu-of-homestead exemption on her own behalf, as a creditor of the estate, under various sections of the Texas Estates Code. Debtor's widow argued that under Texas law, her domicile—rather than the domicile of the debtor—determined her right to an allowance. The court found it critical that the spouse was not seeking the exemption under Bankruptcy Code § 522, and for that reason, determined that neither the snapshot rule nor the choice of law rules under § 522(b)(3)(A) applied. Thus, the court held that for purposes of the widow seeking the allowance, the domicile of the debtor was not determined by examining where debtor had lived longest in the 910 days before filing up to 730 days after filing, but by the traditional notions of domicile. Under a traditional examination of domicile, the debtor was determined to be domiciled in Florida, because he had lived there for nearly the past two years and there was no evidence of his intention to move away from Florida before he died. Accordingly, Florida law applied to the question of whether debtor's widow could receive the cash-in-lieu-of-homestead exemption.

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Fortune Natural Resources Corp. v. U.S. Dep't of Interior,
2015 WL 7421988, 806 F.3d 363 (5th Cir. 2015)

The Fifth Circuit held the owner of a percentage working interest in a lease with an oil and gas exploration debtor lacked standing to appeal the bankruptcy court's final sale order of substantially all of the debtor's assets because the order did not did not directly and adversely affect the appellant monetarily. Specifically, the appellant claimed a change in wording from the text of the court's interim sale order to that in the final sale order harmed him by virtue of the fact that the final order language caused him to pay certain decommissioning payments. The Fifth Circuit disagreed, pointing out that, under the language of either the interim or final order, he would not have accessed any funds from the bankruptcy estate and, therefore, was unable to show the bankruptcy court's order had caused him pecuniary harm. For standing, an appellant is required to show the court's order itself resulted in his harm, i.e. that had the sale not been approved, the appellant would have obtained funds from the estate.

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OCTOBER:

In re Treaty Energy Corp. v. Hallin, et al. (In the Matter of Treaty Energy Corp.),
619 F. App'x 443 (5th Cir. 2015)

The Fifth Circuit affirmed the judgment of the district court, affirming the bankruptcy court, dismissing the involuntary petition against Treaty Energy Corp. ("TECO") and denying costs and damages under 11 U.S.C. § 303(i)(2). TECO's motion for costs included a claim for losses incurred in the sale of restricted shares of its stock during the pendency of the involuntary petition. The bankruptcy court granted summary judgment against TECO for two reasons: (i) the stock purchase agreements were not valid sales because, at the time they were entered into, TECO was not authorized to issue any additional shares and (ii) the sale prices of TECO's stock did not decline during the pendency of the involuntary petition. Declining to opine on whether TECO was authorized to issue any additional shares, the Fifth Circuit instead affirmed solely on the second ground and found that TECO did not substantiate the allegations that the involuntary petition caused a loss in stock sale revenue, given that the stock price did not decline.

Neurology & Neurophysiology Associates, P.A. v. Tarbox
(In re Neurology & Neurophysiology Associates, P.A.),
2015 WL 5973588 (5th Cir. 2015)

The Fifth Circuit affirmed the district court's dismissal of debtor's untimely bankruptcy appeal. In determining whether the debtor's neglect was "excusable," the district court carefully considered the relevant factors: "(1) 'the possibility of prejudice to the other parties,' (2) 'the length of the applicant's delay and its impact on the proceeding,' (3) 'the reason for the delay and whether it was within the control of the movant,' and (4) 'whether the movant has acted in good faith." Citing to *Salt v. Epps*, 676 F.3d 468, 474 (5th Cir. 2012). The district court noted that the delay caused prejudice to the appellee in the ongoing state court suit; the over one month delay was substantial and avoidable; the failure to exercise diligence was the sole reason for the delay; and no good cause was shown to excuse the late filing. The Fifth Circuit concluded that given the careful consideration of each factor, the district court's dismissal of the bankruptcy appeal did not amount to an abuse of discretion.

***In re Wilcox*, 2015 WL 6318524, 539 B.R. 137 (Oct. 15, 2015)**

The bankruptcy court found that a chapter 7 debtor's premediated, excessive, prepetition spending and lavish lifestyle constituted cause for dismissal of his bankruptcy under 11 U.S.C. § 707(a). Judge Bohm noted the split among circuits over what establishes "cause" under § 707(a), with some courts finding that "cause" includes bad faith conduct and others holding that it does not. The Fifth Circuit has only issued opinions concerning the issue in the context of corporations, but within those opinions noted that cause is a broad concept, designed to afford flexibility to bankruptcy courts to weigh the benefits and prejudices of dismissal when deciding a § 707(a) motion. Based on the Fifth Circuit's holdings in the corporate chapter 7 cases, Judge Bohm adopted the approach that even if a debtor has satisfied all the basic requirements of a debtor, cause can still exist if the debtor's conduct in some other way, either pre-petition or post-petition, reflects an attitude that is repugnant to the "fresh start" principle of the Bankruptcy Code. In this case, the bankruptcy court found that although the debtor did not commit fraud, he demonstrated no hint of belt tightening and instead engaged in calculated "I come first" bankruptcy planning. Thus, the bankruptcy court dismissed his chapter 7 bankruptcy case for cause under § 707(a). On November 25, 2015, Judge Bohm certified the Order Granting the United States Trustees' Motion to Dismiss for direct appeal to the Fifth Circuit.

Lowe v. DeBerry (In re Deberry),
2015 WL 6528024 (Bankr. W.D. Tex. Oct. 28, 2015)

The bankruptcy court concluded that where a chapter 7 debtor sells his properly exempted Texas homestead post-petition and fails to reinvest the proceeds into a new Texas homestead within six months, the proceeds revert back to the debtor. In finding that the Fifth Circuit's opinion in *Viegelahn v. Frost (In re Frost)*, 744 F.3d 384, 385 (5th Cir. 2014) was inapplicable, the bankruptcy noted the fundamental distinction between 11 U.S.C. § 1306(a) that includes post-petition funds in the chapter 13 estate and 11 U.S.C. § 541(a)(1) that limits the chapter 7 estate to property as of the commencement of the case. Judge Gargotta expressly agreed with Judge Davis' opinion in *In re D'Avila*, 498 B.R. 150 (Bankr. W.D. Tex. 2013) and

declined to follow Judge Bohm's opinion in *Cage v. Smith (In re Smith)*, 514 B.R. 838 (Bankr. S.D. Tex. 2014). Therefore, Texas bankruptcy courts remain split on the applicability of the *Frost* in chapter 7.

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Eighth Circuit

***Home Service Oil Company v. Cecil (In re Cecil)*,**
-- B.R. --, 2015 WL 9583885 (8th Cir. BAP Dec. 28, 2015):

In this matter the BAP for the Eighth Circuit reviewed the bankruptcy court's denial of discharge under § 727(a)(4) for making a false oath or account in connection with the bankruptcy case. The denial of discharge was sought based on the debtor's omission of numerous items on her schedules and Statement of Financial Affairs. Notably, the debtor indicated that she did not have any checking, savings or financial accounts although she owned or had signatory power on at least twelve bank accounts. She also failed to disclose an ownership interest in a business operated by her husband, income from part time employment, a cash payment made to pay off a home mortgage within 90 days prepetition, and the transfer of a vehicle to her daughter's boyfriend within two years prior to filing the case. The Bankruptcy Court found that these omissions amounted to a reckless indifference to the truth, sufficient to find fraudulent intent under § 727(a)(4).

Before the BAP the debtor argued that in order to deny her discharge under § 727(a)(4)(A), a showing would have to be made that she acted with the specific purpose of defrauding her creditors. The debtor claimed that her omission of the bank accounts and transferred vehicle was due to a belief that she did not have an actual ownership interest in them and they would not have been available to satisfy creditors. This argument was rejected by the BAP, stating that the bankruptcy system requires complete disclosure of all apparent interests of any kind and that whether assets titled in the debtor's name are, or are not, property of the estate are questions to be determined by the court and the trustee, not the debtor. The BAP upheld the bankruptcy courts finding that the debtor acted with reckless indifference in failing to list assets which formed a proper basis for the denial of discharge.

Thompson-Rossbach v. Doeling (In re Thompson-Rossbach)
541, B.R. 451 (8th Cir. BAP Dec. 02, 2015):

Here, the BAP affirmed the bankruptcy court's order denying the debtor's motion to compel the chapter 7 trustee to abandon funds received as distributions from a trust created by the debtor's mother. The trust was designed to distribute the trust assets upon the mother's death. The trust agreement included a provision stating that if trust assets became distributable

to some one under the age of 21, the trustee would have the discretion to distribute the assets or retain them in a separate trust. The trust also contained a spendthrift provision preventing alienation of the beneficiaries' interest, "provided that any principal distributable to any beneficiary by reason of having attained a specific age shall be fully alienable by such beneficiary after attaining such age.

During the course of the debtor's bankruptcy case, two distributions were made by the trust and received by the chapter 7 trustee who proposed to distribute these funds to creditors. The debtor brought a motion arguing that her interest in the trust was not property of the estate under § 541(c)(2), which excludes spendthrift trusts. The bankruptcy court found that because the debtor was over the age of 21 at the time of her mother's death, her interest in the trust was fully alienable on the petition date and was not excluded from the estate. The BAP agreed with the bankruptcy court and affirmed its ruling.

Conway v. National Collegiate Trust (In re Conway),
-- B.R. --, 2015 WL 9461545 (8th Cir. BAP Dec. 10, 2015)

Conway follows from an earlier appeal in which the BAP reversed the bankruptcy court's order excepting all of the debtor's student loans from discharge and directing the bankruptcy court to determine if the debtor's disposable income over the course of a year was sufficient to service any of the loan payments. On remand, the bankruptcy court reviewed the debtor income and expenses for the period of November 2013 to October 2014 and determined that the debtor's disposable income was sufficient to make payments on four of the student loans and discharged the remaining eleven. The debtor then asked the bankruptcy court to amend its judgment due to increased expenses and decreased income after the time period reviewed but this request was denied. The debtor then appealed the bankruptcy courts order denying the motion to amend the judgment.

The debtor argued that the bankruptcy court erred by choosing an arbitrary date to calculate her disposable income and should have taken into account supplemental documentation of income and expenses provided to the bankruptcy court in the post October 2014 period in which the debtor indicated that after the cut-off date she was laid off one of her jobs and the monthly payments on her federal student loans and health insurance had increased. The BAP held that the bankruptcy court did not abuse its discretion in denying the motion to amend the judgment. The bankruptcy court chose the November 2013 to October 2014 time frame because it was the most recent 12-month period for which complete income and expense information was available. In the prior appeal, the bankruptcy court had been directed to make its findings based on the debtor's ability to make the student loan payments over the course of an entire year, and it was not an abuse of discretion to decline to base its decision on the post-October 2014 changes which were speculative.

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Ninth Circuit

Windmill Health Prods., LLC v. Sensa Prods., LLC,
2015 WL 6471180 (N.D. Cal. Oct. 27, 2015)

The issue before the District Court was whether it was bound by a prior Ninth Circuit decision, *Sherwood Partners, Inc. v. Lycos, Inc.*, 394 F.3d 1198 (9th Cir.), *cert. denied*, 546 U.S. 927 (2005) which held that Section 1800(b) of the California Code of Civil Procedure, which allowed an assignee in an assignment for the benefit of creditors proceeding to avoid preferential transfers, was preempted by the Bankruptcy Code, specifically section 547(b), which allows trustees and debtors-in-possession to avoid preferential transfers. The District Court rejected the Assignee's contention that it was not bound by *Sherwood Partners* and instead should follow California law which rejected the conclusion reached in that case, *Haberbush v. Charles and Dorothy Cummings Family Ltd. P'ship*, 139 Cal. App. 4th 1630 (2006) and *Credit Managers Ass'n v. Countrywide Home Loans, Inc.,* 144 Cal. App. 4th 590 (2007). The District Court explained that it was bound by *Sherman Partners* because the issue was one of federal law, that is, whether the California law was preempted by federal law—the Bankruptcy Code. In support of that ruling the District Court relied upon *Local Union 598 v. J.A. Jones Constr. Co.,* 846 F.2d 1213, 1218 (9th Cir. 1988) which holds that "preemption is a question of federal law," explaining that the issue arose under the Supremacy Clause of the United States Constitution, citing *Ferguson v. Corinthian Colleges, Inc.,* 733 F.3d 928, 932 (9th Cir. 2013), such that opinions by the highest state courts are not binding authority.

***Free v. Malaier (In re Free),* 2015 WL 9252592 (BAP 9th Cir. Dec. 17, 2015)**

The issue before the Ninth Circuit Bankruptcy Appellate Panel (BAP) was whether debts held by wholly unsecured lienholders on the debtors' principal residence that were discharge in their prior chapter 7 case should be counted for purposes of determining the debtors' eligibility to file a subsequent chapter 13 case under section 109(e) of the Bankruptcy Code. The primary purpose of the chapter 13 filing was to strip off the wholly unsecured liens as against the debtors' residence. The bankruptcy court had granted the chapter 13 trustee's motion to dismiss the debtors' chapter 13 case on the basis that the previously discharged debt should be counted as the (underwater) lienholders retained their *in rem* rights to the proceeds of the sale of their collateral, relying on several cases, including *Johnson v. Home State Bank*, 501 U.S. 78 (1991). The BAP rejected the bankruptcy court's analysis, including its reliance on *Johnson,* and held that debts for which *in personam* liability had been discharged in a prior chapter 7 case should not be counted toward the unsecured debt limit under section 109(e) of the Bankruptcy Code. The BAP was unmoved by the fact that a wholly unsecured claim based on an underwater lien warranted inclusion of the previously discharged *in personam* liability in the section 109(e) eligibility calculation. The BAP stated that it did not "see how the purposes of a chapter 13 reorganization

are met by counting the discharged unsecured obligations of the chapter 20 debtor in the eligibility calculation. Assuming the case is filed in good faith and proper chapter 13 purposes – such as curing an arrearage on a first mortgage or paying priority tax debt - are present, it makes no sense to include in the debt limit calculation a claim for which the right to payment has been discharged. Neither the Code nor case law compels inclusion of the discharged *in personam* liability in such calculation." Slip. Op. at 17-18.

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Good v. Daff (In re Swintek),
--- B.R. ----, 2015 WL 928572361, (B.A.P. 9th Cir. Dec. 18, 2015)

In *Good v. Daff*, the Bankruptcy Appellate Panel for the Ninth Circuit held, as a matter of first impression, that section 108(c) of the Bankruptcy Code tolled the one-year expiration period imposed under section 708.110 of California's Code of Civil Procedure. Before its analysis, the court provided preliminary observations as to section 708.110 and the debtor's prior discharge. According to the court, section 708.110(d) is a statute of duration rather than a statute of limitations despite section 108(c) applying to both. Further, the creditor's appeal is not moot based on the debtor's discharge because the automatic stay remained in effect as a result of existing funds in the bankruptcy estate.

Relying on *Spirtos v. Moreno*, where the Ninth Circuit held that the ten-year prior during which the creditor had to renew judgment lien had not expired, the court believed that the automatic stay prohibited the creditor from enforcing the ORAP lien attaching the debtor's non-exempt personal property which became, and remains, property of the estate. The creditor held money judgments through California's state court, took the steps necessary to obtain the ORAP from the same court, and properly served the debtor. To hold otherwise would not only create a substantial inequity but would also give the debtor the power to eliminate certain secured claims imply by filing for bankruptcy at the appropriate time and then allowing the limitation period to run while it remained under the protection of the automatic stay.

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11th Circuit

***Parker v. Credit Central South, Inc.* (*In re Marion*)**
2015 WL 9240495 (11th Cir. Dec. 17, 2015)

Following a trial, the bankruptcy court awarded the debtor compensatory damages for emotional distress, punitive damages, and actual damages for attorney's fees after determining that the defendant violated the automatic stay by continuing, for more than two months, to prosecute its claim against the debtor in state court, despite receiving notice of the debtor's bankruptcy filing from both the debtor and the bankruptcy court. The bankruptcy court concluded that the debtor suffered emotional distress when the defendant destroyed the peace that the debtor should have enjoyed by incessantly demanding payment, and that the punitive damages award was necessary to deter the defendant "from continuing to use unsophisticated collection actions as a cost-saving measure."

On appeal, the district court affirmed the award of punitive damages and attorney's fees, but vacated the award of compensatory damages for emotional distress after finding the debtor's testimony—that the defendant's actions caused him to be embarrassed and to feel anxious—insufficient to sustain such an award. The defendant appealed once more. Agreeing that the defendant willfully contravened the automatic stay and that it litigated in bad faith, the Eleventh Circuit affirmed the district court's judgment in full. The Eleventh Circuit did not address the bankruptcy court's compensatory damages award because the debtor did not take a cross appeal.

***Ullrich v. Welt* (*In re Nica Holdings, Inc.*)**
2015 WL 9241140 (11th Cir. Dec. 17, 2015)

In 2007, the debtor executed an assignment for the benefit of creditors. Over the following years, a shareholder of the debtor contested the way in which the debtor's assignee was disposing of the debtor's assets, and ultimately filed a lawsuit against the assignee in state court. In turn, the assignee filed a malpractice claim against his lawyers and then a voluntary Chapter 7 petition on behalf of the debtor. Quickly, the shareholder moved to dismiss the debtor's bankruptcy case, arguing that the assignee did not have the authority, under the assignment, to put the debtor into bankruptcy. The bankruptcy court denied this motion and eventually approved the Chapter 7 trustee's proposals to settle the litigation between the shareholder and the assignee and between the assignee and his state court counsel. The bankruptcy court later denied the shareholder's multiple efforts to stay the proceedings so that he could seek appellate review of the bankruptcy court's orders.

The shareholder appealed and the district court affirmed. But the Eleventh Circuit reversed and remanded, first rejecting the assignee's and trustee's argument that the appeal was equitably moot because the litigation settlement agreements had already been consummated, and second, ruling that the assignee did not have the ability to put the debtor into bankruptcy because the debtor had not (via the documents establishing the assignment for the benefit of creditors) granted the assignee "specific authorization" to take such action. As for the mootness question,

the appeals court was not convinced that the settlement agreements had in fact been consummated. And even if they had, the agreements were "neither particularly complicated nor irreversible."

***Houston v. Welt* (*In re Herman*)**
2015 WL 9461756 (11th Cir. Dec. 28, 2015)

The debtor paid his lawyer, in one lump sum, a total of $35,000 for handling his bankruptcy case. On his lawyer's advice, though, the debtor listed on his statement of financial affairs that he paid his lawyer $15,000 for services related to debt consolidation and preparation for bankruptcy. The lawyer, on his own required disclosure, listed that he was accepting $20,000 in fees for services related to the bankruptcy. In addition to this discrepancy, the lawyer took $17,000 of the $35,000 paid by the debtor from his law firm's trust account for personal use, something that neither the debtor nor the other members of the law firm knew about.

After learning of this behavior, the bankruptcy court sanctioned the lawyer for filing false statements of compensation in violation of 11 U.S.C. section 329 and Rules 2014, 2016, and 2017 of the Federal Rules of Bankruptcy Procedure, and for suborning false testimony. The sanctions included a monetary penalty and an indefinite suspension from practicing law in the bankruptcy court. On appeal, the Eleventh Circuit affirmed the bankruptcy court's order, concluding that the bankruptcy court had not abused its discretion in disciplining the lawyer in the manner that it had.

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