Bankruptcy Circuit Update

Featuring cases from October 2016

Special Announcement
Group Section Conference Call to Discuss Significant Cases

This month our writers Circuit Writers and Section Leaders will be convening our third section-wide conference call on **Friday, November 18th, at 4:00 E.S.T./1:00 P.S.T**. to present and discuss notable cases from the past few months of the summaries. Volunteers will be summarizing significant or interesting cases. The presenters will be open for questions and lead discussion of key points. We hope you will join us for this call. The call-in information is: **dial in 866-690-2070 – code 787-594-2077**. We had a good first kick-off to this section-wide conference call last month and are looking forward to the second call! If any section–members, whether or not you are a Circuit Writer, would like to volunteer to discuss a significant case or recent bankruptcy development, please e-mail us at csullivan@diamondmccarthy.com.

Second Circuit

Kadoch v. Kadoch (In re Kadoch),
16-143, 2016 WL 5817267 (2d Cir., October 5, 2016)

The Second Circuit affirmed the judgment of the district court, affirming the bankruptcy court's denial of the motion for reconsideration filed by Laurie Kadoch ("Laurie"). Laurie's motion for reconsideration related to the bankruptcy court's overruling of her and her mother's objections to the claim of debtor David Kadoch ("David") to a homestead exemption.

In 2004 and 2005, Laurie and David, as husband and wife, borrowed money from Laurie's parents to renovate their Vermont property. Laurie and David divorced in 2010, and their final divorce decree reflected their stipulation that David would sell the house and the parties would use the proceeds to repay the outstanding loan from Laurie's parents, and that until the property was sold, David could remain in sole possession. In October 2010, a state court judgment was entered on the debt against David in favor of Laurie's mother, and in July 2014, David was found in contempt of the divorce decree because he failed to sell the property. David filed for bankruptcy in October 2014 and claimed a homestead exemption in the property under Vermont law. Laurie and her mother objected to the homestead exemption, but the bankruptcy court overruled the objection and ruled David's homestead exemption effective.

On appeal, Laurie argued that (1) the Rooker-Feldman doctrine deprived the bankruptcy court of jurisdiction to decide whether David was entitled to a homestead exemption, (2) Laurie and David's divorce decree excluded the property from the bankruptcy estate, (3) the bankruptcy court erred in its calculation of equity in the homestead property, and (4) the bankruptcy court abused its discretion when it denied her motion to reconsider.

The Second Circuit first held that the Rooker-Feldman doctrine did not bar the bankruptcy court from determining whether a homestead exemption applied because David the issue of the homestead exemption was not raised in the state court proceedings. The state court divorce decree was a so-ordered stipulation imposing obligations on both Laurie and David, and by requesting a homestead exemption, David was not "seeking review and rejection" of the divorce decree as would be prohibited by the Rooker-Feldman doctrine.

Second, the Second Circuit held that, notwithstanding the divorce decree, the property at issue remained property of the bankruptcy estate because it did not create either a lien on the property or a debt owed by David to Laurie; instead, both Laurie and David were required to sell their interests in their jointly owned property to pay joint marital debt. Although the family court determined how Laurie and David would manage their debts and liabilities, once David filed for bankruptcy, the family court decree could not override his discharge in bankruptcy, except as permitted by the Bankruptcy Code.

Third, the Second Circuit held that the bankruptcy court did not clearly err in concluding that there was sufficient equity in the property to which a homestead exemption could attach or in computing the allocation of net proceeds from the sale.

Finally, the Second Circuit held that the bankruptcy court did not abuse its discretion when it denied Laurie's motion for reconsideration. The Second Circuit noted that the issue of whether the property was excepted from discharge because of 11 U.S.C. §523(a)(15), and the other issues raised in her motion for reconsideration, could have been or should have been raised in Laurie's original motion. Moreover, the bankruptcy court considered and rejected the §523(a)(15) issue on the merits. As such, the Second Circuit held that the bankruptcy court did not err in holding that the divorce decree did not preclude David's invocation of the homestead exemption in subsequent bankruptcy proceedings.

344 Individuals v. Giddens (In re Lehman Bros. Holdings Inc.),
15-3480, 2016 WL 5853265 (2d Cir., October 6, 2016)

In a case arising out of the Securities Investor Protection Act ("SIPA") liquidation proceeding of Lehman Brothers, Inc. ("LBI"), the Second Circuit affirmed the judgment of the district court affirming the bankruptcy court's order denying the motion to compel arbitration filed by the plaintiffs (the "Plaintiffs"), former employees of Shearson Lehman Brothers, Inc. ("Shearson"), the predecessor of LBI.

The Plaintiffs sought deferred compensation pursuant to employee compensation plan agreements (the "Agreements") that they each signed with Shearson in 1985. James W. Giddens, the SIPA trustee, objected to the Plaintiffs' proofs of claim and sought to enforce the provision of the Agreements mandating that each former employee's benefits would be subordinated to certain of LBI's other obligations. After the bankruptcy court converted the trustee's objections into an adversary proceeding, the Plaintiffs moved to stay the adversary proceeding and to compel arbitration, arguing that, pursuant to an arbitration clause in the Agreements, their level of priority should be decided by arbitrators, not by the bankruptcy court.

The Second Circuit began its analysis of whether to compel arbitration in bankruptcy by setting forth the applicable two-part test. First, the court must determine whether the proceeding at issue is core or non-core. If the proceeding is non-core, generally the bankruptcy court must stay the proceedings in favor of arbitration, as non-core proceedings usually do not warrant overriding the presumption in favor of arbitration. Second, if the proceedings are core, a court must consider whether enforcing the arbitration provisions would seriously jeopardize any underlying purpose of the Bankruptcy Code. If arbitration would severely conflict with the text, history, or purposes of the Bankruptcy Code, the bankruptcy court has discretion to compel or to stay the arbitration. In this case, the bankruptcy court had held that (1) the proceeding was a core proceeding, and (2) compelling arbitration of the subordination claim would jeopardize the objectives of the Bankruptcy Code.

Based on a review of the record and case law, the Second Circuit held that the bankruptcy court did not abuse its discretion in denying plaintiffs' motion to compel arbitration. First, the Second Circuit noted that the bankruptcy court correctly concluded that the dispute over where the Plaintiffs' claims fell in the priority scheme of distributions was a core proceeding. Additionally, the Second Circuit noted that the bankruptcy court correctly concluded that the dispute involving the enforcement of a contractual subordination agreement was core, especially where the parties disputed whether the subordination provision may only be applied by the former entity, Shearson, and not LBI, and whether they were the same entity.

Second, the Second Circuit held that the bankruptcy court did not abuse its discretion in concluding that compelling arbitration would jeopardize the objectives of the Bankruptcy Code in this case. The bankruptcy court considered the conflicting policies of the Federal Arbitration Act and the Bankruptcy Code, made a particularized inquiry into the nature of the claims and the facts of LBI's bankruptcy, and found that an underlying purpose of the Bankruptcy Code would be jeopardized by enforcing an arbitration clause in this case. The bankruptcy court reasonably determined that "Congress simply could not have intended to turn over the determination of the relative priority of claims against the estate and the equitable distribution of the estate's assets in the largest SIPA liquidation in U.S. history [to] the financial industry regulatory authority to be decided under the rules of the New York Stock Exchange." The bankruptcy court therefore had discretion over whether to permit arbitration of subordination claim.

Accordingly, the Second Circuit affirmed the bankruptcy court's decision to stay arbitration because the Plaintiffs were unable to show that such decision constituted an abuse of discretion.

Meadows v. Amr Corp. (In re Amr Corp.),
15-3655, 2016 WL 6427232 (2d Cir., October 31, 2016)

The Second Circuit affirmed the district court's judgment affirming the bankruptcy court's order disallowing and expunging three proofs of claim filed by creditor Lawrence Meadows ("Meadows"), proceeding pro se, as untimely.

The Second Circuit began its analysis by addressing Meadows's challenge of the bankruptcy court's denial of late-filed amended proofs of claim, noting that a timely original claim can be amended to add otherwise untimely claims if the latter relate back to the former and if amendment would be equitable. However, such amendments may be allowed if the delay in pursuing the untimely claims results from excusable neglect.

Meadows argued that his untimely claims for discrimination and whistleblowing related back to his timely claim for long-term disability benefits, but the Second Circuit, like the district court, was not persuaded by this reasoning. The Second Circuit also was not persuaded by Meadows's effort to demonstrate relation back by reference to the timely filed omnibus claim of the Allied Pilots Association ("APA"), which included a pending grievance pertaining to Meadows, because allowing the amended proofs of claim would not be equitable in this case. Specifically, the Second Circuit deferred to the bankruptcy court's findings that (1) Meadows's delay in pursuing his untimely statutory claims was unjustified and (2) allowing amendment to add such claims would prejudice the debtor by threatening to disrupt its omnibus settlement with the APA and "opening the floodgates to potential claimants." Accordingly, the Second Circuit held that the bankruptcy court's findings effectively precluded either issue from being resolved in Meadows's favor.

The Second Circuit then turned to Meadows's claim that certain actions by the bankruptcy court denied him due process. Specifically, Meadows alleged that the bankruptcy court's purported refusal to allow him to refute unanticipated testimony from an APA representative, as well as the court's written modification to its pronounced oral order permitting him to pursue his grievance in other venues, denied him due process. The Second Circuit found such complaints meritless. In response to the testimony of the APA witness, the bankruptcy court did not permit Meadows to testify to his interactions with APA attorneys, but it did allow him to submit an affidavit to establish any prior contrary "official action" or "official position" taken by the union. In fact, Meadows submitted an affidavit, attaching (1) an email to him from an APA attorney purporting to show support for his whistleblower claims, and (2) a copy of the legal brief on his whistleblower claim that Meadows claimed to have forwarded to the APA for its submission. The Second Circuit held that Meadows failed to demonstrate how the testimonial presentation of such evidence would have been any more likely to persuade the bankruptcy court that the union had previously taken contrary actions or positions.

The Second Circuit also found no prejudice to Meadows based on the language in the bankruptcy court's written order allowing Meadows to pursue his grievance "to the extent permitted by applicable law." Indeed, Meadows pointed to no authority that would have allowed him to pursue of the grievance on any other terms. Accordingly, the Second Circuit affirmed the judgment of the district court.

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Third Circuit

In re: Dana N. Grant-Covert,
2016 WL 5846227 (3d. Cir. Oct. 6, 2016) Unreported

Wells Fargo Bank, N.A. filed a motion for relief from the automatic stay in a Chapter 7 proceeding in New Jersey in order to foreclose on real property. The debtor opposed the motion, arguing that Wells Fargo did not have standing and was not the real party in interest. The Bankruptcy Court overruled the motion and granted stay relief to Wells Fargo. The debtor appealed the Bankruptcy Court's order, and the District Court affirmed. The Third Circuit upheld the District Court and held that the mortgage had been properly transferred to Wells Fargo despite the fact that the associated note was indorsed to Wells Fargo and then indorsed "in blank." Under New Jersey law, an instrument that is indorsed in blank becomes payable to the bearer and may be negotiated by transfer of possession until specially indorsed. Additionally, Wells Fargo had submitted a certification that it had possession of the promissory note directly or through an agent. Thus, the Third Circuit ruled, Wells Fargo provided sufficient evidence that it had been assigned the mortgage and that it was in possession of the Note.

Hutt and Osborn v. Maryland Casualty Company (In re: W.R. Grace)
2016 WL 6137275, Bankr. D. Del. Oct. 17, 2016 Unreported

Hutt and Osborn filed a declaratory judgment that their claims against Maryland Casualty Company are not barred by the Asbestos PI Channeling Injunction that was established by the confirmed plan of reorganization filed by W.R. Grace, et al. (the "Debtors"), a former manufacturer and seller of asbestos-related products. The Debtors and Maryland Casualty Company ("MCC") entered into a settlement agreement regarding coverage and payment obligations under the various insurance policies issued by MCC to the Debtors. Pursuant to that agreement, MCC falls within the Plan's definitions of an "Asbestos Insurance Entity" that entered into an "Asbestos Insurance Settlement," thereby becoming a "Settled Asbestos Insurance Company." At that time, the District Court affirmed the Bankruptcy Court's determination that it was fair and equitable to include MCC as a Settled Asbestos insurance Company entitled to receive the injunctive protection of Section 524(g).

The Hutt and Osborn plaintiffs (the "Plaintiffs") subsequently filed a negligence and bad faith claim against MCC, alleging that MCC was liable for its own actions or omissions with respect to an industrial hygiene program, failure to conduct proper inspections, sampling, or testing, and failure to warn Plaintiffs of the danger of asbestos. The Plaintiffs also allege that MCC's liability arose by reason of MCC's provision of insurance to the Debtors. The Bankruptcy Court stated that Plaintiffs' claims were based on exposure to Grace's asbestos products, and that therefore, the Plaintiffs were seeking to hold MCC indirectly liable for the Debtor's conducts and policies. Next, the Bankruptcy Court found that the Plaintiffs were seeking additional and alternative forums for Asbestos PI Claims arising out of Grace's products, and the Bankruptcy Court rejected the Plaintiffs' argument that the PI Channeling injunction did not enjoin Plaintiffs' claims.

Additionally, the Plaintiffs argued that because they were former employees of Grace, recovery for their negligence and bad faith claims could stem from the workers' compensation policies provided by MCC to Grace. However, the Bankruptcy Court rejected the Plaintiffs' claims, stating that the Plaintiffs were not asserting workers' compensation claims for statutory benefits, and that therefore, the exception for workers' compensation claims in the Plan did not apply. However, due to the way that an exhibit to the plan was drafted, the Bankruptcy Court ruled that the channeling injunction did not protect a Settled Asbestos Insurance Company from claims arising out of insurance policies that were not listed on the exhibit. The exhibit provided that the Asbestos Insurance Entity is protected "only with respect to and to the extent of" policies identified as the subject of an Asbestos Insurance Settlement Agreement.

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In re ADI Liquidation, Inc. et al.,
2016 WL 6126245, Bankr. D. Del. October 19, 2016 Unreported

In *ADI*, Judge Carey overruled the debtors' objection to a priority severance claim filed by a former employee. The employee was terminated one month before the Debtors filed their bankruptcy petitions and was entitled to severance benefits based on a company policy in which he earned one week of severance pay for each year continuous service. By the petition date, the employee was owed 15 weeks' worth of severance pay, half of which remain unpaid.

The Court examined whether the unpaid severance was entitled to priority status under § 507(a)(4) as severance earned by an employee "within 180 days before the date of the filing of the petition…to the extent of $12,850." 11 U.S.C. § 507(a)(4). In their opposition, the debtors argued that, under the policy, because the employee completed only one year of service within the 180-day period, he was only entitled to priority status for the one week of severance pay earned for that year prior to the filing.

The Court disagreed, citing its decision in *In re Garden Ridge Corp.*, 2006 WL 521914, at *1-2 (Bankr. D. Del. Mar. 2, 2006), finding that although the employee's *eligibility* for severance accrued over time, he *earned or became entitled* to the severance only upon the termination of his employment—a "contingent" event that triggered his right to payment within the prescribed 180-day period.

However, the Court did not afford administrative priority status to the employee's claim. The employee, appearing *pro se*, testified that the debtors requested he, after his termination, continue to assist the debtors in locating company records, computer files, procedures, and information relating to his unfinished projects from his time working for the debtors. For this post-petition work, the employee claimed that his severance pay should be elevated to administrative

priority status. The court held that the employee's severance payment "derived from his pre-petition work," not his post-petition work, and that the debtors did not enter into a post-petition agreement with the employee to provide as such. As such, the Court concluded that the employee was a volunteer and thus was not entitled to compensation for those services.

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Fifth Circuit

***Janvey v. Libyan Investment Authority*,**
--- F.3d ---, 2016 WL 6276051 (5th Cir. Oct. 26, 2016)

In this matter, the Fifth Circuit examined whether the sole shareholder of a creditor could be a "person for whose benefit the transfer was made" for purposes of being held liable for a transfer under the Texas Uniform Fraudulent Transfer Act ("TUFTA").

Ralph S. Janvey, the court-appointed receiver for a Ponzi scheme orchestrated by Allen Stanford, who brought claims for fraudulent transfer and unjust enrichment against the Libyan Foreign Investment Company ("LFICO") and its sole shareholder, the Libyan Investment Authority ("LIA"). Stanford, through a group related of entities, had sold sham CDs issued by the Stanford International Bank, Ltd. ("SIB") to unsuspecting investors. However, rather than investing the funds it they received from later investor, the Stanford entities paid those funds to earlier investors, including LFICO. LIA had not purchased any SIB-issued CDs from the Stanford entities, and was wholly-owned by Libya.

After examining whether the Foreign Sovereign Immunities Act ("FSIA") provided for jurisdiction over LIA (it didn't) and LFICO (the court remanded for further jurisdictional determinations), the court turned to the issue of whether LIA was a transfer beneficiary of LFICO under TUFTA. Noting that "[i]n the context of bankruptcy, a transfer beneficiary is typically the guarantor of a debt that was extinguished by the transfer," the Fifth Circuit opined that mere shareholder status, without more, is insufficient to make a majority shareholder a beneficiary of a transfer made to the subsidiary corporation. Approving the approach put forth by the Bankruptcy Court for the Northern District of Illinois in *In re Hansen*, 341 B.R. 638, 644 (Bankr. N.D. Ill. 2006) (interpreting § 550(a)(1) of the Bankruptcy Code), the Circuit Court reasoned that:

> When a debtor transfers assets to a creditor to satisfy a guaranteed debt, there are independent benefits: The creditor, as transferee, receives the assets, and the guarantor, as the beneficiary, retains assets that he would otherwise have lost as a

> result of the debtor's insolvency. . . . [T]he transferee and beneficiary have independent obligations. . . . Further, when a debtor transfers assets to a creditor to satisfy a guaranteed debt, the guarantor is involved as a party, or at least an independent obligor, to the contract giving rise to the transfer.

Janvey, --- F.3d ---, 2016 WL 6276051, at *11. Because LIA was merely the sole shareholder of LFICO – the transferee – and not a guarantor or party to the contract between SIB and LFICO, LIA had no independent obligation. Thus, LIA did not receive an independent benefit as a result of the transfer, and could not be considered a transfer beneficiary under TUFTA.

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***In re McCloskey*,**
--- Fed. App'x ---, 2016 WL 6436844 (5th Cir. Oct. 31, 2016)

In *McCloskey*, the parties argued the issue of awarded attorney's fees in conservatorship proceedings. The debtor, Christopher J. McCloskey, filed for bankruptcy, seeking a discharge of the award. Debtor's former wife, Anne McCloskey, maintained that the debt was a non-dischargeable support obligation under 11 U.S.C. § 523(a)(5).

Initially, the Texas state trial court awarded Anne $50,398 in attorney's fees from proceedings that determined conservatorship, support, and property division arising from the McCloskey's divorce. Mr. McCloskey subsequently appealed the judgment and then filed for bankruptcy. The bankruptcy court granted a limited stay for the appeal to go forward in state court. The state appellate court subsequently upheld the trial court's award, but, struck any reference to "child support" within the judgment, deeming the award of attorney's fees as solely necessary for "conservatorship of the children." This singular issue set up a string of appeals that eventually landed before the Fifth Circuit to finally determine dischargeability.

The issue over dischargeability stemmed from the fact that the Texas Supreme Court had recently limited the circumstances in which attorney's fees could be awarded in child support proceedings. In *Tucker v. Thomas*, the Texas Supreme Court held that "in absence of express statutory authority, a trial court may not award attorney's fees recoverable by a party in a non-enforcement modification suit as necessaries or additional child support." 419 S.W.3d 292, 295 (Tex. 2013). Thus, Mr. McCloskey argued that the award of attorney's fees in his case was for non-enforcement proceedings and should therefore be discharged.

The Fifth Circuit held that attorney's fees awarded in custody disputes in Texas state district courts are not discharged in chapter 7 bankruptcy cases. The Court found that the attorney's fees qualified as support and were therefore non-dischargeable because the award was in connection with a separation agreement. The Court further reasoned that Mr. McCloskey's use of the *Tucker*

case was unavailing as the bankruptcy court was not constrained by a state-court ruling because determination of a support obligation as a dischargeable debt is a determination for federal bankruptcy law. The fact that the award was in connection with a separation agreement was enough for the bankruptcy court to determine that the debt was non-dischargeable. Classification of the award as enforcement or non-enforcement had no bearing under federal bankruptcy law. The Court also addressed arguments on standing, violation of the automatic stay, and estoppel, which are not included in this summary.

***Wilson v. Navika Capital Group LLC*,**
--- Fed. App'x ---, 2016 WL 6068126 (5th Cir. Oct. 14, 2016)

This appeal arises out of a collective action under the Fair Labor Standards Act (FLSA) brought by a number of hotel workers against Defendants (collectively "Navika") who sought unpaid wages and over-time pay "on behalf of themselves and other similarly situated persons." The class was conditionally certified and approximately 330 individuals joined the class. The Fifth Circuit reviewed two motions in this case: 1) Motion for Reconsideration of Order on Motion for Extension of Time, and 2) Motion to Dismiss.

Regarding the Motion for Reconsideration, the district court had previously decertified, the class and dismissed without prejudice the claims of all plaintiffs that had opted in to join and tolled the applicable statute of limitations for 30 days in order to allow for filing of individual suits by decertified plaintiffs. The Opt-in Plaintiffs subsequently filed a motion requesting a fourteen-day extension of the tolling provision, which the court granted. The reason for the extension was that plaintiffs claimed that they had "dutifully filed lawsuits in the local jurisdictions where the consenting plaintiffs reside," but were having filing problems in the United States District Court for the Western District of Missouri, which prevented filing a timely suit in that jurisdiction. Navika filed its Motion for Reconsideration arguing that the Opt-in plaintiffs had failed to diligently file their suits. The district court granted the motion and revoked the tolling provision.

However, on appeal, the Fifth Circuit did not address the arguments related to the Motion for Reconsideration because Plaintiffs did not comply with Federal Rule of Appellate Procedure 3(c)(1), which requires that a notice of appeal must "specify the party or parties taking the appeal by naming each one in the caption or body of the notice." The rule continues and states that "an attorney representing one or more party may describe those parties with such terms as 'all plaintiffs,' 'the defendants,' 'the plaintiffs A, B, et al.,' or 'all defendants except X.'" Here, the notice of appeal stated, simply, "Plaintiffs Wilson et al.," which the Fifth Circuit determined was insufficient. However, the parties, and the Court, both agreed that the notice of appeal was not deficient as to all plaintiffs and the parties named in the caption, Ashley DeLeon and Joanna Wilson, had properly given notice of intent to appeal on the Motion to Dismiss. Thus, the Fifth Circuit did address arguments solely on the Motion to Dismiss, as to DeLeon and Wilson, because both of them gave sufficient notice of appeal as to the Motion to Dismiss.

Regarding the Motion to Dismiss, the district court had previously held "that all Plaintiffs who remain a party to this action… are required to provide Defendants with individual damages computations within twenty (20) days of entry of this order." Further, the court ordered that failure to provide the computations would result in dismissal without prejudice. Navika then moved for

dismissal as to all Plaintiffs who had failed to provide computation pursuant to Federal Rules of Civil Procedure 37 and 41(b) and the court granted the motion. DeLeon and Wilson were two such Plaintiffs.

In the case at bar, DeLeon and Wilson argued that the district court abused its discretion in dismissing their claims under Federal Rule of Civil Procedure 37(c)(1). However, the district court dismissed pursuant to Federal Rules of Civil Procedure 37 and/or 41(b), and in their brief, DeLeon and Wilson only contested dismissal pursuant to Rule 37. The Fifth Circuit held that because DeLeon and Wilson failed to raise any challenge to dismissal under Rule 41(b), the issue was waived. Therefore, the court did not need to address an arguments relating to Rule 37.

Thus, the Fifth Circuit affirmed the dismissal of DeLeon and Wilson, and dismissed for want of jurisdiction for all other plaintiffs.

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In the Matter of Skyport Global Communications, Inc.,
--- Fed. App'x ---, 2016 WL 5931415 (5th Cir. Oct. 12, 2016)

In this case, the Fifth Circuit affirmed a contempt order against attorney Samuel Goldman ("Goldman") and advisor Franklin Craig ("Craig").

Goldman represented a group of investors in a state court action seeking damages for, among other things, mismanagement of Skyport Global Communications. The state court defendants removed the case to the bankruptcy court and sought a preliminary injunction to determine whether the suit was barred by Skyport's confirmation order. The bankruptcy court granted the injunction and ordered Goldman and Craig to refrain from pursuing any and all claims against the defendants and/or contacting any Skyport's current or former employees. Immediately after the injunction was entered, Goldman and Craig began communicating with Dawn Cole ("Cole"), Skyport's former president, including encouraging her to pursue her own claims against Skyport and pursuing financial backing for their state court litigation.

The investors filed a motion for contempt against Goldman and Craig for these violations. The bankruptcy court found them in contempt and entered an order awarding monetary sanctions equaling 25% of the defendants' attorneys' fees and 95% of expenses. Goldman and Craig appealed, arguing: (1) the bankruptcy court lacked jurisdiction because the contempt proceeding was criminal, not civil; (2) the attorneys' fees awarded were not reasonable or necessary; (3) the award was erroneous because the preliminary injunction was dissolved; and (4) Goldman and Craig did not violate the injunction as they understood its terms.

The Fifth Circuit easily disposed of the first two arguments, explaining civil contempt is used to compensate a party who suffered unnecessary injury because of contemptuous conduct. Such remedial contempt is civil in nature, the court explained, because it addresses the consequences of the opponent's defiant conduct without punishing the defiance per se. Because the sanctions essentially restored Skyport to the position it was in prior to the wrongful conduct, it was remedial in nature and the bankruptcy court had jurisdiction to impose it. For the same reasons, the Court found the award of attorneys' fees reasonable and necessary.

The Fifth Circuit likewise rejected Goldman's and Craig's argument that the dissolution of the preliminary injunction rendered the award erroneous. Specifically, the Court held that where, as here, a contempt order is compensatory in nature, it is not mooted by termination of the underlying action. Finally, the Fifth Circuit found that the language and terms of the preliminary injunction were clear, undermining Goldman's and Craig's claim that they did not knowingly violate the order.

Matter of Monaco,
--- F.3d ---, 2016 WL 5864090 (5th Cir. Oct. 6, 2016)

This appeal arose out of construction contract gone awry and subsequently complicated by bankruptcy proceedings. TAG Investments ("TAG") entered into a construction contract with Buildings by Monoco ("BBM"). Under the agreement, BBM, as general contractor, received progress payments that required it to certify all project subcontractors and supplies had been paid. Despite BBM's certifications, TAG began to receive lien notices from BBM's subcontractors and suppliers and fired BBM. At the time of BBM's termination, it had received nearly $1.8 million in payments from TAG but had dispersed only $1.6 million to its subcontractors and suppliers.

TAG sought reimbursement for this discrepancy from BBM but, before it was paid, BBM and its principle, Adam Monoco ("Monoco"), filed for bankruptcy. The bankruptcy court held the debt to TAG non-dischargeable under 11 U.S.C. § 523(a)(4), finding Monoco had misapplied funds held in trust for the subcontractors and suppliers under the Texas Construction Trust Fund Act ("CTFA"), which holds a trustee liable when he intentionally or knowingly with an intent to defraud retains, uses, disperses, or diverts trust funds without first paying obligations to the beneficiaries of the trust.

On appeal, Monoco argued, among other things, that he was protected by § 162.031(b) of the CTFA, which provides an affirmative defense where trust funds not paid to a beneficiary were used by the trustee to pay actual expenses related to construction or repair of the project. The Fifth Circuit pointed to circuit precedent holding the affirmative defense permitted general contractors to use payments from construction projects to further the construction, even in some instances where beneficiaries were not paid first. Permissible uses included payment for overhead costs. Because Monoco had used the fund to pay salaries, overhead, and supervision costs, the Fifth Circuit held Monoco was protected by the affirmative defense. Further, TAG failed to carry its burden to show Monoco had misapplied the funds, which required evidence the funds were spent on impermissible expenses under the CFTA.

In the Matter of Lisa Ann Galaz,

--- F.3d ---, 2016 WL 6407211 (5th Cir. Oct. 28, 2016)

This case involves a complicated history of ownership of the Worldwide Subsidy Group ("WSG"). Raul Galvez owned WSG with his legal assistant, Marian Oshita ("Oshita"). When Raul and his wife, Lisa, divorced, Lisa received half of Raul's interest in WSG. Raul subsequently sold the remainder of his interest to Oshita, which she improperly purchased with WSG funds. Lisa challenged the sale in state court and was awarded the portion of Raul's interest sold to Oshita, as well as monetary damages, which Oshita failed to pay (the "State Court Judgment"). These events left Lisa with a 75% interest in WSG, while Oshita owned 25%.

Thereafter, Lisa sold half of her interest in WSG to Raul's sister, Denise Vernon ("Vernon"). Vernon, Oshita, and Lisa disagreed over the management of WSG, resulting in additional lawsuits for control of the company. During the litigation arising from these disagreements, Lisa filed for bankruptcy. The disagreements regarding management of WSG resulted in two separate settlements, the first of which resolved disputes between Oshita and Lisa (the "2008 Settlement"). The second resulted in Vernon purchasing Lisa's interest in WSG, as well as any unliquidated claims against Oshita (the "2011 Settlement"). Vernon later assigned the claims against Oshita to her father, Alfred Galaz ("Galaz"). As part of the 2011 Settlement, Vernon also released all claims against Lisa.

Galaz successfully sued Oshita in California state court for the unpaid State Court Judgment owed to Lisa and foreclosed on Oshita's WSG interest to satisfy the judgment. As successor-in-interest to Oshita, Galaz then sued Lisa, alleging she owed past monetary distributions on Oshita's interest. Lisa brought a separate adversary proceeding in the bankruptcy court seeking to enjoin Galvez's claims on the ground they violated the discharge order in her bankruptcy. The bankruptcy court held the 2011 Settlement, which discharged Vernon and Lisa's rights to sue each other, barred Galvez's claim.

On appeal, Galaz first challenged the bankruptcy court's jurisdiction to enjoin his claims because Lisa's Chapter 13 proceeding was previously closed. The Firth Circuit held the bankruptcy court maintained jurisdiction to enforce its prior orders. Here, Galaz's claims related to pre-confirmation conduct, principally the 2008 Settlement that resolved disputes between Oshita and Lisa regarding WSG ownership. Further, Galaz's state court suit was arguably a violation of Lisa's discharge rights under the bankruptcy code, implicating the bankruptcy court's "arising under" jurisdiction.

Galaz also argued the bankruptcy court lacked authority to enter final judgment because the proceeding was not core. The Fifth Circuit disagreed, explaining that proceedings are core if they are dependent on rights created in bankruptcy. Here, Lisa alleged her discharge rights--which are statutory rights provided by the bankruptcy code--were violated. Thus, the bankruptcy court was within its statutory authority to enter judgment on Galaz's claims. The Fifth Circuit summarily rejected Galaz's contention that mandatory abstention was appropriate based on its holding that the case was a core proceeding.

Galaz next claimed the bankruptcy court erred in finding his claims barred by res judicata, compromise and settlement, and accord and satisfaction because (1) Lisa did not raise the defenses

in her pleadings and (2) these defenses were meritless. The Fifth Circuit, however, held Galaz waived these arguments by failing to raise them specifically in his statement of issues presented under Bankruptcy Rule 8006. In particular, the Court found Galaz's statement of issues too broad to encompass these arguments. In any event, the Fifth Circuit agreed Galaz's claims were barred by res judicata in light of the 2011 Settlement, which released Vernon's claims against Lisa. Galaz's claims arose out of rights assigned to him by Vernon and were subject to the legal and equitable defenses existing at the time of assignment, including the 2011 Settlement release.

Finally, the Fifth Circuit held the bankruptcy court properly held Galaz's claims were barred by judicial estoppel, which it invoked to prevent Galaz from taking positions in the case that were inconsistent with positions taken by his predecessor in interest, Vernon, in prior proceedings. Specifically, Vernon previously argued Oshita had abandoned her ownership in WSG. Accordingly, Galaz could not now argue Oshita possessed an ownership interest.

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Ninth Circuit

Spokane Law Enforcement Federal Credit Union v. Drummond (In re Barker)
2016 WL 6276078 (9th Cir. Oct. 27, 2016)

In *Spokane Law Enforcement Federal Credit Union v. Drummond*, the Ninth Circuit affirmed the bankruptcy appellate panel's affirmance of the bankruptcy court's decision to disallow a creditor's late-filed claims in a Chapter 13 proceeding. The Court held that even with the debtor's acknowledgement of debt owed to the creditor in a bankruptcy schedule, it does not relieve the creditor of the affirmative duty to file a timely proof of claim in order to participate in a the distribution of a debtor's assets under a Chapter 13 plan.

In order for a proof of claim to be timely, a creditor generally must file it within 90 days after the first date set for the meetings of creditors. Fed. R. Bankr. P. 3002(c). If a creditor fails to file a timely proof of claim, a debtor or trustee may file a claim on the creditor's behalf within thirty days after the creditor's ninety-day clock has expired. Fed. R. Bankr. P. 3004.

Although creditor Credit Union admitted that it filed its proof of claims late, Credit Union argued that the bankruptcy court should have allowed it given that the debtor listed this debt in her bankruptcy schedules. The Ninth Circuit disagreed. The plain language of the Federal Rules of Bankruptcy Procedure clearly provides that an unsecured creditor must file a proof o claim for the

claim or interest to be allowed. This further supports Congress's intentions given that a creditor in a Chapter 11 context is not always required to file a proof of claim.

Moreover, bankruptcy schedules serve multiple purposes independent of a proof of claim. Relatedly, the Court did not consider the debt listed in the schedules by the debtor as a judicial admission, an informal proof of claim, nor the debtor's "proof of claim" on Credit Union's behalf.

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Eleventh Circuit

In re Failla,
838 F.3d 1170, 2016 WL 5750666 (11th Cir. Oct. 4, 2016)

Background: Residential mortgagee filed a motion to compel Chapter 7 debtors to surrender property consistent with their statement of intentions filed in the bankruptcy case. The debtors' had decided to surrender their house since the amount owed was more than the value of the home. Because there was no value to estate, the Chapter 7 Trustee abandoned the property back to the debtors who continued to live in the house. The debtors sought to fight the state foreclosure action. The bankruptcy court granted the bank's motion and ordered the debtors to stop opposing foreclose, which the district court affirmed.

Holding: On appeal the debtors argued that "surrender" applied to surrendering the property to the Trustee, thus since the Trustee abandoned the property back to the debtors, they could oppose the foreclosure. The Court held that when a debtor files a statement of intent to surrender property pursuant to 11 §521(a)(2) that they must surrender to both the Chapter 7 and the creditor, otherwise section 11 §521(a)(4) would be superfluous. The Court further held that the bankruptcy court had the authority to remedy the debtors' abuse of the bankruptcy process by directing debtors to withdraw their affirmative defenses and dismiss their counterclaim in the foreclosure action.

In re Stanton,
--- B.R. ----, 2016 WL6299750 (Bankr. M.D. Fla. Oct.26, 2016)

Background: Counsel for Chapter 7 Trustee filed a fee application, which contained all the information required for a chapter 7 fee application under Local Rule 2016-1. The U.S. Trustee objected to the fee application on the basis that it failed to provide any meaningful breakdown on how he spent time in the main case, division of labor between himself and special counsel, and failed to provide any meaningful narrative regarding the results obtained from his services. In

response to the objection, counsel opted to supplement his initial fee application by providing more detail and then subsequently included the additional time spent in a subsequent fee application. The U.S. Trustee objected to the additional fees as unrecoverable under the Supreme Court's Baker Botts decision. *Baker Botts v. ASARCO* 135 S. Ct. 2158, 2163, 192 L. Ed. 2d 208 (2015).

Holding: The U.S. Trustee urged the court to adopt a bright-line rule that fees incurred on a fee application following the filing of that application are not compensable under the Supreme Court's *Baker Botts* decision. The Court disagreed. Judge Williamson reasoned that supplementing the fee application was "in service of" the estate—and thus compensable—because providing a heightened level of detail on fee applications benefits the estate. He also reasoned that because the time spent supplementing the fee application would have been compensable if it had been done initially, the mere fact that the work occurred after the filing of the fee application doesn't make it not compensable. "The takeaway from the Supreme Court's decision in *Baker Botts* is clear: it is the nature of the work—not when it is performed—that determines whether it is compensable."

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