

2004

**RECENT DEVELOPMENTS:
TEXAS BANKRUPTCY COURT,
TEXAS FEDERAL DISTRICT COURT,
FIFTH CIRCUIT COURT OF APPEALS,
UNITED STATES SUPREME COURT
BANKRUPTCY DECISIONS**

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**20TH ANNUAL ADVANCED CONSUMER
BANKRUPTCY COURSE**

**STATE BAR OF TEXAS
SEPTEMBER 24, 2004
HOUSTON, TEXAS**

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**RECENT DEVELOPMENTS:
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ABSTENTION

Barbee v. Colonial Healthcare Center (In re East Texas Healthcare, Inc.), 2004 WL 609394; (N.D.Tex., March 22, 2004, Judge David C. Godbey)

Issue: Whether the bankruptcy court abused its discretion in dismissing a cross-complaint based on permissive abstention

Issue: Whether plaintiff should have been granted leave to amend their pleadings to allege diversity jurisdiction

In this involuntary proceeding, the chapter 7 trustee filed a complaint to determine the validity of competing claims to certain funds interpleaded into the registry of the bankruptcy court. By agreed judgment, plaintiff was determined to hold the first priority lien and security interest in the accounts receivable of defendant, a stranger to the proceedings. After an agreed judgment was entered, plaintiff amended its answer and filed a cross-claim against defendant seeking turnover.

The bankruptcy court granted defendant's motion to dismiss, applying permissive abstention under 28 U.S.C. § 1334(c)(1). The bankruptcy court reasoned that it should abstain because: (1) absent the bankruptcy case, there would be no federal jurisdiction; (2) the matters raised were wholly dependent on state law; (3) litigation concerning the accounts receivable of defendant had been pending in state court; and (4) comity and respect for state law weighed in favor of abstention. After the bankruptcy court dismissed the cross-claim, plaintiff sought leave to amend its cross-complaint to allege diversity jurisdiction. The bankruptcy court denied the motion for leave to amend, finding the motion untimely, and holding that allegations of diversity jurisdiction would not affect its decision to abstain.

The court held that the appropriate standard of review for permissive abstention is abuse of discretion and that reversal is not justified if the ruling of the court can be supported on any ground. Bankruptcy courts can consider a variety of factors when determining whether to permissively abstention including (1) the administrative effect on the estate in the event of a bankruptcy court recommendation of abstention; (2) the extent to which state law issues predominate over bankruptcy issues; (3) the difficulty or unsettled nature of applicable state law; (4) the existence of any related proceedings; (5) the jurisdictional basis, if any, other than 28 U.S.C. § 1334; (6) the degree of relatedness of the proceeding to the main bankruptcy case; (7) the substance rather than the form of an asserted core proceeding; (8) the feasibility of state claim severance from core bankruptcy matters; (9) the present docket burden in the

Bankruptcy Court; (10) the likelihood of forum shopping by one party; (11) the existence of the right to a jury trial by either party; and (12) the presence of nondebtor parties in the proceeding. The bankruptcy court is not required to address each factor, and permissive abstention may be warranted even though some of factors are absent.

Further, a decision to grant leave to amend is within the discretion of the trial court, and is also reviewed under an abuse of discretion standard. In deciding whether to grant leave to amend, the court may consider such factors as undue delay, bad faith or dilatory motive on the part of the movant, repeated failure to cure deficiencies by amendments previously allowed, undue prejudice to the opposing party, and futility of amendment.

Centre Strategic Inv. Holdings Limited v. Official Committee of Unsecured Creditors (In re Senior Living Properties, LLC), 294 B.R. 698; (Bankr. N.D. Tex., June 24, 2003, Judge Steven A. Felsenthal)

Issue: Whether the bankruptcy court should abstain, either under mandatory abstention or discretionary abstention provisions of 28 U.S.C. §1334(c), from hearing an action brought by the parent corporation of a Chapter 11 debtor seeking a declaratory judgment that it was not liable for the debtor's debts as a de facto partner.

In a declaratory judgment adversary proceeding, the parent corporation of a Chapter 11 debtor sought a declaration that it had no liability to the debtor's estate based on alter ego claims. The debtor's unsecured creditors committee requested the court to abstain from adjudicating the complaint. The court first addressed whether mandatory abstention, found in 28 U.S.C. §1334(c)(2), applied. Such provision requires abstention if a proceeding is based on a state law claim, is related to a bankruptcy case but not arising under title 11 or arising in a title 11 case, with respect to which an action could not have been brought in federal court absent bankruptcy jurisdiction, and can be timely adjudicated in a state court.

The committee asserted that the parent was is liable to the creditors of the debtor as a de facto general partner with the debtor, and that this alter ego claim derived from state law. On its surface, the court agreed that the alter ego claim would have an existence outside of bankruptcy. However, the court found guidance from the Fifth Circuit that a state law cause of action that could exist outside of bankruptcy may be so inseparable from the bankruptcy case to give the court discretion whether to abstain from hearing the cause. A claim not based on any right created by the Bankruptcy Code can nevertheless be inseparable from a bankruptcy court to be considering "arising in" the case. The court found that the committee's alter ego claim against the parent fit this scenario for various reasons, including: The entire posture of the litigation of the alter ego claim by the committee is intertwined with the bankruptcy case. The committee is an entity created by the Bankruptcy Code. The alter ego claim constitutes property of the bankruptcy estate.

The court further found that the parent had filed a large claim in the bankruptcy case, and that the parent's claim and the committee's de facto partnership claim arise from the same underlying facts regarding the operation of the nursing homes. As a counter-claim to the parent's claim, the de facto partnership claim presented a core matter. Therefore, the court held that the de facto partnership alter ego claim arose in the debtor's bankruptcy case, as the claim was inseparable from the case. Therefore, mandatory abstention was inapplicable, and the court had discretion as to whether to abstain.

The court next held that it would not exercise discretionary abstention, citing to the following considerations: First, the court found the alter ego claims to be inextricably involved with the bankruptcy case. Next, resolution of the dispute would facilitate the ultimate resolution of the bankruptcy case. Next, the de facto partnership alter ego counter-claim should be resolved in the same forum. Next, the claims allowance process as affected by the counter-claim constituted a core matter, which should be

resolved in the administration of the bankruptcy case. The court therefore denied the committee's request that the court abstain from the adversary proceeding.

ADMINISTRATIVE CLAIMS

In re Reed, 293 B.R. 698; (Bankr. N.D. Tex., May 16, 2003, Judge Robert L. Jones)

Issue: Whether interest is allowable to administrative claimants in a Chapter 7 bankruptcy case under section 726(a)(5) where a surplus is available over creditor claims.

A Chapter 7 trustee's final report showed enough funds on hand to pay all of the debtor's creditors and distribute a surplus back to the debtor. The trustee's final report therefore proposed to pay interest on administrative claims, which the trustee argued was mandated in surplus cases by section 726(a)(5), which provides in a surplus case for payment of interest at the legal rate from the date of the filing of the petition on certain claims, including priority claims. The trustee proposed to pay interest on his trustee fees, expenses, attorneys fees and accountant fees. As provided in section 726(a)(5), the trustee proposed to pay interest from the date of the petition. The United States Trustee agreed that administrative expenses were entitled to interest under section 726(a)(5), but argued that such interest cannot accrue from the petition date, which would lead to the absurd result of payment of interest on a claim for a time period before which such claim exists.

The court found that most courts that have addressed the issue of interest on administrative claims in a surplus case generally agree that interest is payable pursuant to section 726(a)(5), but disagree over when such interest begins to accrue. The majority of courts hold that interest begins to accrue as of the date of the trustee's fee award, while the minority view holds that interest begins to accrue as of the date of the filing of the petition. The court in this case could not fully agree with either the majority or the minority view. Instead, the court began the analysis with section 726(a)(5), which, in a surplus case, directs the payment of interest at the legal rate from the date of filing of the petition on any claim paid under paragraph (1) of section 726(a). Paragraph (a)(1) refers to payment of section 507 claims, proof of which is timely filed under section 501. The court raised the question raised of whether section 727(a)(1) authorizes the payment of an administrative expense as opposed to a claim, and found dispositive that section 501 addresses the filing of a proof of claim by a "creditor," which, in turn, is defined in section 101(10) as an "entity that has a claim against the debtor that arose at the time of or before the order for relief concerning the debtor. . . ." Therefore, with such section read together, the court held that the claims of the Trustee, his attorney, and accountant for compensation and expenses arose during the pendency of the Chapter 7 proceeding and thus after the order for relief. They do not, therefore, constitute claim-filing creditors. The court concluded that the trustee, his attorney, and his accountant did not represent the holders of claims intended to be paid under section 726(a)(1), and therefore denied payment of interest under section 726(a)(5).

APPEALS

Till v. SCS Credit Corp., 124 S. Ct. 1951, 2004 WL 1085321; (US, May 17, 2004, plurality opinion by Justice John P. Stevens)

Issue: The appropriate interest rate to be utilized in a bankruptcy "cram down" plan

Chapters 11 and 13 of the Bankruptcy Code permit bankrupt debtors to confirm bankruptcy plans that force secured lenders to accept treatment of their indebtedness against their will, within certain statutory guidelines. This type of plan is typically referred to as a “cram down” plan. One of the statutory requirements of a “cram down” plan is that the debtor’s proposed treatment of the secured lender must provide for payments to the lender over time whose total value, as of the plan’s confirmation date, “is not less than the [claim’s] allowed amount.” This statutory provision, in turn, requires that the creditor receive disbursements whose total present value equals or exceeds the allowed secured claim. To satisfy these requirements, courts require a debtor’s plan to provide the secured lender with a rate of interest that will provide to such lender the equivalent of the present value of the lender’s allowed secured claim.

Since the Bankruptcy Code does not specify what rate of interest is appropriate, courts have wrestled with the appropriate methodology to determine the rate of interest that must be paid by a debtor in a bankruptcy plan to satisfy statutory confirmation requirements. Various bankruptcy courts, federal district courts and federal courts of appeal have adopted a number of approaches to fill in the blanks left by the Bankruptcy Code as to the appropriate rate. These approaches, all discussed in the three Supreme Court opinions in *Till v. SCS Credit Corp.*, include the formula approach, the coerced loan approach, the presumptive contract rate approach, and the cost of funds approach.

The particular facts addressed by the Supreme Court in *Till v. SCS Credit Corp.* involved a Chapter 13 (or individual debt adjustment) plan. However, at least the plurality opinion, authored by Justice Stevens, found it likely that Congress intended bankruptcy courts to follow essentially the same approach when choosing an appropriate interest rate under other Chapters of the Bankruptcy Code, including Chapter 11.

Under the facts before the Court, the debtor’s plan had proposed the lender an interest rate of 9.5% on its secured claim, a rate that was reached by augmenting the national prime rate of 8% to account for the nonpayment risk posed by borrowers in petitioners’ financial position. In confirming the plan, the bankruptcy court overruled the lender’s objection that it was entitled to its contract interest rate of 21%. The district court reversed, ruling that the 21% rate was appropriate because cram down rates must be set at the level the creditor could have obtained had it foreclosed on the loan, sold the collateral, and reinvested the proceeds in equivalent loans. This approach is commonly referred to as the “coerced loan” approach. The Seventh Circuit Court of Appeals adopted even a different approach, holding that the original contract rate was a “presumptive rate” that could be challenged with evidence that a higher or lower rate should apply, and remanding the case to the bankruptcy court to afford the parties an opportunity to rebut the presumptive 21% rate. A dissenting opinion in the Seventh Circuit case proposed yet another approach, the “cost of funds rate,” which focuses on what it would cost the creditor to obtain the cash equivalent of the collateral from another source.

On appeal to the Supreme Court, the issue squarely before the Court was the appropriate test to be adopted in a bankruptcy “cram down” scenario for a bankruptcy court to determine which rate of interest satisfies the statutory requirement of plan confirmation. The resolution of the issue, however, was not so square. Instead, three separate opinions were offered by Justice Stevens (writing the plurality opinion on behalf of four justices), Justice Thomas (concurring on his own), and Justice Scalia (dissenting with the Court’s judgment on behalf of four justices). These opinions do not contain a majority voice definitively adopting any of the specific interest rate approaches developed by the lower courts. Under principles of Supreme Court plurality opinion interpretation, “[w]hen a fragmented Court decides a case and no single rationale explaining the result enjoys the assent of five Justices, the holding of the Court may be viewed as that position taken by those Members who concurred in the judgments on the narrowest grounds.” *Marks v. United States*, 430 U.S. 188, 193, 97 S.Ct. 990 (1977). Therefore, to discern any holding from the *Till* decision, some degree of analysis of each of the three opinions becomes necessary.

Justice Stevens' plurality opinion rejected the coerced loan, presumptive contract rate, and cost of funds approaches utilized by the lower courts, and concluded that the appropriate formula to determine the appropriate interest rate in a "cram down" plan begins with the national prime rate, and thereafter makes certain adjustments based on various market factors. The plurality opinion found that the Bankruptcy Code does not give much guidance as to the manner in which the appropriate rate should be calculated. The promise of future payments to a lender is obviously worth less than an immediate lump sum payment, due to lost opportunity and the risks of inflation and nonpayment. In the marketplace, lenders look to the national prime rate, which reflects the financial market's estimate of the amount a commercial bank should charge a creditworthy commercial borrower to compensate for the loan's opportunity costs, the inflation risk, and relatively slight default risk. Likewise, the plurality opinion believed that a bankruptcy court should begin with the prime rate, and make adjustments to account for the greater nonpayment risk that bankrupt debtors typically pose. Such adjustments should take into consideration various factual circumstances that would require the bankruptcy court to hold a hearing to permit the debtor and creditors to present evidence about the appropriate risk adjustment. Factors that a bankruptcy court should take into consideration in determining the appropriate risk adjustment include the circumstances of the estate, the nature of the security, and the duration and feasibility of the reorganization plan.

Justice Thomas' concurring opinion, unlike those of the eight other Justices, did not believe that the plain meaning of the present value requirement of the appropriate Chapter 13 plan confirmation statute required any analysis regarding risk. Instead, stated Justice Thomas, a creditor receives the present value of its claim only if the total amount of the deferred payments includes the amount of the underlying claim plus an appropriate amount of interest to compensate the creditor for the decreased values of the claim *caused by the delayed payments*. In most, if not all cases, Justice Thomas believed that the Bankruptcy Code's present value requirement is met where a bankruptcy plan proposes to simply pay a cash stream with the appropriate risk-free rate of interest, which would be most closely approximated by the prime rate.

Justice Scalia's dissenting opinion agreed with the plurality on a number of points of analysis, most notably that deferred payments must compensate for risk in order to meet the requirements of the relevant Bankruptcy Code provisions. However, the dissenting opinion sharply disagreed with the beginning point of the analysis as the prime rate of interest. Instead, Justice Scalia would have bankruptcy courts begin with the contract rate of interest as the starting point, to which a presumption would attach, only to be defeated by an evidentiary showing of a more appropriate rate. This starting point, according to the dissent, would more appropriately compensate a creditor for the actual risk of the bankruptcy plan.

Given the lack of a clear majority, the holding of the Court is difficult to discern. Utilizing the Court's plurality interpretive devices contained in *Marks*, several points of agreement of majority members may be significant. First, five Justices agreed that the presumptive contract rate is not the appropriate rate. Second, eight of the Justices agreed that risk of default must be taken into consideration when determining whether a secured creditor is receiving the present value of its claim in a Chapter 13 bankruptcy plan. Third, five of the Justices agreed that the prime rate of interest is the foundation of the analysis (with the plurality adding on for risk, and Justice Thomas ending there). Fourth, five of the Justices seem to agree that the appropriate rate is *no more* than the formula of the prime rate plus add-ons for risk. Which of these apparent points of agreement come to be viewed as "holdings" of the Court remains to be seen. In the mean time, without crystal clear guidance from the Supreme Court, it is likely that lower courts will remain split in their analysis of the issue. Only a change in the statute by Congress or a more decisive ruling from the Supreme Court will finally resolve the question.

Issue: In a bankruptcy appeal to the district court, whether the failure to provide the district court with a transcript of the evidence from the trial should result in the bankruptcy court's ruling being affirmed.

Debtor was diagnosed with bipolar for a number of years. Since the diagnosis, debtor obtained a Masters in Business Administration and worked in various fields. He also graduated from law school and passed the bar exam. While attending law school, debtor obtained several student loans. After debtor filed for bankruptcy under Chapter 7, he sought to have the student loans discharged as an "undue hardship" exception of section 523(a)(8). He argued that repayment of the loans would impose on him an undue hardship because his bipolar disorder would prevent him from obtaining and maintaining gainful employment necessary to repay the loans. The bankruptcy court rejected his argument and ruled in favor of the student loan lenders.

On appeal to the district court, the court reviewed the elements of the *Brunner* test, based on undue hardship, as requiring the debtor to show: (1) that he cannot maintain, based on current income and expenses, a "minimal" standard of living for himself and his dependents, if forced to repay the loans; (2) that additional circumstances exist indicating that this state of affairs is likely to persist for a significant portion of the repayment period of the student loans; and (3) that he has made good faith efforts to repay the loans. The district court found that although the debtor argued numerous points of error in the bankruptcy court's judgment, he had not provided the district court with a transcript of the evidence from the bankruptcy court trial. If an appellant intends to urge on appeal that a finding or conclusion is unsupported by the evidence or is contrary to the evidence, the appellant must include in the record a transcript of all evidence relevant to that finding or conclusion. In this case because the debtor failed to provide a transcript, the district court held that the debtor had not carried his burden of showing that the factual findings of the bankruptcy court were clearly erroneous. Therefore, the district court affirmed the decision of the bankruptcy court.

General Electric Capital Corp. v. Torres Concrete Pumping Services, Inc., 43 Bankr. Ct. Dec. 6; 2004 WL 885203; (W.D. Tex., April 15, 2004, Judge Xavier Rodriguez)

Issue: Whether the appeal of an order confirming a plan should be dismissed as equitably moot where the appellant had failed to seek a stay pending appeal, the plan was substantially consummated, and the requested relief would adversely impact the success of the plan.

A Chapter 11 debtor was the lessor of various trucks and equipment. During the pendency of the bankruptcy proceeding the bankruptcy court entered an order permitting the debtor to wait until confirmation of its reorganization plan to assume or reject the leases, conditioned on making various payments until the assumption or rejection of the leases. Debtor filed its plan, and a motion to assume, proposing to assume the leases and cure the arrearages. Lessor objected to the plan, asserting that the arrearages on the first three leases were in excess of the proposed cure amount. The bankruptcy court confirmed the plan over lessor's objections, and granted the motion to assume. However, it did not enter written orders at that time. Two months later, the lessor filed a motion to modify the plan, for various reasons. After a hearing, the bankruptcy court entered orders confirming the plan and denying the motion to modify.

On appeal to the district court, the debtor opted to file, in lieu of a response brief on the merits, a motion to dismiss the appeal, arguing that the appeal was moot under the doctrine of equitable mootness because the plan of reorganization had been substantially consummated. The court found that equitable mootness is not an Article III inquiry as to whether a live controversy is presented; rather, it is a recognition by the appellate courts that there is a point beyond which they cannot order fundamental

changes in reorganization actions. A reviewing court may decline to consider the merits of a confirmation order when there has been substantial consummation of the plan such that effective judicial relief is no longer available, even though there may still be a viable dispute between the parties on appeal. To determine whether an appeal of a reorganization plan is moot, the court evaluates three factors: (1) whether a stay has been obtained; (2) whether the plan has been substantially consummated; and (3) whether the relief requested would affect either the rights of parties not before the court or the success of the plan. In applying the three prong factors, the court first found that the lessor had failed to seek a stay pending appeal. The court next found that plan had been substantially consummated, and that payments had been made on the leases. The second prong of the equitable mootness test requires only substantial consummation, not absolute or complete consummation. With respect to the third prong, the court concluded that the relief requested by the lessor would substantially affect the success of the debtor's Chapter 11 plan. Allowing the debtor to assume the leases under the terms of the plan was essential to the plan and debtor's ability to reorganize and emerge from bankruptcy as a viable concern. To unravel the plan would not only jeopardize but also eviscerate the plan and thwart debtor's ability to reorganize. The district court therefore dismissed the appeal as moot.

Roth v. Mims, 2003 WL 21739007; (N.D. Tex., July 11, 2003, Judge Sam A. Lindsay)

Issue: Whether, pursuant to Fed. R. App. P. 4(a)(5)(A), a party was entitled to file an appeal of a district court judgment 3 months after its entry where the party was entitled to receive notice of entry of the judgment, but did not receive such notice.

A party to a judgment of the district court did not receive notice of the entry of a judgment. Based on this failure, the party did not file an appeal of the judgment in the normal 30 day timeframe contained in Fed. R. App. P. 4(a)(1)(A). The party therefore filed a motion to reopen the time to file an appeal.

The district court found that ordinarily, a party in a civil case must file a notice of appeal within 30 days after the judgment or order appealed from is entered. The district court may extend this deadline upon a showing of "excusable neglect" if the party moves for an extension within 30 days after the expiration of the appellate time period under Fed. R. App. P. 4(a)(5)(A). The court may also reopen the time to file an appeal if (A) the motion is filed within 180 days after the judgment or order is entered or within 7 days after the moving party receives notice of the entry, whichever is earlier; (B) the court finds that the moving party was entitled to a notice of the entry of the judgment or order sought to be appealed but did not receive the notice from the district court or any party within 21 days after entry; and (C) the court finds that no party would be prejudiced.

In this case, the district court found, with undisputed evidence, that the party did not receive notice of the court's judgment entered until nearly 3 months later. After receiving notice of the judgment, the party filed his motion within the seven-day time period contained in the Rule. The court therefore granted the motion to reopen the time to file the appeal out of time.

ATTORNEYS

In re Luna, 2004 WL 1618824 (W.D. Tex., July 19, 2004, Judge Xavier Rodriquez)

Issue: Whether the bankruptcy court had the authority to disbar an attorney from practicing before the bankruptcy courts for the Western District of Texas without complying with a local rule requirement first requiring referral of the attorney to a committee.

A Chapter 13 debtor's attorney appealed to the district court the bankruptcy court's decision to bar counsel from practicing before the Bankruptcy Courts of the Western District of Texas and ordering him to disgorge certain fees. The bankruptcy court's order also commanded the U.S. Chapter 13 Trustees to withhold any fees previously earned in Chapter 13 bankruptcies.

The district court found that any court, including a bankruptcy court, has the power to discipline attorneys who appear before it. However, disbarment and suspension plainly are among the most grievous sanctions which can be imposed. Local District Court rules for the Western District of Texas, which the bankruptcy court must conform with, lay out a procedure which affords attorneys an opportunity to be heard and to challenge their disbarment. This rule requires referral of the attorney to a committee for appropriate review, investigation, and recommendation. While this procedure is not necessary when the court wields its inherent power to sanction an attorney or hold an attorney in contempt of court, it is absolutely necessary when a judge considers disbarring an attorney from practicing in the district. In this case, the bankruptcy judge issued the order to disbar counsel from practicing before the bankruptcy courts of the Western District of Texas, rather than complying with the local rule that refers this action to the division's committee. Accordingly, the district court vacated the bankruptcy court's order and remanded to comply with the local rules, as well as the district court's order.

ATTORNEYS' FEES

Lamie v. United States Trustee, 124 S.Ct. 1023; (January 26, 2004, Justice Anthony M. Kennedy)

Issue: Whether section 330(a), governing compensation of professionals, permits a Chapter 11 debtor's counsel to be compensated for work performed for the debtor following a conversion of the bankruptcy case to Chapter 7.

Prior to an amendment of section 330(a) in 1994, the statute authorized a court to award to a trustee, an examiner, a professional person employed under section 327, or to a debtor's attorney reasonable compensation for services. In 1994 Congress amended section 330(a) by deleting "or to the debtor's attorney," resulting in a revised statute with a grammatical error. In this case, the Chapter 11 debtor's counsel filed an application with the bankruptcy court seeking attorney's fees under section 330(a)(1) for the time he spent working on a behalf of a debtor after the case had been converted to Chapter 7. The U.S. Trustee objected, arguing that section 330(a) makes no provision for the estate to compensate an attorney who is not employed by the estate trustee and approved by the court under section 327. The bankruptcy court, district court, and Fourth Circuit all held that in a Chapter 7 bankruptcy case section 330(a)(1) does not authorize payment of attorney's fees unless the attorney has been appointed under section 327.

On appeal, the Supreme Court affirmed the Fourth Circuit, holding that under the plain meaning rule, section 330(a)(1) does not authorize compensation awards to debtors' attorneys from estate funds, unless they are employed as under section 327. If an attorney is to be paid from estate funds under section 330(a)(1) in a Chapter 7 case, he must be employed by the trustee and approved by the court. In so ruling, the Supreme Court agreed with rulings of the Fourth, Fifth and Eleventh Circuits, and disagreed with the rulings of the Second, Third and Ninth Circuits. The Court disagreed that the Court must look to legislative history to determine Congress' intent because the existing statutory text is ambiguous in light of the predecessor statute and the grammatical error created by the amendment. Instead, the Court found that despite the grammatical error, the statute was capable of being read as to its plain meaning. The missing verbiage in the statute did not alter the text's substance, nor did it obscure its meaning.

In re Texasoil Enterprises, Inc., 296 B.R. 431; (Bankr. N.D. Tex. July 30, 2003, Judge Dennis Michael Lynn)

Issue: Whether fees for counsel for a Chapter 11 debtor in a failed reorganization case should be reduced for counsel's various administrative deficiencies in the case, and for counsel's failure to monitor the debtor under an order entered by the court under section 1107 requiring him to do so.

A Chapter 11 debtor owned and operated three retail gas station/convenience stores. On the motion of a creditor, the court held a status conference where the United States Trustee and other parties advised the court at the status conference that they were concerned by actions of debtor that were inconsistent with the authority and duties of a debtor in possession, including (1) payment of prepetition debt; (2) retention of an accountant without court authority; and (3) use of cash collateral without court authority. As a result, the court entered an order pursuant to sections 1107 and 1108 limiting debtor's operating authority and imposing on debtor's counsel certain oversight responsibilities to ensure debtor's compliance. Thereafter, the case failed and the debtor was converted to Chapter 7.

The United States Trustee objected to attorneys' fees of counsel for the debtor, arguing that counsel's performance was unsatisfactory. Specifically, the United States Trustee complained that counsel failed to give notice of the initially scheduled 341 meeting, that the debtor employed an accountant without court approval, and that there were a number of errors or omissions in debtor's schedules. The United States Trustee also argued that debtor's case failed to produce a good result and that the failure was attributable in significant part to counsel's inadequacy. Finally, the United States Trustee argued that did not properly comply with the 1107 order.

The court explained that it had entered the section 1107 order rather than impose a number of other remedies against the debtor, including appointment of a Chapter 11 trustee, appointment of an examiner and conversion of the case. For that order to have served its intended purpose, it was essential that counsel supervise the debtor. The court found that there was virtually no evidence presented that counsel in fact monitored his clients performance under the section 1107 order. However, given that counsel's adherence to the order probably would not have affected the outcome of the case, the court found that no independent sanction was warranted. The court further found that the debtor's failure to reorganize could not be blamed on its counsel. Success or failure of a reorganization case is only a fair measure of the value and competence of counsel if counsel can be charged with responsibility for the cause of the case's outcome. Here, no action of counsel caused debtor to lose money, nor did counsel create the debt structure that left secured creditors with inadequate collateral. With respect to the various administrative deficiencies, although the court found these to be troubling, the harm caused was minimal.

In ultimately ruling on counsel's request to pay himself out of his retainer, the court found that some of counsel's errors in the case in large part resulted in the appointment of a creditor's committee, and that it would be inequitable to allow debtor's counsel all of his retainer, while leaving no assets in the estate to pay to counsel for the creditors committee. Therefore, the court permitted debtor's counsel to pay himself part of the retainer, and to remit the remaining portion to committee members and its counsel.

In re Sterling Chemicals Holdings, Inc., 293 B.R. 701; (Bankr. S.D. Tex., May 14, 2003, Judge William R. Greendyke)

Issue: Whether fees should be allowed to counsel for a Chapter 11 debtor for performing a conflicts check.

Issue: Whether fees should be awarded to counsel for a Chapter 11 debtor for compliance with attorney disclosure requirements contained in Bankruptcy Rule 22014(a).

The United States Trustee objected to the fee applications of counsel for a Chapter 11 debtor primarily on the ground that counsel were requesting compensation for time spent conducting conflicts checks to demonstrate their “disinterestedness” under section 327, and for preparing retention applications and verified statements of connections pursuant to Bankruptcy Rule 2014. The United States Trustee argued that that because the Bankruptcy Code requires bankruptcy counsel to be disinterested, the obligation to determine whether a professional meets this standard and can work on a particular case is a prerequisite and continuing obligation for continued employment. Counsel responded, citing primarily the Fifth Circuit opinion in Rose Pass Mines, Inc. v. Howard. In that case, the Fifth Circuit held that counsel for any professional hired under section 327 should be entitled to reasonable compensation for preparation of fee applications and attendance at any necessary hearings. Counsel made a direct analogy between the facts and circumstances involved in Rose Pass Mines and those involved in this case.

The court distinguished Rose Pass Mines in finding that in this case, one of the applicants merged with another law firm midstream during this case. Part of that merger process involved a conflicts check with the members of the new firm. This work neither benefited the debtor or the estate, nor was it required by the court but for the business decisions of the two firms. The court held that this activity fell outside the rationale of Rose Pass Mines and was not compensable. Further, the Texas Disciplinary Rules of Professional Conduct pertaining to conflicts are largely mandatory as opposed to discretionary. The court found that a client should not be charged for that level of conflicts checking that is mandated by the disciplinary rules as a condition of employment.

However, the court found that when the level of involvement crosses over from a conflicts check required by the Texas Disciplinary Rules to that level of analysis and disclosure required by the Bankruptcy Code and Rules, the activity becomes compensable under the holding of Rose Pass Mines. The court held that it would, therefore, allow compensation for all reasonable and necessary efforts to comply with the disclosure requirements of Bankruptcy Rule 2014(a).

AUTOMATIC STAY

Bustamante v. Cueva (Matter of Cueva) 371 F.3d 232; (5th Cir., May 19, 2004, Judge Harold R. DeMoss, Jr.)

Issue: Whether section 549(c) provides an exception to the automatic stay imposed by section 362, where property is purchased at a post-petition foreclosure sale by a good faith purchaser of property who lacks knowledge of the debtor’s bankruptcy filing.

After debtor filed for bankruptcy, a foreclosure sale was conducted against property of the estate that was subject to the automatic stay of section 362. Purchaser A purchased a one-half interest in that property at a foreclosure sale, and purchaser B purchased the other one-half interest. Purchaser A then subsequently purchased the other one-half interest from purchaser B. Prior to the filing of bankruptcy, purchaser B was informed that a bankruptcy would be filed, and that the foreclosure sale would not go forward. Purchaser A was not aware of that conversation at the time of the foreclosure sale. Prior to the foreclosure sale going forward, the debtor’s bankruptcy attorney faxed a notice of the bankruptcy to the lender’s attorneys. However, the attorneys, who claimed that they had not seen the notice in time, did not notify the substitute trustee of the bankruptcy filing and the foreclosure sale went forward.

In an adversary action brought by purchaser A, the bankruptcy court awarded him a one-half interest in the property based on his status as a good faith purchaser, and awarded the debtor the other one-half interest. The court held that although the foreclosure sale violated section 362, under section 549(c) purchaser A did not have notice of the bankruptcy and therefore was a good faith purchaser, meaning his purchase of a one-half interest of the property was valid. The bankruptcy court awarded the other one-half interest in the property to the debtor, holding that purchaser B's purchase of a one-half interest at the foreclosure sale was void because he had notice of the bankruptcy at the time of the sale. The parties appealed. The district court reversed the portion of the bankruptcy court's award that granted purchaser A one-half interest in the property, holding that the foreclosure sale violated the automatic stay imposed by section 362.

On appeal to the Fifth Circuit, purchaser A argued that he was entitled to both his one-half interest and purchaser B's one-half interest in the Property. The Fifth Circuit found that when a bankruptcy case is filed, section 362 automatically imposes a statutory stay against any act to enforce any lien against property of the estate, and that such actions are invalid whether or not a creditor acts with knowledge of the stay. Section 362 delineates eighteen exceptions to the automatic stay, but does not provide an exception for bona fide purchasers. Because section 362 does not prohibit a debtor from disposing of property belonging to the bankruptcy estate, section 549 provides additional protection to the estate for post-petition transactions neither subject to section 362(a) nor authorized by the court. In turn, section 549(c) gives a bona fide purchaser a defense to a trustee's avoidance powers under section 549(a).

However, the Fifth Circuit held that section 549(c) only applies as a defense to the limited authority of a bankruptcy trustee to "avoid" certain transfers of property under section 549(a). It does not act as an exception to the automatic stay of section 362. Foreclosures in violation of the automatic stay are invalid, even if the parties did not have notice of the bankruptcy, unless the court grants retroactive relief from the stay. Therefore, the Fifth Circuit held that the district court did not err in reversing that part of the bankruptcy court's decision.

CASH COLLATERAL

All Trac Transportation, Inc. v. Transportation alliance Bank, (In re All Trac Transportation, Inc.), 310 B.R. 570; (Bankr.N.D.Tex., June 8, 2004, Judge Steven A. Felsenthal)

Issue: The appropriate amount of attorneys fees to be awarded to a debtor for prosecuting a civil contempt case against a creditor for violations of the automatic stay and various court orders.

In a previously decided memorandum opinion and order, the bankruptcy court held that a creditor had, on several occasions, violated provisions of the automatic stay of section 362(a), and various court orders, resulting in the court finding the creditor in civil contempt of court. For the contemptuous violations of the stay and court orders, the court found that the debtor established damages of approximately \$5,700. The court also found that the creditor had tortiously interfered with debtor's contractual relationship with another party, causing recoverable damages of approximately \$5,700. Based on these findings, the court found that the debtor was entitled to recover reasonable attorney's fees and expenses. The question addressed in this opinion was the reasonable amount of those fees, given total damages in the amount of approximately \$5,700, and a fee request in excess of \$437,000.

The court found that a federal court determines reasonable attorney's fees by applying a lodestar analysis. Debtor reported its hours in the litigation to be approximately 2,200, resulting in a blended hourly rate of \$178.00. The court found those hourly rates to be reasonable, being well within the rates customarily charged in the community by attorneys with comparable experience. The court therefore

turned to the reasonableness of spending 2,200 hours on a matter that ultimately resulted in an award of approximately \$5,700. Although the debtor asserted that the development of the factual issues in the case were significantly difficult, challenging and highly time consuming, the court found that the debtor had failed to meet its burden of proof on many contentions in the litigation, and that had the debtor focused on some of the reasons for the demise of their business that did not implicate the creditor actions, the debtor would have reasonably taken a more nuanced approach to the litigation. The litigation strategy of blaming the creditor for debtor's demise skewed the litigation, adding excessive hours of trial time and related trial preparation and pretrial disputes.

Having presided over the trial and after a review of counsel's time records, the court found that it could infer the reasonable amount of time needed to present the stay and court order violation issues with a reasonable approach to damages. In making these findings, the court found that the trial should have taken no more than eight six-hour court days, with two attorneys representing the debtor, for a total of 96 hours in court time and 288 hours of trial preparation time. Applying the blended rate of \$178.00 per hour, the lodestar fee would be \$68,352.00. The court therefore ordered attorneys fees in that amount.

Mirant Americas Energy Marketing, L.P. v. Kern Oil & Refining Co. (In re Mirant Corp.), 310 B.R. 548; (Bankr. N.D. Tex. May 17, 2004, Judge Dennis Michael Lynn)

Issue: Whether reversal of payment from defendant to debtor violated section 362 automatic stay or was protected as the exercise of contractual right to liquidate forward contract pursuant to Section 556.

Issue: Whether a creditor violated the automatic stay by receiving and retaining deliveries of goods from the debtor after the termination of the contract.

Issue: Whether a creditor is entitled to offset or recoup damages from the rejection of contract against post-termination payments due to a debtor.

Issue: Whether an agreement was a forward contract.

Issue: Whether a creditor was a forward contract merchant.

The plaintiff/debtor was in the business of trading in and supplying energy products, including natural gas. Defendant was a small, independent refining company. In 2002, Defendant entered into a two-year agreement with plaintiff/debtor to supply a set amount of natural gas at a fixed price to fuel defendant's cogeneration facility, beginning on January 1, 2003. Prior to entry of the agreement, plaintiff/debtor and defendant had entered into a netting agreement that contemplated being applicable to future contracts between plaintiff/debtor and defendant and which contained "an *ipso facto* default provision of the kind referred to in section 365(e)(2)(A)(i) of the Bankruptcy Code."

In July of 2003, plaintiff/debtor (and its parent company and other affiliates) filed for Chapter 11 protection. Plaintiff/debtor continued to supply natural gas to defendant; however in October, 2003, plaintiff/debtor filed a motion to reject the agreement. Approximately one week later, defendant notified plaintiff/debtor that it was liquidating the agreements as forward contracts pursuant to section 556. After the filing of the rejection motion but prior to notice of liquidation, defendant "acted to reverse" a prior payment. The prior payment had already posted to plaintiff/debtor's account, therefore the reversal appeared as a debit from plaintiff/debtor's account rather than acting simply as a stop payment. Subsequently, the court authorized rejection of the agreement.

The bankruptcy court held that the automatic stay was violated by the reversal of the payment, but declined to rule that the defendant violated the stay because the record only reflected that defendant directed its bank to reverse payment. In determining that the automatic stay was violated, the court acknowledged that the automatic stay does not prevent the exercise of a party's contractual right to liquidate forward contracts post-petition. The court found that the defendant, however, lacked a contractual right to invade the debtor's account, and therefore lacked the authority pursuant to section 556 to reverse payment to the debtor. Without the protection of section 556, the automatic stay was violated.

The court further ruled that the automatic stay was not violated by the defendant's receipt and retention of deliveries post-termination, whether such termination occurred by virtue of the rejection of the contract or by the defendant's notice of termination. The defendant is not entitled to offset amounts due for the post-termination deliveries against the defendant's rejection damages or for recoupment since any right to offset or recoupment must arise from the same transaction.

The court restated the section 101(25) definition of forward contracts as "a contract (other than a commodity contract) for the purchase [or] sale . . . of a commodity, as defined in section 761(8) . . . or any similar good. . . or interest which is presently or in the future becomes the subject of dealing in the forward contract trade . . . with a maturity date more than two days after the date [of] the contract." The court found that the agreements in question were forward contracts because they were for natural gas, a commodity, and the contracts matured more than two days after their execution. With respect to the phrase "other than a commodity contract," the court applied the definition of commodity contract from section 761(4). The court rejected the argument that the Code definition only included contracts which presently or in the future becomes the subject of dealing in the forward contract trade. Instead, the court found that the Code definition would only require a contract for the purchase or sale of an interest which is presently or in the future becomes the subject of dealing in the forward contract trade.

Finally, the court found insufficient evidence in the summary judgment record to determine whether the defendant was a forward contract merchant. The court first noted that the critical portion of the definition of forward contract merchant found in section 101(26), in this case, was "a person whose business consists in whole or in part of entering into forward contracts as or with a merchant." The court further noted that, in enacting specific provisions of the Code to deal with forward contracts, Congress intended to "protect certain person (*i.e.*, those engaged in the forward contract trade) and the market in which they were participants," rather than "a class of transactions (*i.e.*, forward contracts)."

The defendant argued that the definition of forward contract included any person that entered into a forward contract in connection with its business. The court defined merchant to mean one who "buys, sells or trades in a market." The court defined business to mean "something one engages in to generate a profit." Thus, the court found that the definition of forward contract merchant is one who enters into forward contracts as a participant seeking profit in the forward contract trade. The court reasoned that such a "construction gives effect to all parts of the definition of forward contract merchant" and avoided the absurd result of rendering virtually every person that is a party to a contract for goods and services a forward contract merchant and the protections and/or rights afforded thereby.

Singleton v. Abussad (In re Abussad), 309 B.R. 895; (Bankr. N.D. Tex., March 18, 2004, Judge Harlin D. Hale)

Issue: Whether a post-petition sheriff's sale of real property of a debtor conducted without actual knowledge by the judgment creditor or the purchaser of the filing of the bankruptcy petition, violates the automatic stay of section 362(a).

Issue: Where a property is purchased at a post-petition foreclosure sale at which the purchaser does not

have knowledge of the debtor's bankruptcy case, whether section 549(c) acts as a defense or exception to the automatic stay of section 362(a).

Debtor owned certain real property subject to homeowners association dues. After debtor became delinquent on his homeowners dues, the association obtained a judgment and an order forcing the sale of the property in satisfaction of the judgment. The day before the scheduled sale the debtor filed for bankruptcy under Chapter 13. Notice of the bankruptcy filing was sent that day via facsimile to counsel for the association. However, counsel apparently did not become aware of the fax until after the sheriff's sale. No notice of the bankruptcy petition was filed in the real property records prior to the sheriff's sale. Purchaser, without knowledge of the debtor's bankruptcy filing, purchased the property at the sheriff's sale. After learning of the bankruptcy, purchaser filed a motion to lift the stay to allow him to take possession of the property, and an adversary proceeding seeking a declaratory judgment that his purchase of the property was protected under section 549(c).

The court first held that the sale of the property after the petition was filed clearly constituted an act to enforce the association's judgment against the debtor and/or an act to enforce their lien against property of the estate, and was therefore a violation of the automatic stay regardless of whether the association, the Sheriff or the purchaser had knowledge of the filing of the petition. Purchaser argued that even if the transfer violated the stay, the provisions of section 549(c) prevented the recovery of the post-petition transfer from him because he purchased the property in good faith without knowledge of the commencement of the case and for present fair equivalent value. Debtor argued that section 549(c) did not apply because the transfer that violated the automatic stay was null and void.

The court found that actions taken in violation of the automatic stay are "voidable," not "void," but regardless of the label placed on the effect of an action taken in violation of the stay, it was clear that such an action would be invalid and of no effect unless and until the action were made valid by subsequent judicial action annulling the automatic stay. In this case, the court found that the post-petition sale of the debtor's property violated the automatic stay and was thus invalid when it occurred.

The court next rejected purchaser's argument that section 549(c) constitutes an exception to the automatic stay. Section 549(c), by its very terms is not an exception to section 362, but an exception to the trustee's avoiding powers under section 549(a). First, Congress set forth specific exceptions to the automatic stay within section 362 itself. Next, the section 549(c) exception to the trustee's avoidance powers applies, by definition of "purchaser" contained in section 101(43), only to transferees in a voluntary sale. Therefore, the court held that the post-petition involuntary transfer to purchaser at the sheriff's sale violated the automatic stay and was therefore invalid and of no effect.

All Trac Transportation, Inc. v. Transportation Alliance Bank (In re All Trac Transportation, Inc.), 306 B.R. 859; (Bankr.N.D.Tex., February 17, 2004, Judge Steven A. Felsenthal)

Issue: Whether a violation of the automatic stay must be willful for the court to find the violator in civil contempt.

Issue: Whether lost profit damages are available as a remedy for civil contempt of court orders.

Issue: Whether a choice of law provision in a contract applies to tort causes of action.

A trucking company filed chapter 11 bankruptcy petition. Pre-petition, the debtor had an arrangement with its secured creditor under which the secured creditor purchased a majority of the debtor's accounts receivables, and collected the balance of debtor's receivables for a fee, taking a security interest in those receivables that it did not purchase. The debtor maintained its bank accounts with the

secured creditor, and made its fuel purchases through an affiliate of the secured creditor. Debtor's fuel purchases were paid by automatic draft from the debtor's bank account to the secured creditor's affiliate.

The court entered two agreed orders authorizing the debtor to use the secured creditor's cash collateral, and authorizing the debtor and secured creditor to maintain their pre-petition factoring arrangement in the ordinary course of business. In the agreed orders, the court ordered that the automatic stay provisions were lifted and terminated to implement the provisions of the orders. After the expiration of the second interim order, the debtor made alternative financing arrangements with a new lender which were approved by the bankruptcy court.

Shortly after the petition date, the debtor filed an adversary proceeding alleging civil contempt and seeking a temporary restraining order against the secured creditor alleging various violations of the automatic stay and the bankruptcy court's orders. The debtor also alleged that the secured creditor had tortiously interfered with contracts between the debtor and its customers, drivers and new lender. The bankruptcy court entered an agreed order between the debtor, the secured creditor and the new lender, defining the collection roles of the secured creditor and the new lender.

The bankruptcy court held that in the Fifth Circuit, a violation of the automatic stay is voidable, not void, and that actions taken in violation of the stay are subject to discretionary cure by the court. To find civil contempt, the movant must establish by clear and convincing evidence: (1) that a court order was in effect, (2) that the order required certain conduct by a party, and (3) that the party failed to comply with the court's order. The provisions of section 362(a) of the Bankruptcy Code stand as a court order, the automatic stay constituting a Congressionally-imposed, self-executing injunction. For civil contempt of a court order, the movant need not show that the conduct was willful so long as the party actually failed to comply with the court's order. For a stay violation, the movant need not show that the party intended to violate the stay. Rather, the movant must show that the party intentionally committed the acts which violate the stay. However, for contemptible conduct warranting a sanction of damages, the movant must show that the party acted willfully and had notice of the bankruptcy petition at the time that it committed the contemptible acts.

The bankruptcy court considered the various allegations of stay violations by the debtor and found that the following acts did not constitute stay violations by the secured creditor: (1) refusing to honor the debtor's checks for pre-petition payments post-petition after it had knowledge of the bankruptcy; (2) paying pre-petition fuel charges post-petition when the interim cash collateral order could be fairly read to allow such payments; (3) varying the manner that it purchased accounts from the debtor post-petition; (4) negotiating for releases of claims; (5) varying the manner of controlling post-petition fuel card access and use; (6) suspending access to online banking and information; (7) holding funds in escrow to cover resubmitted checks; and (7) applying funds to complete the buyout by the new lender.

The bankruptcy court found that the following acts by the secured creditor did constitute contemptible stay violations: (1) paying of pre-petition license fee claims to itself post-petition without court authorization; (2) sending letters to the debtor's customers on two occasions alleging that it was the owner of estate property; (3) exercising control over property of the bankruptcy estate transferred by debtor's shareholder; (4) refusing to honor debtor's checks in the month after the petition date; (5) applying the balance of one of debtor's bank accounts to pay the secured lender's pre-petition line of credit; (6) selling back accounts to the debtor for amounts greater than the amounts advanced as payments for the accounts by the secured lender; (7) selling back accounts to the debtor before the expiration of the term set in the pre-petition agreement; and (8) retaining funds from the new lender and collecting the debtor's accounts after the deadline set by the bankruptcy court without a showing that the funds derived from non-assigned accounts. In addition, the bankruptcy court found that payment by the secured creditor of pre-petition fuel charges on the day after the bankruptcy petition was filed did violate the automatic

stay, but that the violation did not constitute contempt because the secured lender did not have knowledge of the bankruptcy at the time that it made the payment.

The bankruptcy court found that the secured lender did not violate court orders by the following acts: (1) the manner it purchased accounts during the period of the first interim cash collateral order; (2) the manner it used to control the post-petition fuel card access and use; and (3) not sending notarized releases to customers following the second letter that it sent to debtor's customers that stated payments on the debtor's accounts should be submitted to the secured lender until the customers received a notarized letter from the secured lender stating otherwise. However, the secured lender did violate the bankruptcy court's orders, and was subject to contempt by (1) sending the letters to the debtor's customers that contained false statements; (2) collecting and retaining funds after the expiration of the second interim order between the debtor and the secured lender, and (3) asserting a first lien on accounts after the court entered its order approving the debtor's financing with the new lender and granting the new lender a first lien on debtor's accounts.

A court has broad discretion when assessing damages for civil contempt. In this case, the debtor did not seek itemized damage claims for particular stay or order violations, and instead sought to recover for lost profits. A claim for lost profits must be proved with reasonable certainty. In projecting future profits, the debtor must consider the incremental costs of running the debtor's business. Because the debtor did not include the cost of the trucks for running a trucking business, the debtor did not meet its burden of proof to establish its lost profits.

The debtor also alleged various tortious interference claims against the secured lender including claims for tortious interference with the new lender, its customers, its drivers, its secured creditors and its business-decision making. In a suit on a tort, contractual choice of law provisions do not apply. Instead, the court will apply the law of the place with the most significant relationship to the events at issue. In this case, Texas law applied because Texas had the most significant relationship with the parties and the events at issue.

To prevail on a claim of tortious interference under Texas law, the debtor must prove that (1) a contract subject to interference exists, (2) the alleged act of interference was willful and intentional, (3) the willful and intentional act proximately caused damage, and (4) actual damage or loss occurred. In this case, the debtor was able to prove that the secured lender tortiously interfered with the contract between the debtor and the new lender by knowingly and deliberately sending letters to the debtor's customers that were false and misleading, resulting in the new lender demanding additional collateral from the debtor. However, the debtor was not entitled to punitive damages on this tortious interference claim because it did not prove that the secured creditor acted with actual malice.

With regard to debtor's allegations that the secured lender tortiously interfered with its customers, drivers, its secured creditors and its business-decision making, the debtor did not introduce evidence that the secured creditor's actions adversely affected the debtor's relationship with these parties.

In re Hassell, 2004 WL 721373; (Bankr. N.D. Tex., February 10, 2004, Judge Harlin D. Hale)

Issue: Whether cause existed to lift the automatic stay to permit the IRS to proceed with collection of a judgment obtained against Chapter 7 debtors in the federal district court.

Debtors filed a Chapter 11 proceeding that was later converted to Chapter 7 for cause. Early during the pendency of the case, the federal district court entered a judgment in favor of the IRS against Debtors for taxes, and declaring the transfer of their home as a fraudulent transfer. The bankruptcy court annulled the automatic stay as to the entry of that judgment. The Debtors appealed to the Fifth Circuit,

which affirmed. The IRS filed a motion for relief from the stay to allow it to proceed with its collection rights under the district court judgment. Debtors opposed the stay motion claiming that lifting the stay would constitute a denial of due process to the debtors and was unfair under Due Process of law.

In determining whether to lift the automatic stay, the court found that debtors had for several years been involved in contentious litigation with the IRS, had been uncooperative in discovery, had launched personal attacks on government counsel, had questioned the federal income tax system, the authority of the IRS to collect taxes, and the authority of a Department of Justice lawyer to represent the IRS. The court found those arguments to be frivolous. The court further found that no party other than the debtors had filed a response to the IRS' motion for relief from stay, and that the debtors had little standing to contest the motion. Either their house was exempt property, not enjoying the protection of the automatic stay, or the house was non-exempt property in which the debtors had lost their interest. The court found that based on these facts, cause existed under section 362(d) to modify the automatic stay to allow the IRS to proceed before the district court to collect its judgment.

CLAIMS

FFP Operating Partners, L.P., Case No. 03-90171, slip opinion; (Bankr. N.D. Tex., June 16, 2004, Judge Barbara J. Houser).

Issue: For purposes of determining whether a debtor is required to perform an obligation contained in an unexpired lease arising from and after the filing of bankruptcy, pursuant to 365(d)(3), whether certain indemnification obligations arose post-petition or pre-petition.

Section 365(d)(3) mandates that a trustee (or debtor-in-possession in a Chapter 11 case) shall timely perform all the obligations of the debtor arising from and after the order for relief under any unexpired lease until such lease is assumed or rejected. In this case the Chapter 11 debtor was the tenant under a convenience store lease whereby the debtor agreed to indemnify the landlord for claims by other persons arising in connection with the leased premises. Prior to the filing of bankruptcy, the landlord was sued for a slip and fall injury in the leased premises. Prior to bankruptcy, the debtor provided the landlord with a defense to the lawsuit, but after the filing of bankruptcy the debtor notified the landlord that it would no longer continue to defend the lawsuit. As a result, the landlord requested the bankruptcy court to require the debtor to honor the indemnity obligation. Debtor opposed the relief, arguing that the obligation did not fall within the requirement of section 365(d)(3) because it was not an obligation that arose after the filing of bankruptcy.

The court agreed that the obligation to defend arose pre-petition. The lawsuit was filed pre-petition and a notice was presumably sent that triggered the obligation to defend. These events caused the obligation to have arisen pre-petition, outside the scope of section 365(d)(3). With respect to the debtor's indemnification obligation to ultimately pay the landlord in the event of a lawsuit recovery, the court found that under Texas law the motion was premature. An indemnification against liability under Texas law does not accrue until all of the liabilities of the indemnitee become fixed and certain by judgment.

FFP Operating Partners, L.P., Case No. 03-90171, slip opinion; (Bankr. N.D. Tex., June 16, 2004, Judge Barbara J. Houser).

Issue: For purposes of determining whether a debtor is required to perform an obligation contained in an unexpired lease arising from and after the filing of bankruptcy, pursuant to 365(d)(3), when an obligation of the debtor to pay real estate taxes arose.

Section 365(d)(3) mandates that a trustee (or debtor-in-possession in a Chapter 11 case) shall timely perform all the obligations of the debtor arising from and after the order for relief under any unexpired lease until such lease is assumed or rejected. In this case the Chapter 11 debtor was the tenant under convenience store leases which obligated the debtor to pay real estate taxes. Landlord filed a motion to require the debtor to pay 2003 taxes, which the landlord argued had “arisen” post-petition, within the meaning of section 365(d)(3). Debtor argued that since a substantial portion of the tax liability accrued prior to the filing of bankruptcy the debtor would be required to pay, at most, only the portion of the taxes that accrued post-petition.

The court found that the language of section 365(d)(3) does not look to when an obligation has accrued, but instead plainly looks to when the obligation has arisen. The court therefore rejected the “proration approach” adopted by some other courts. The court found many instances in the Bankruptcy Code where Congress had utilized the word “accrue,” and found that Congress instead chose in section 365(d)(3) to use the word “arises.” Under the facts of the case, the court found that the debtor’s obligation to pay taxes under the lease did not arise until the landlord sent a bill for the payment of the taxes, which had not yet occurred. Therefore, the court found that the debtor was not yet obligated to pay the taxes and denied the landlord’s motion.

In re Mirant Corporation, 296 B.R. 427; (Bankr. N.D. Tex. July 16, 2003, Judge Dennis Michael Lynn)

Issue: Whether a Chapter 11 debtor would be required, as a prerequisite to providing preferential payment of prepetition claims of certain “critical vendors,” to obtain advance approval from the bankruptcy court.

Chapter 11 debtors were the generation and sale of electric power. The court found that they were among the most important providers of power in the United States, and that a disruption of the services provided by them could have a meaningful, adverse effect on segments of the national economy. In connection with their bankruptcy filings, debtors requested authorization from the bankruptcy court to pay prepetition claims of certain classes of “critical vendors.” As the court had previously expressed in its CoServ opinion, such preferential treatment should be considered on a claim-by-claim basis and accorded a creditor only when it is shown by a preponderance of the evidence that: (1) it is critical that the debtor continue to deal with the creditor in question; (2) the debtor’s failure to deal with the creditor creates a risk of harm or loss of economic advantage to the debtor’s estate that is disproportionate to the creditor’s prepetition claim; and (3) there is no practical or legal alternative by which the debtor can cause the creditor to deal with it other than by payment of the prepetition claim.

The court found that it could require proof of these elements in every case before a debtor paid any prepetition claim outside of a confirmed plan of reorganization. However, the court said that it was acutely aware of the precarious position of a company operating in chapter 11 (especially early in the case). In the case at bar the consequences of the failure of a given vendor to provide goods or services could be disastrous, and a requirement of advance court approval in every instance as a prerequisite to payment of a prepetition claim could lead to an interruption of debtors’ generation of power.

The court’s concern that debtors’ businesses could be seriously damaged by the delay required to satisfy the court that a particular creditor should be paid its prepetition claim outside of a confirmed plan caused the court to enter an order achieving the following: 1) to the extent an entity claimed a lien against property of any of debtors’ estates to secure prepetition debt and to the extent payment of such prepetition debt was, in the exercise of debtors’ business judgment, in the best interests of such estate, debtors would be authorized to pay such prepetition debt, and later to file an accounting of such payments; 2) to the extent an entity asserted a prepetition claim that debtors, upon advice of counsel, reasonably

believed would be authorized to be paid pursuant CoServ, debtors would be permitted to pay such claims, also with the filing of an accounting, and with a requirement to later show cause why payment of such claim should be deemed by the court to be properly authorized; 3) debtors would be permitted to pay a prepetition claim of an entity that refused to deal with debtors on any basis if debtors reasonably believed, in the exercise of business judgment, that such claim must be paid in order for debtors to continue their respective businesses.

With respect to the third prong of the order, the court further provided that if the prepetition claim of an entity that believes it may be paid notwithstanding section 362(a)(6) were to be paid despite debtors' belief that such claim did not meet the CoServ test, such entity would be required to show cause to the court why it may require payment, and in the event a final order were entered determining that such entity may not require payment of its prepetition claim as a condition to providing postpetition goods or services, the entity would be required to repay to debtors all amounts paid on account of such prepetition claim, but provided it continued to deal with debtors, would suffer no further sanction for violation of section 362(a)(6). The court further provided that an entity that demanded payment of prepetition debt as a condition to providing postpetition goods or services to debtors and refused to furnish such goods and services would be required to show cause why it should not be sanctioned for violation of section 362(a)(6).

The court finally ordered that any entity provided with a copy of the court's order would be deemed on notice that a refusal to provide postpetition goods or services to any debtor by reason of non-payment of any prepetition debt, and despite assurance, in the form of a deposit or prepayment, that such entity would suffer no loss through provision of postpetition goods or services, absent good cause, would constitute a willful violation of section 362(a)(6) of the Code.

CONVERSION

Pequeno v. Schmidt, 307 B.R. 568; (S.D. Tex., March 31, 2004, Judge Andrew S. Hanen)

Issue: Whether section 706(a) gives a debtor an absolute and unfettered right to convert a Chapter 7 bankruptcy case to one under Chapter 13.

This case was an appeal from a bankruptcy court order prohibiting the debtor from converting his Chapter 7 bankruptcy case to one under Chapter 13 pursuant to section 706(a). The bankruptcy court found that the debtor had previously acted in bad faith and, therefore, denied the conversion motion. On appeal to the district court, the debtor questioned whether the bankruptcy court had the power to deny his motion to convert in fact of section 706(a).

The issues raised on appeal were: 1) does section 706(a) give a debtor an absolute and unfettered right to convert a Chapter 7 bankruptcy case to one under Chapter 13; and 2) if the right to convert is not absolute, did the circumstances in this case warrant the bankruptcy court's denial of the motion to convert. The district court found that the Fifth Circuit case of In re Martin addressed the issue of whether section 706(a) gives an absolute right to convert. The Fifth Circuit in Martin stated that conversion is an absolute right. In supporting its holding, the Fifth Circuit opined that section 706(a) spoke "in absolute terms" and was "unequivocal in its statement of the right to convert. Martin has been cited by other courts for that proposition. However, dicta in the Martin case went on to suggest that there might be exceptions to that right if exceptional circumstances exist. Martin has therefore been cited by other cases for the proposition that courts can carve out an exception to the otherwise plain language of section 706(a). These courts recognize an exception to conversion for a variety of laudable reasons: 1) the debtor lacked good faith; 2) the debtor was incapable of proposing a confirmable plan; 3) the debtors control

under Chapter 11 or 13 would prejudice other parties or creditors; 4) the debtor abused the bankruptcy process; or 5) conversion would result in a gross inequity. Regardless of the label given or the means used, courts have struggled with how to treat a request made under a seemingly mandatory statute where the result may be damaging to the bankruptcy system or the creditors in the individual case.

In the present case, the district court found that the bankruptcy court had struggled with the dilemma of a statute previously described by the Fifth Circuit, and others, as being absolute, while at the same time it had what it believed was a debtor who had acted in bad faith. The bankruptcy court chose to follow those cases which have permitted courts to create exceptions to Section 706(a). The district court reversed, holding that the debtor had a right to convert and should have been allowed to convert his Chapter 7 case. The district court found persuasive the fact that the Fifth Circuit Martin case in at least five different places stated that the right to convert is absolute. A statutory right that is absolute cannot have court-made exceptions. If that were the case, it would not be an absolute right. The court refused to allow judicially made exceptions to section 706(a) for several reasons. First, the clear language of the statute is phrased in such a way as to give the option to convert to the debtor. Second, the legislative history clearly evidences Congress' intent to make this conversion right mandatory. Third, while acknowledging that other courts from other circuits have chosen to create exceptions, the Fifth Circuit in Martin did not adopt and has not subsequently adopted those decisions. The court further found a number of alternatives means for policing the conduct of the lawyers and litigants, such as reconverting to Chapter 7, which can be done because of a debtor's bad faith, issuance of sanctions, and criminal referral. Due to the fact that the court held that a debtor's right to convert is absolute, it did not reach the issue whether the bankruptcy court's factual conclusions were clearly erroneous as to whether debtor's conduct would arise to exceptional circumstances contemplated by the Fifth Circuit in its brief reference to exceptional circumstances in Martin.

CREDITORS' COMMITTEE

In re Venturelink Holdings, Inc., 299 B.R. 420; (Bankr. N.D. Tex., August 28, 2003, Judge Steven A. Felsenthal)

Issue: Whether the United States Trustee acted arbitrarily and capriciously in failing to remove a former officer and director of a Chapter 11 debtor from the creditors committee where the debtor was in litigation with the former officer and director, alleging causes of action, including breaches of fiduciary duty, misappropriation of corporate assets and conversion.

Issue: Whether, as a matter of public policy, former officers and directors of a Chapter 11 debtor should be excluded from membership on a creditors committee.

The United States Trustee appointed to the Chapter 11 debtor's creditors committee a former officer and director of the debtor. Prior to bankruptcy, the director and the debtor had been engaged in state court litigation where the director had sued the debtor for breach of contract and other causes of action, and the debtor had counter-sued the director for various causes of action, including breaches of fiduciary duty, misappropriation of corporate assets and conversion. Debtor alleged, in the lawsuit, that the director had breached his fiduciary duty to the debtor by causing the debtor to transfer \$4.75 million to the director to build a home in Mexico, by using debtor funds for personal business opportunities, and by causing the debtor to transfer \$7 million to the director within 2 years of the bankruptcy filings. The lawsuit was pending as of the commencement of the bankruptcy case.

Based on the above, counsel for the debtor requested the United States Trustee to remove the director from the creditors committee. The United States Trustee refused, and the debtor filed a motion

requesting the court to remove the director. At the hearing, the director refuted the allegations contained in the lawsuit and argued that committee members typically have conflicts with a debtor. The United States Trustee likewise argued that it is not atypical for a committee member to be the target of a debtor lawsuit.

The court first found that questions concerning committee membership, including removal of a committee member for a conflict of interest, must, in the first instance, be directed to the United States Trustee. The court may review the United States Trustee's decision on the question of the removal of a committee member to determine if the United States Trustee acted arbitrarily and capriciously. Although the court found that not all conflicts mandate removal, a creditor on a committee who exudes the appearance of a breach of fiduciary duty undermines basic bankruptcy tenets, thereby corrupting the process.

The court found that the debtor's claims against the director in this case amounted to more than a typical creditor-debtor dispute. The dispute implicated the director's fiduciary duty and thereby his ability to honor his fiduciary duty to all unsecured creditors or the appearance of his ability to honor his fiduciary duty to all unsecured creditors. The court therefore held that the United States Trustee acted arbitrarily and capriciously in not removing the director from the creditors committee. For precedential purposes, the court further found, in the present climate, that, as a matter of public policy, a former officer or director of a debtor should not serve on a creditors committee. Officers and directors will have a natural tendency to steer the focus of the committee from their performance, creating an inherent conflict of interest.

DISCHARGE

Kontrick v. Ryan, 124 S.Ct. 906; (US, January 14, 2004, Justice Ruth B. Ginsburg).

Issue: Whether a debtor forfeits right to rely on the time limit for a creditor to file objections to discharge contained in Bankruptcy Rule 4004(a) if the debtor does not raise issue before bankruptcy court reaches merits of creditor's objection.

Under Bankruptcy Rule 4004(a), a creditor in a Chapter 7 bankruptcy case has 60 days after the first date set for the meeting of creditors to file a complaint objecting to the debtor's discharge. In this case, a creditor filed an adversary proceeding objecting to the debtor's discharge for alleged fraudulent transfers, under section 727(a). After the time period of Bankruptcy Rule 4004(a) expired, the creditor filed an amended complaint without seeking or gaining a court-approved time extension. Debtor's answer to the amended complaint did not raise the untimeliness of the amended claim. Instead, the debtor filed an answer on the merits. The bankruptcy court awarded summary judgment to the creditor on the amended claim, and the debtor moved for reconsideration. For the first time, debtor urged that the court was powerless to adjudicate the amended claim, arguing that the amended complaint was untimely under Bankruptcy Rules 4004(a) and (b) and 9006(b)(3), and that those rules establish a mandatory, unalterable and jurisdictional time limit. The bankruptcy court denied reconsideration and entered final judgment, holding that the time limits imposed by the Bankruptcy Rules were not jurisdictional, and that the debtor had waived the right to assert the untimeliness of the amended complaint by failing to raise the point before the court reached the merits of the objections to discharge. The district court and the Seventh Circuit affirmed.

On appeal to the Supreme Court, the Court affirmed, holding that the time limits contained in Bankruptcy Rule 4004 to object to discharge are not jurisdictional. Instead, they are affirmative defenses that must be raised in an answer, amended answer or responsive pleading. A debtor forfeits the right to

rely on Bankruptcy Rule 4004(a)'s time limitations if the debtor does not raise the issue before the bankruptcy court reaches the merits of the creditor's objection to discharge.

Cadle Company v. Mitchell (In re Mitchell), 102 Fed.Appx. 860, 2004 WL 1448041 (5th Cir., June 28, 2004, Per Curiam – unpublished opinion)

Issue: Whether the district court erred in holding that the debtors had demonstrated a reckless disregard for the truth in connection with numerous material false statements in their original and amended bankruptcy petitions, which warranted reversing the bankruptcy court's refusal to deny the debtors' discharge under section 727(a)(4).

A debtor may be denied discharge under section 727(a)(4)(A) if he knowingly and fraudulently, in or in connection with the case makes a false oath or account. Under the present facts, a creditor objected to debtors' discharge based on the following allegations of errors and omissions in the debtors' bankruptcy filings: 1) they provided only half a month's income in response to a question that demanded a full month's income; 2) they initially listed a life insurance policy as having no cash value and a face value of \$15,000, though it actually had a cash value of approximately \$3,500 and a face value of \$100,000; 3) they omitted multiple payments made to creditors within 90 days of bankruptcy; 4) in their initial filing, they did not list a counterclaim against the plaintiff as an asset even though they listed plaintiff's claim against them as a liability; 5) they failed to list debtor's substantial vintage-car refurbishing tools in their initial schedules, and their final amended schedules did not include all of the tools and undervalued the remainder; and 6) they omitted a set of Wedgewood china.

The bankruptcy court awarded debtors a discharge, holding that the debtors did not have fraudulent intent because their mistakes were honestly made, minor in importance, and relatively few in number. The district court reversed, and the debtor appealed to the Fifth Circuit.

On appeal to the Fifth Circuit, the court concluded that the debtors demonstrated a reckless disregard for the truth, as evidenced by their repeated insistence that their errors were due to carelessness, not bad intent. The court found that the debtors had numerous errors and omissions in their original schedules; they did not amend their schedules to correct several of those errors and omissions; and their only excuse was that they filled out the forms in great haste and did not bother going over forms prepared by their attorney to make sure they were accurate. The court found this to be the essence of a reckless disregard for the truth, and affirmed the district court.

Robertson v. Dennis (Matter of Dennis), 330 F.3d 696, (5th Cir., May 23 2003, Judge Jerry E. Smith)

Issue: Whether the bankruptcy court erred in not denying the debtor's discharge under section 727(a)(2), based on a transfer of a minimal amount of savings bonds to a family member within one year of bankruptcy, or under section 727(a)(3), for alleged failure of the debtor to maintain adequate records.

Issue: Whether failure to tender a reasonable mileage allowance with a deposition subpoena constitutes grounds to quash the subpoena.

Issue: Whether the bankruptcy court erred in failing to deny dischargeability of a property settlement debt under section 523(a)(15).

The Fifth Circuit affirmed the bankruptcy court's granting of the debtor's discharge in the face of objections under sections 727(a)(2) and (3) alleging that the debtor had fraudulently transferred or

concealed assets and had failed to keep and file adequate financial records. The court concluded that the finding of intent to hinder, delay, or defraud a creditor is a factual one which must be reviewed under the clear error standard, that the given the low value of assets transferred, the bankruptcy court did not clearly err in finding a lack of requisite intent. With respect to alleged failure to keep and file adequate financial records, the court found that a debtor's financial records need not contain "full detail," but "there should be written evidence" of the debtor's financial condition. If an objecting creditor satisfies its burden under section 727(a)(3), the debtor must prove that the inadequacy is "justified under all the circumstances." The bankruptcy court has wide discretion in both inquiries, and its determination is a finding of fact reviewed for clear error. Finding no clear error, the Fifth Circuit affirmed.

The court further found no error in the bankruptcy court's decision determining the creditor's marital property settlement debt to be dischargeable under section 523(a)(15) because the debtor did not have the ability to pay the debt, in either a lump sum or periodic payments. Important to the court's ruling were the facts that the debtor had primary custody of three dependent children, the debtor's monthly income exceeded monthly expenses by just a few dollars, and the debtor would retain sizable non-dischargeable student loan debt following the conclusion of the bankruptcy case.

The court next addressed the issue of whether the bankruptcy court erred in quashing a deposition subpoena to the debtor because the subpoena did not come with a reasonable mileage allowance. Federal Rule 45(b)(1) provides that service of a subpoena upon a person named therein shall be made by delivering a copy and, if the person's attendance is commanded, by tendering to that person the fees for one day's attendance and the mileage allowed by law. Based on the plain meaning of this rule, the court agreed with the bankruptcy court that the subpoena had not been properly served. The creditor tendered the forty-dollar fee with the subpoena but did not tender the mileage allowance. Even though such an allowance would have been less than \$5, the subpoenaing party plainly violated rule 45(b)(1) and left the court with no factual basis from which to review the court's decision. Thus, the court held that a bankruptcy court does not abuse its discretion by quashing a subpoena where the subpoenaing party tenders no mileage allowance whatsoever with the subpoena.

Womble v. Pher Partners, 299 B.R. 810; (N.D. Tex., September 30, 2003, Judge Mary Lou Robinson)

Issue: For purposes of determining whether to deny a debtor's discharge under section 727(a)(2)(A) for alleged fraudulent transfers made more than one year prior to the filing of the debtor's bankruptcy case, whether equitable tolling applies to the one year lookback period in the event of a debtor's multiple bankruptcy filings.

The bankruptcy court denied the debtor's discharge under section 727(a)(2)(A) for fraudulent transfers made more than one year before the filing of the bankruptcy petition, holding that a previous bankruptcy filing equitably tolled the one year lookback period. Debtor appealed to the district court.

On appeal, the court found that the Supreme Court held in Young v. United States, that equitable tolling applies to the three-year lookback period contained in section 507(a)(8) for purposes of determining dischargeability of a debt. The court held that similarities between section 507(a)(8) 727(a)(2)(A) dictate similar treatment. Both statutes reference the date of the filing of the petition, and both act as limitations periods, requiring creditors to promptly protect their rights or risk having a debt discharged in bankruptcy. In concluding that equitable tolling could be employed in section 507(a)(8) cases, the Supreme Court noted that back-to-back bankruptcy filings disabled the IRS from protecting its claim during the pendency of the Chapter 13 petition, and that the period of disability tolled the lookback period of § 507(a)(8). Similarly, the creditor in the present case was prevented from protecting its claim during the pendency of debtor's bankruptcy case.

The Cadle Company v. Mitchell (In re Mitchell), 2003 WL 22016948; (N.D. Tex., July 28, 2003, Judge John H. McBryde)

Issue: Whether the bankruptcy court clearly erred in finding facts in favor of the debtor in an action to deny the debtor's discharge under section 727(a)(4) for various incorrect statements contained in the debtor's schedules and statements of affairs.

A creditor filed an action to block the debtors' Chapter 7 discharge for alleged false oaths on the debtors' schedules and statements of affairs under section 727(a)(4). Following a trial, the bankruptcy court ruled against the creditor, and granted the debtors their discharge. The bankruptcy court found, among other things, that (1) debtors' statement of income was a fair and truthful response to the inquiry posed by the schedules; (2) the statement of financial affairs cured any deficiency in the schedules; (3) various omissions from the schedules were immaterial and adequately explained; (4) the debtors' homestead valuation in the schedules was reasonable; and (5) debtors prepared and filed their bankruptcy schedules in good faith and not in reckless disregard for the truth. The creditor appealed to the district court.

On appeal, the creditor argued that the bankruptcy court erred in concluding it failed to meet its burden to establish a *prima facie* case under section 727(a)(4)(A). The district court went through the bankruptcy courts findings, and reversed for clear error. The district court first found that the elements of section 727(a)(4)(A) require an objecting party to show by a preponderance of the evidence that: (1) the debtor made a statement under oath; (2) the statement was false; (3) the debtor knew the statement was false; (4) the debtor made the statement with fraudulent intent; and (5) the statement related materially to the bankruptcy case. Regarding debtors' misstatements regarding their income on the schedules, the court found that the debtors had listed income only for a partial month prior to bankruptcy filing and failed to disclose their average monthly income. The court found that no reasonable person could fail to understand that he was required to disclose his total average monthly income on that schedule. The court further found that the failure to list the existence of a counterclaim in the schedules was not justified by the later listing of the existence of the asset in the statements of affairs.

The court next found that the debtors had undervalued their homestead in the schedules, which underevaluation allowed debtors more availability of a wildcard exemption. The court further found significant debtors' omission of a cash surrender value of an insurance policy, omission of various tools used in the restoration of old cars, and omission of china from the schedules. The district court disagreed with the bankruptcy judge's failure to see a pattern of action by the debtors. The court found that although mistakes in schedules may be common, a debtor has an obligation to correct those mistakes and presumably an honest debtor would do so. In this case, the testimony was that debtors only amended their schedules after appellant brought to light the errors. The court therefore concluded that debtors would not be entitled to the discharge granted them. The bankruptcy court judgment was therefore reversed.

DISCHARGEABILITY

United States Dept. of Education v. Gerhardt (Matter of Gerhardt), 348 F.3d 89,(5th Cir., October 23, 2003, Judge Edith H. Jones)

Issue: The appropriate standard for determining whether a debtor qualifies to have a student loan discharged as an "undue hardship" under section 523(a)(8).

Debtor, a professional cellist, obtained over \$77,000 in government-insured student loans to finance his education at the University of Southern California, the Eastman School of Music, the University of Rochester, and the New England Conservatory of Music. After filing for bankruptcy under Chapter 7, debtor filed an adversary proceeding seeking discharge of his student loans as an “undue hardship” pursuant to section 523(a)(8). The bankruptcy court discharged the student loans and the district court reversed.

On appeal to the Fifth Circuit, the court first held that the “undue hardship” determination under section 523(a)(8) is a question of law subject to de novo review. The court found that the bankruptcy court’s decision represented a conclusion regarding the legal effect of the court’s factual findings as to his circumstances.

Regarding the substantive dischargeability issues, the court adopted the Brunner test, which requires the following three-part showing: (1) that the debtor cannot maintain, based on current income and expenses, a “minimal” standard of living for himself and his dependents if forced to repay the loans; (2) that additional circumstances exist indicating that this state of affairs is likely to persist for a significant portion of the repayment period of the student loans; and (3) that the debtor has made good faith efforts to repay the loans.

Applying the test, the court first found that the bankruptcy court was correct in determining that the debtor’s current income as a cellist, as compared with his current expenses, left him without the ability at the present time to maintain a minimal standard of living if forced to repay his loans. With regard to the second prong of the test, the court found that a debtor must specifically prove a total incapacity in the future to pay his debts for reasons not within his control. The Fifth Circuit held that the district court had correctly concluded that the debtor had not established persistent undue hardship entitling him to discharge his student loans because the debtor held a masters degree in music from the New England Conservatory of Music, was about 43 years old, healthy, well-educated, and had no dependents, yet had repaid only \$755 of his over \$77,000 debt. The court was further troubled by the fact that the debtor had collected unemployment, but had somehow managed to attend the Colorado Music Festival. The court found that there were several things that the debtor could do to increase income and employment, and that no reasons out of his control existed that perpetuated his inability to repay his student loans. In addition, nothing in the Bankruptcy Code suggests that a debtor may choose to work only in the field in which he was trained, obtain a low-paying job, and then claim that it would be an undue hardship to repay his student loans. Therefore, the court affirmed the district court’s denial of dischargeability of the student loan debt.

Milligan v. Evert (Matter of Evert), 342 F.3d 358; (5th Cir., August 6, 2003, Judge William L. Garwood). **See case summary under topic “EXEMPTIONS” below.**

Wright v. Blythe-Nelson, 2004 WL 1923871 (N.D. Tex., August 26, 2004, Judge Sidney Fitzwater)

Issue: Whether a claim against a debtor for intentional infliction of emotional distress and assault and battery arising out of an alleged sexual harassment was non-dischargeable as a willful and malicious injury under section 523(a)(6).

Prior to filing bankruptcy, plaintiff initiated an action against the debtor (and a partnership) for, among other things, emotional distress and assault and battery arising out of an alleged sexual harassment. The district court heard the lawsuit, along with the adversary proceeding to determine dischargeability filed in the debtor’s subsequently filed bankruptcy case. Following trial, the district court found that the plaintiff had proved each of the elements of her claim for intentional infliction of emotional

distress, which are (1) debtor acted recklessly, (2) his conduct was extreme and outrageous, (3) his actions caused her emotional distress, and (4) the emotional distress was severe. The court further found that the plaintiff had proved each of the elements of her claim for assault and battery, which are that the debtor (1) intentionally caused physical contact with her (2) when he knew or should reasonably have believed that she would regard the contact as offensive.

With respect to the dischargeability of the debts incurred thereby, the court found that the test for willful and malicious injury under section 523(a)(6) is condensed into a single inquiry of whether there exists either an objective substantial certainty of harm or a subjective motive to cause harm on the part of the debtor. A debtor must commit an intentional or substantially certain injury in order to be deprived of a discharge. Intent to injure may be established by showing that the debtor intentionally took action that necessarily caused, or was substantially certain to cause, the injury. Under this standard, the court found that the plaintiff had met her burden in establishing the non-dischargeability of debts incurred thereby.

Skaja v. Skaja (In re Skaja), 2004 WL 1824680 (W.D. Tex., August 16, 2004, Judge Xavier Rodriguez)

Issue: On appeal to the district court, whether the bankruptcy judge correctly ruled that attorneys' fees arising out of a divorce proceeding were related to alimony, maintenance and support, and therefore non-dischargeable under section 523(a)(5).

Prior bankruptcy, debtor and his spouse were divorced. The divorce decree provided, among other things, that the debtor pay his ex-spouse a portion of her attorneys' fees. After the debtor filed a Chapter 7 bankruptcy petition, he filed an adversary proceeding asking the bankruptcy court to order the attorneys' fees discharged under section 523(a)(15), the section dealing with dischargeability of divorce property settlements. The bankruptcy Court held that the attorneys' fees were not dischargeable under 523(a)(5), the section dealing with non-dischargeability of alimony, support and maintenance.

On appeal to the district court, the debtor argued that 1) the bankruptcy judge incorrectly ruled that attorneys' fees were related to alimony, maintenance and support, effectively blocking debtor's attempt to discharge his obligation through bankruptcy; and 2) the bankruptcy judge's analysis using section 523(a)(5) was clearly erroneous in light of the further statutory addition of section 523(a)(15). The basis for debtor's argument was that 1) that the attorneys' fees were classified as a property division by the state court and both collateral estoppel and res judicata prevented the bankruptcy court from labeling attorneys' fees as alimony, maintenance, and support; 2) that the attorneys seeking their fees do not have standing under section 523, which limits protection of obligations to spouses and children; and finally 3) that the bankruptcy court incorrectly balanced the interests of the parties.

The district court disagreed with the debtor's assertion that bankruptcy courts are required to follow the language used by state courts. Instead, the district court found that the determination of whether a debt is nondischargeable is a matter of federal bankruptcy law, not state law. Bankruptcy courts are not obligated to follow the labels made by divorce courts regarding obligations. Concerning collateral estoppel and res judicata issues, parties and state courts, as a general rule, do not label obligations with federal bankruptcy standards in mind, making collateral estoppel inapplicable.

With respect to the argument that attorneys seeking payment do not have standing, the court also disagreed, finding that the attorneys' fee obligation extends to attorneys seeking payment because the ultimate purpose of the proceeding is to provide support for the spouse or child. The district court finally held that the bankruptcy court correctly weighed the factors involved in assessing attorneys' fees as alimony, maintenance, or support by balancing of the parties' financial needs. The court found that the factors to balance include: 1) disparity in earning power of the parties; 2) their relative business

opportunities; 3) the physical condition of the parties; 4) their probable future need for support; 5) the educational background of the parties; 6) and the benefits they would have received had the marriage continued. The district court therefore affirmed the decision of the bankruptcy court.

Sonntag v. Prax (In re Sonntag), 2004 WL 764728; (N.D. Tex., April 7, 2004, Judge John H. McBryde)

Issue: Whether any exceptions for unusual circumstances exist to nondischargeability in bankruptcy, pursuant to section 523(a)(5), of attorneys' fees ordered to be paid by the debtor by a divorce court in a suit affecting the parent/child relationship.

As a part of a divorce decree, appellee was granted custody of the parties' children and appellant was ordered to pay child support and certain medical bills. Shortly thereafter, appellant filed a suit attempting to modify the custody order. In that matter, appellant was ordered to pay to appellee attorneys' fees. After appellant filed a Chapter 7 bankruptcy petition, appellee filed an adversary proceeding seeking a declaratory judgment that appellant's obligations to pay child support, medical costs, and the attorneys' fees awarded in the suit affecting parent/child relationship were nondischargeable under section 523(a)(5). In her response to the complaint, appellant admitted nondischargeability of the child support and medical reimbursement payments, but denied nondischargeability of the claim for attorneys' fees and interest. The bankruptcy court granted appellee's motion for summary judgment, holding that the attorneys' fees and interest were nondischargeable.

On appeal to the district court, the sole issue was whether debtor's obligation to pay the attorneys' fees and interest thereon awarded to appellee was nondischargeable under section 523(a)(5). The district court found that the Fifth Circuit has interpreted section 523(a)(5) to include court-ordered payment of attorneys' fees incurred in post-divorce/child custody litigation. The Fifth Circuit has not allowed, much less alluded to, any exception to its strict interpretation of the statute. Appellant argued that the court should follow the reasoning of the Tenth Circuit, where an exception to the general rule of nondischargeability exists in certain "unusual circumstances," such as where the payment of court-ordered attorney's fees would clearly affect the debtor's ability to financially support the child. The district court was not persuaded that the Fifth Circuit would follow this Tenth Circuit exception, and that even if it did, appellant had not raised a genuine issue of material fact to show that the declaration of nondischargeability would severely impair her ability to support the children. The district court therefore affirmed.

Cornwell v. Loesch, 2004 WL 614848; (N.D. Tex., February 27, 2004, Judge Jorge A. Solis)

Issue: Whether issue preclusion applies to except a debt from discharge under section 523(a)(2)(A) of the Bankruptcy Code where the state court found that the debtor had obtained funds under false pretenses, false representations and actual fraud, but the plaintiff did not produce an adequate record of the evidence considered by the state court in rendering the underlying judgment.

Appellees held a state civil court judgments against appellants based in part on its determination that appellants had obtained "funds under false pretenses, false representations and actual fraud." Appellants filed for bankruptcy, and appellees filed a complaint alleging that their judgments were non-dischargeable under sections 523(a)(2)(A) and 523(a)(6). The bankruptcy court granted appellees' motion for summary judgment with respect to the 523(a)(2)(A) claim, concluding that the findings of the state court in the civil case brought against the appellants entitled the appellees to summary judgment on this claim. Specifically, the bankruptcy court gave preclusive effect to the Kansas Court's finding that the Appellants obtained funds "under false pretenses, false representations and actual fraud in the amount of \$627,030.60."

Where a state court judgment states that the court's findings were "based on the well pled complaint and based upon a preponderance of the evidence and after opportunity to be heard," it is not necessary for the plaintiff to present the preponderance of the evidence purportedly considered by the state court for issue preclusion to apply. Issue preclusion applies in bankruptcy court if three elements are met: (1) the issue at stake must be identical to the one involved in the prior action; (2) the issue must have been actually litigated in the prior action; and (3) the issue must have been necessarily determined in the prior action. An issue is actually litigated and preclusion is appropriate when a default judgment is entered as a sanction for discovery abuses and dilatory tactics, or where a party had a full and fair opportunity to defend a case on the merits, but subsequently chose not to do so.

Although the party who bears the burden of proof should produce an adequate record from the prior court's proceedings to support the application of issue preclusion, a full record from the prior action is not required for a bankruptcy court to apply issue preclusion. Rather, the produced record must only provide a sufficient basis upon which the bankruptcy court may determine that issue preclusion may be applied.

Ridley v. Holt (In re Holt), 2004 WL 1325777; (Bankr. N.D. Tex., May 11, 2004, Judge Steven A. Felsenthal)

Issue: Whether plaintiffs had established that defendant sexually assaulted a 14-year-old girl against her will, such that the resulting liability was non-dischargeable in the defendant's bankruptcy case as a willful and malicious injury under section 523(a)(6).

Guardians of a 14-year-old girl brought an action pursuant to section 523(a)(6) against a debtor for injuries caused by the defendant, alleging that the defendant sexually assaulted the girl, giving rise to damages for intentional assault and battery, for false imprisonment and for the tort of outrage, all under Arkansas law. Defendant responded that the girl consented to the sexual act.

The court first found that a willful and malicious injury under section 523(a)(6) requires a deliberate or intentional injury, not merely a deliberate or intentional act that leads to injury. To establish an intentional injury, the creditor must establish either an objective substantial certainty of harm or a subjective motive to cause harm. In addition to being willful, the injury must be malicious, meaning without just cause or excuse. Thus, to be non-dischargeable, the debtor had to act to intentionally injure a person without just cause or excuse to do so.

Plaintiffs claimed that defendant was liable for intentional assault and battery which, under Arkansas law, would require the plaintiffs to establish that defendant acted to create a risk of apprehension of immediate harm or offensive contact on the girl; that defendant intended to cause that harm or contact; and that the girl was actually put in that apprehension. For the intentional battery of the girl, the Plaintiffs would have to establish that defendant acted with intent to cause some harmful or offensive contact with the girl, or acted with the intent to create the apprehension of some harmful or offensive contact with the girl; and that harmful or offensive contact with the girl directly or indirectly resulted. Plaintiffs further asserted a claim for false imprisonment, and for the tort of outrage.

Following trial of the dischargeability action, the court found that the plaintiffs had established by a preponderance of the evidence that plaintiff engaged in sexual intercourse with the girl while she was fourteen years old, turning fifteen the following day, by forcible compulsion, and that the girl did not consent to the sexual intercourse. By doing so, the court found the defendant intended to harm the girl. An intent to harm necessarily includes an intent to injure, within the meaning of section 523(a)(6). The

court therefore held that the plaintiffs had established a debt, and the debt would not be discharged. The amount of the debt would be determined by a court of competent jurisdiction in a subsequent proceeding.

DISCRIMINATION

Wakefield v. SWS Securities, Inc. (In re Wakefield), 293 B.R. 372; (N.D. Tex., May 27, 2003, Judge Sidney A. Fitzwater)

Issue: Whether the bankruptcy court erred in applying an objective standard of intent, rather than a standard of subjective motivation, in its ruling that the defense of judicial estoppel was not available where a debtor filed an adversary proceeding against a party without having scheduled a litigation claim.

Issue: Whether the bankruptcy court erred in granting judgment in favor of a debtor against his former employer under section 525(b) for terminating the debtor from employment based on debtor's filing of bankruptcy.

Debtor was employed as a broker for a securities firm. After the debtor filed a Chapter 7 bankruptcy petition, his employer terminated him for the stated reasons that he would require heightened supervision, the firm would have to hire additional personnel to supervise him, and the firm did not have the resources to accommodate such supervisory needs. When the securities firm terminated the debtor, it was required to file a Form U-5 with the NASD, where it stated that it had terminated the debtor with cause because the debtor would require heightened supervision due to his personal financial difficulties, and that the firm had chosen not to employ additional personnel for that specific requirement.

The day that the debtor was terminated, he became aware that he had a potential cause of action against the firm for bankruptcy discrimination under section 525(b), which provides, in relevant part, that no private employer may terminate the employment of, or discriminate with respect to employment against, an individual who is or has been a bankruptcy debtor solely for that reason. After the debtor's discharge was granted, the debtor filed an action against the firm alleging claims for discrimination, in violation of section 525(b), libel *per se*, and negligence. The firm relied on the defense of judicial estoppel, arguing that the debtor had failed to include the cause of action in his bankruptcy schedules.

The bankruptcy court awarded debtor damages under section 525(b) and Texas libel law after finding that the firm had terminated his employment solely because he had filed for bankruptcy and had given false reasons in a Form U-5. The bankruptcy court rejected the firm's reliance on the defense of judicial estoppel, applying a purely objective standard to find that, when the debtor failed to amend the schedules in his chapter 7 case to reflect his section 525(b) claim, he had no motive to conceal the claim. The firm appealed to the district court.

The district court found that the bankruptcy court abused its discretion in applying a purely objective standard to the defense of judicial estoppel. The court found that judicial estoppel is a common law doctrine by which a party who has assumed one position in his pleadings may be estopped from assuming an inconsistent position. The purpose of the doctrine is to protect the integrity of the judicial process by preventing parties from playing fast and loose with the courts to suit the exigencies of self interest. Judicial estoppel is applied when two requirements are met: 1) the position of the party to be estopped is clearly inconsistent with its previous one, and 2) the party convinced the court to accept the previous position. Additionally, the court found that the Fifth Circuit had at least implicitly recognized the additional requirement that the party to be estopped must have acted intentionally rather than inadvertently. At issue in this case was the appropriate standard for a court to use in determining the

intentional standard. In applying a purely objective standard, the bankruptcy court had found that the debtor did not have a motive for concealment because, objectively, debtor's concealment and subsequent discharge would have had no effect on such claim because the claim was owned by him and not by his estate under section 541(a)(7). In other words, the court essentially held that the debtor had no objectively-ascertainable motive to conceal the section 525(b) claim because, as a matter of law, it was not property of the chapter 7 estate and need not have been disclosed in the schedules.

The district court held that the bankruptcy court erred as a matter of law when it applied an objective test to determine the debtor's intention, devoid of any subjective component. Instead, the district court found that the debtors motivation is relevant to the analysis, and that a motive determination should not be purely objective. The Fifth Circuit has held that a party either must lack knowledge of the undisclosed claim or must have no motive to conceal it. Motive and subjective intent are closely-related concepts and are often intertwined in the law. To say that motive should be determined from a purely objective standpoint is to ignore the common sense understanding that motive must be evaluated subjectively as well. The court therefore concluded that an assessment of the debtor's motive not to disclose his section 525(b) claim must include subjective considerations, and that the bankruptcy court abused its discretion by erroneously limiting its determination to an objective evaluation.

The court further found that on remand, if the bankruptcy court were to determine that the debtor was not obligated to list the section 525(b) claim on his schedules, the first requirement of judicial estoppel would not be met because there would be no inconsistent pleadings. In such event, there would be no need to reach the issue of intention.

With respect to the firm's argument that the debtor had failed to prove a section 525(b) claim, the court found that the record amply supported the bankruptcy court's constituent findings, and affirmed those findings. In the context of anti-discrimination laws, the Fifth Circuit has held that it is only necessary that an award of back pay be reasonable and supported by record evidence. In next considering whether the bankruptcy court committed reversible error in holding that the debtor was entitled to recover for libel, the court found that the bankruptcy court did not clearly err in finding that the firm lied when it reported on the Form U-5 that it had terminated his employment because of a need for heightened supervision and a financial disincentive not to hire necessary additional personnel to accommodate the new supervisory needs. The court affirmed in part, and remanded for further proceedings consistent with its opinion.

DISMISSAL

Berger v. Piranha, Inc. (In re Piranha, Inc.), 297 B.R. 78; (N.D. Tex., June 20, 2003, Judge Sidney A. Fitzwater)

Issue: Whether the bankruptcy court was correct in denying a motion to dismiss a corporate debtor's bankruptcy case, concluding that the debtor's director had not resigned.

A party filed a motion to dismiss the debtor's corporate bankruptcy case for lack of subject matter jurisdiction. For reasons that were not explained in the opinion, in order for the debtor to have properly filed for chapter 11 protection, it was necessary for the court to find that a particular individual was a director of the debtor as of the date of a certain board of directors. The motion to dismiss the bankruptcy contended that the director had resigned. Following a hearing, the bankruptcy court denied the motion, and an appeal was taken.

On appeal, it was argued that the director had submitted a written resignation in an SEC filing that bore the director's electronic signature. The party argued that the bankruptcy court ignored section 107(a) of the Delaware Uniform Electronic Transactions Act, which he contended precluded the director from asserting that his electronic signature was not his signature or was not a written signature. The court found that section 107(a) actually states that a record or signature may not be denied legal effect or enforceability *solely because it is in electronic form*. In other words, section 107(a) forecloses the assertion that a signature is not binding because it is an *electronic* signature. Section 107(a) says nothing about proving that an electronic signature was *neither executed, adopted, nor authorized*. Having found section 107(a) inapplicable, the court found that the bankruptcy court had not clearly erred in determining that the director had not resigned until a later date. The court therefore affirmed the bankruptcy court's denial of the motion to dismiss the bankruptcy case.

In re Ferguson, 295 B.R. 96; (Bankr. S.D. Tex., June 2, 2003, Judge Wesley W. Steen)

Issue: Whether a Chapter 7 bankruptcy case should be dismissed as a substantial abuse under section 707(b).

Chapter 7 debtors were employed, respectively, as an analyst for a trading company and a director of a modeling and acting agency. Their combined monthly income was \$7,673.00, and their debts included \$158,853.70 in secured debt, \$69,156.17 as unsecured priority debt, and \$49,656.87 in unsecured non-priority debt. The United States Trustee filed a motion to dismiss their case as a substantial abuse under section 707(b).

The court found that the Bankruptcy Code does not define "substantial abuse" and that the Fifth Circuit has not yet provided a definition. Two lines of jurisprudence have developed: Some courts conclude that the court should consider the fundamental principle of a chapter 7 fresh start in the context of the totality of the circumstances, discussing various criteria which primarily focus on the debtor's ability to pay debts out of his or her future income. The second line of cases holds that substantial abuse may exist wherever the debtor has the ability to pay a significant portion of his or her debts without undue hardship. In application, the court found the two lines of authority not substantially different. The ability of a debtor to pay his or her debts can be regarded as the most important consideration in the analysis.

In applying the criteria from the case law, the court found the case to be a substantial abuse under section 707(b). The court found the debtor's proposed family budget was excessive, including monthly line items of: \$502.00 for transportation, \$306.00 for telephone service, including mobile phones for both debtors and their 14 year-old child, \$143.00 for television cable service, trash disposal service, TIVO digital television recording, and internet service, \$400.00 for recreation, clubs and entertainment, newspapers, magazines, and \$175.00 for fingernail and hair care. Considering only the \$400.00 per month proposed for recreation and entertainment, the court found that the debtor's would have the ability to contribute over \$14,000.00 in 36 months (over which a Chapter 13 plan might be proposed). Given the amount of disposable income that the debtors had with the court-adjusted budget, the court found that the debtors could fund a 40% payout to creditors in a Chapter 13 plan. Based on this and other factors, the court granted the United States Trustee's motion to dismiss the bankruptcy case.

ERISA

In re Philip Services Corp., 2004 WL 302309; (Bankr.S.D.Tex., February 3, 2004, Judge Wesley W. Steen)

Issue: Whether a requirement in a purchase agreement that a debtor reject all single employer pension plans was a sufficient showing of financial distress to terminate the pension plans under the distress termination provisions of ERISA, when the requirement could be waived by the purchaser.

Issue: Whether a debtor may reject a pension plan as an executory contract if the requirements of distress termination are not met.

Debtor proposed a liquidating chapter 11 plan which incorporated an agreement under which it would sell its assets to a purchaser. The agreement with the purchaser included closing contingencies, including a condition that the debtor reject all of its single employer pension plans. Under the agreement, the purchaser was not obligated to close the purchase unless all of the conditions in the purchase agreement were met, but the purchaser had the right to waive any and all of the conditions. Based upon the condition in the purchase agreement, the debtor sought approval from the bankruptcy court to terminate the pension plans under the distress termination provisions of ERISA, or alternatively to reject the pension plans as executory contracts.

Under Section 1341(c)(2) of ERISA, a bankruptcy court may terminate a single employer pension plan pursuant to the distress termination provisions if the bankruptcy court determines that without termination the entities will be unable to pay all their debts pursuant to a plan of reorganization and will be unable to continue in business outside the chapter 11 reorganization process and approves the termination. The burden is on the party seeking termination to prove by a preponderance of the evidence that the conditions for termination exist.

The bankruptcy court held that in determining whether a pension plan must be terminated as a distress termination, the bankruptcy judge should consider the provisions of a proposed chapter 11 plan (if one has been proposed at the time of the decision), but the bankruptcy judge must also look to existential financial reality and try to determine whether the plan provisions are necessary or whether they are merely desired by the entities that would benefit from the termination. In this case, where the payments required under the pension plans were estimated at 0.8% of the net cash provided by the debtor's operations, and the testimony presented to the bankruptcy court that the investor would not close the purchase if the pension plans were not terminated was not persuasive, the bankruptcy court concluded that pension plan terminations were not necessary even though they were desired by the purchaser.

The bankruptcy court further concluded that rejection of a pension plan as an executory contract is not permissible if the requirements of distress termination are not met. The specific language of ERISA states that ERISA provides the exclusive means of plan termination. This specific provision trumps the general language of section 365 that authorizes a debtor to reject executory contracts because there is no demonstrated conflict between ERISA and the Bankruptcy Code.

ESTOPPEL

Superior Crewboats, Inc. v. Primary P & I Underwriters (Matter of Superior Crewboats, Inc.), 2004 WL 1375712; (5th Cir., June 18, 2004, Judge Edith H. Jones)

Issue: Whether judicial estoppel would apply to prohibit debtors from prosecuting a personal injury lawsuit that was not timely disclosed to the bankruptcy court.

Prior to bankruptcy, debtor was involved in a personal injury. After filing for Chapter 13, debtors filed bankruptcy schedules representing that they had no pending or potential lawsuits. However, while

their bankruptcy case was still pending, the debtors filed the personal injury lawsuit, while waiting six months to effectuate service of process. Debtors did not formally amend their bankruptcy filings, before discharge, to reflect this lawsuit. After conversion of the bankruptcy case to Chapter 7, debtors disclosed the lawsuit at their creditors' meeting convened in the converted case, but inaccurately informed the creditors that the suit was barred by limitations. Shortly after the creditors' meeting, the bankruptcy trustee abandoned the lawsuit and granted a "no asset" discharge. Later, the defendant to the personal injury action informed the bankruptcy trustee that the debtors were continuing to pursue the pre-petition personal injury claim, and the trustee moved to re-open the bankruptcy case. Debtors then filed amended schedules disclosing the personal injury claim.

In the personal injury lawsuit, the defendant filed a motion to dismiss, arguing that the personal injury claim was barred by judicial estoppel. The district court rejected the judicial estoppel argument, determining that it could not conclude that the debtors took inconsistent positions because it was a question of fact to be determined at trial and not a matter of law to be decided summarily. Thereafter, the district court designated its rulings as immediately appealable to the Fifth Circuit under 28 U.S.C. § 1292(b).

The Fifth Circuit Court found that the threshold and dispositive question was whether judicial estoppel barred the debtors from pursuing the personal injury claim. Judicial estoppel is a common law doctrine that prevents a party from assuming inconsistent positions in litigation. The purpose of the doctrine is to protect the integrity of the judicial process by preventing parties from playing fast and loose with the courts to suit the exigencies of self-interest. Importantly, because judicial estoppel is designed to protect the judicial system, not the litigants, detrimental reliance by the party opponent is not required. The Fifth Circuit has recognized three particular requirements for judicial estoppel: (1) the party is judicially estopped only if its position is clearly inconsistent with the previous one; (2) the court must have accepted the previous position; and (3) the non-disclosure must not have been inadvertent.

In the present case, the district court ruled that the debtors, at least as a matter of law, had not taken clearly inconsistent positions. The Fifth Circuit disagreed, finding that the debtor's positions in the bankruptcy court and personal injury litigation were clearly inconsistent. The Bankruptcy Code and Rules impose upon bankruptcy debtors an express, affirmative continuing duty to disclose all assets, including contingent and unliquidated claims. The debtor's omission of the personal injury claim from their mandatory bankruptcy filings is tantamount to a representation that no such claim existed. However, the personal injury case they argued that the claim was viable and worth \$2.5 million.

With respect to the second prong, the court found that the bankruptcy court had adopted the debtor's contention that the personal injury claim was prescribed. Finally, the court found that non-disclosure of a viable personal injury claim was not inadvertent. The debtors certainly had knowledge of the undisclosed claim, initiating the suit only months after filing for bankruptcy and requesting service of process during the pendency of the bankruptcy petition. When the debtor finally informed the bankruptcy trustee about the suit, she wrongly identified it as prescribed by limitations. The court further found that the debtors had the requisite motivation to conceal the claim, as they would certainly reap a windfall had they been able to recover on the undisclosed claim without having disclosed it to the creditors. The court therefore reversed the district court and concluded that judicial estoppel barred the personal injury suit as a matter of law.

Wakefield v. SWS Securities, Inc. (In re Wakefield), 293 B.R. 372; (N.D. Tex., May 27, 2003 Judge Sidney A. Fitzwater). **See case summary under topic "DISCRIMINATION" above.**

EVIDENCE

Manix Energy, Ltd., v. James (In re James), 300 B.R. 890; (Bankr. W.D. Tex., October 22, 2003, Judge Leif M. Clark)

Issue: By taking judicial notice of the existence of documents filed in a prior proceeding, whether the court receives such documents into evidence.

In an adversary proceeding filed by a creditor against the Chapter 7 debtor objecting to discharge under section 727 or, alternatively, to the dischargeability of debt under section 523, creditor filed a motion requesting the court to take judicial notice, under Rule 201 of the Federal Rules of Evidence, of ten official court records, including various pleadings and transcripts, and that the court receive those documents into evidence based on such judicial notice.

The court found that it has become a commonly-accepted practice to take “judicial notice” of a court’s records. However, the taking of judicial notice of court records generally has a limited purpose. There is a very crucial distinction between taking judicial notice of the fact that an entity has filed a document in the case, or in a related case, on a given date, i.e., the existence thereof, and the taking of judicial notice of the truth or falsity of the contents of any such document for the purpose of making a finding of fact. Judicial notice can be taken as to the existence of documents, such as proofs of claim or a debtor’s schedules, without inquiring whether the information contained in them is true. In ruling on the creditor’s request in this case, the court held that it may take judicial notice of the existence of the documents filed in the prior proceeding, but that by doing so the court did not receive any of those documents into evidence in this case because that involved a separate process of determining the admissibility of evidence. In other words, the invocation of Federal Rule of Evidence 201(d) does not relieve a party of the duty to gather, organize, and present evidence to the court.

EXEMPTIONS

Milligan v. Evert (Matter of Evert), 342 F.3d 358; (5th Cir., August 6, 2003, Judge William L. Garwood)

Issue: Whether a promissory note arising from a divorce decree was exempt under section 522(d)(10)(D) as “alimony, support or maintenance.”

Issue: Whether the case law analysis for determining whether a debt is in the nature of alimony, support and maintenance for purposes of section 523(a)(5) is the same analysis for determining whether the debt is in the nature of alimony, support and maintenance, and therefore exempt under section 522(d)(10)(D).

In connection with debtor’s prepetition divorce, an agreed divorce decree was entered giving debtor a promissory note from her husband. A section of the decree specifically dealt with child support. A different section of the decree divided the assets and liabilities of the parties. This section provided for the execution of the promissory note to the debtor. A still different section of the decree provided for post-divorce spousal support. After debtor filed for bankruptcy she scheduled the promissory note as “support” exempt under section 522(d)(10)(D). The bankruptcy trustee argued that the promissory note should be part of the debtor’s estate, and that it did not qualify as an exempt asset. The bankruptcy court held for the debtor, and the district court affirmed.

On appeal to the Fifth Circuit, the court first found that by virtue of section 522(d)(10)(D), a debtor may exempt from the bankruptcy estate “(10) the debtor’s right to receive. . . (D) alimony, support, or separate maintenance, to the extent reasonably necessary for the support of the debtor and any dependent of the debtor.” The bankruptcy court and district court relied on precedent interpreting section 523(a)(5), regarding dischargeability of marital related debts. In interpreting section 523(a)(5), courts generally look beyond the labels that state courts - and even parties themselves - give obligations that debtors seek to have discharged. The nonexclusive list of factors that should be considered in determining whether a Texas divorce related obligation constitutes alimony, support, or maintenance is: the parties’ disparity in earning capacity, their relative business opportunities, their physical condition, their educational background, their probable future financial needs, and the benefits each party would have received had the marriage continued. In applying these factors, including fault in breaking up the marriage, the bankruptcy court concluded in this case that the promissory note payments were support under section 522(d)(10)(D).

The bankruptcy trustee argued that the bankruptcy court applied the wrong law because the factors used to define alimony, support, and maintenance in the discharge context are not applicable to the interpretation of the exemption under section 522(d)(10)(D), especially when the parties’ intent at the time of their agreement is clear and unambiguous. The threshold question before the court was, therefore, whether the same approach the Fifth Circuit has used for determining what constitutes alimony in the context of dischargeability under section 523(a)(5) should apply to exemptions under section 522(d)(10)(D). The court found that nearly all the courts that have considered the question have determined that the same interpretation given to section 523(a)(5) should also be applied to section 522(d)(10)(D). The Fifth Circuit disagreed for a number of reasons. The court found that the statutes differ somewhat in their underlying purpose. A liberal or broad interpretation of “alimony” may be particularly appropriate under section 523(a)(5) because of the desire to avoid harming someone who is completely innocent and depends on their former spouse for their support because of the bankruptcy of that former spouse. In contrast, in the section 522(d)(10)(D) context, the person seeking the exemption is the individual who has taken bankruptcy so there is an arguable element of fault and there is no incentive to hurt an innocent third party, except perhaps the creditor. Also, in the section 523(a)(5) context the interests of the debtor and former spouse in the proceedings before the bankruptcy court are virtually always adverse, while in the section 522(d)(10)(D) context they are likely to be aligned against the third party creditor. Therefore, in the latter context it becomes more than normally questionable to rely on oral testimony of the spouse and former spouse where that testimony runs counter to the clear purport of the relevant documents, which were likely all that would have been available to a third party extending credit.

The court held that for purposes of section 522(d)(10)(D), where in the agreed divorce decree there is 1) also a meaningful separate alimony provision, 2) the obligation in question is described as being part of the property division, 3) the label given to the obligation in question is matched by its actual characteristics, and 4) the evidence does not suggest the parties conspired to disguise the true nature of the obligation in order to subvert the bankruptcy or tax laws, there is no ambiguity necessitating the use of the factors utilized in section 523(a)(5) actions to essentially work backwards to determine the nature of the obligation. The court therefore reversed the lower courts. The court further held that only if an agreement is ambiguous, then the court must determine the parties’ intentions by looking to extrinsic evidence.

Forsberg v. Forsberg (In re Forsberg), 2004 WL 744420; (N.D.Tex., February 25, 2004, Judge John H. McBryde)

Issue: Whether the debtor timely filed her claim of exemptions when her schedules were filed beyond the 15 day period allowed under Bankruptcy Rule 1007(c)

Issue: Whether the family court or the state district court had jurisdiction to determine whether the orders of the family court tolled the six-month period that protects proceeds of a sale of a homestead under the Texas Property Code

In a state court divorce proceeding commenced prior to debtor's bankruptcy case, debtor sold the homestead that she had shared with her spouse, and pursuant to a family court order, deposited the proceeds from the sale in her attorney's trust account to hold pending further order of the family court. Later, debtor's spouse obtained a judgment against the debtor and a writ of garnishment from a state district court, and sought to attach the proceeds from the sale of the homestead held in trust by debtor's attorney, arguing that the proceeds were no longer exempt because more than six months had passed since the sale of the homestead. Prior to the determination of the issue by the state court, debtor filed for bankruptcy under chapter 13.

Appellant filed a motion for relief from stay in the bankruptcy court to allow him to proceed with the state court garnishment action. The bankruptcy court granted the motion in part to allow the family court to determine whether its orders tolled the six-month period provided by Texas Property Code § 41.001(c) such that no lien could attach to the sale proceeds held by Debtor's attorney. The family court determined that the six-month period was tolled while the Debtor's attorney held the sale proceeds pursuant to its order.

In its order granting in part appellant's motion to lift stay, the bankruptcy court implicitly found that the debtor's claim of exemptions were timely filed even though her schedules were filed 21 days after she filed her bankruptcy petition. The bankruptcy court found that no harm was alleged to have been caused by the late filing, and that the court is authorized to enlarge the time for filing schedules. Moreover, the time for claiming an exemption is not so strictly limited and the bankruptcy court did not err in accepting the claim of exemption as timely made.

With regards to the order lifting stay, the court found that appellant is estopped from complaining that the state district court is the only court with jurisdiction to determine whether the six-month period set forth in § 41.001(c) of the Texas Property Code was tolled because appellant asked for relief from stay to allow further proceedings in the family court, and he received the relief that he sought.

In re Brown, 299 B.R. 425; (Bankr. N.D. Tex., September 17, 2003, Judge Harlin D. Hale)

Issue: Whether section 522(d)(1) authorizes a debtor, residing on a military base in Texas, to claim as exempt a timeshare at a Florida vacation resort.

Debtors, whose primary residence was a Texas military base, sought to exempt their interest in a Florida vacation timeshare under section 522(d)(1), which allows an exemption for a the debtor's interest in property, not to exceed \$17,425 in value, used as a residence. The Chapter 13 Trustee objected, contending that the timeshare did not constitute a residence for purposes of the federal exemption.

The court first found that the Bankruptcy Code does not define "residence," but that the legislative history shows that Congress intended section 522(d)(1) to provide debtors with a homestead exemption. The court next found that under Florida law, a homestead is established by actual intention to live permanently in a place, coupled with actual use and occupancy. Under this analysis, the court held that the timeshare did not fit within the definition of homestead established by the Florida courts because the debtors maintained their permanent residence on a military base in Texas, and because they had no intention or option to change their permanent residence to the timeshare. The court stated that this finding comported with the purpose of the homestead exemption, which is to assist a debtor in keeping a roof over his head.

In re Martinez, 293 B.R. 387; (Bankr. N.D. Tex., May 21, 2003, Judge Robert L. Jones)

Issue: Whether the bankruptcy court in a chapter 13 case has jurisdiction over distribution of a personal injury settlement where the debtor exempted the personal injury claim and no objection to the exemption was timely filed.

Debtors filed a Chapter 13 case, and listed as exempt a personal injury claim. The schedules listed the market value of the claim to be \$10,000, and claimed 100% of the value of the exemption. The exemption claim corresponded with their description of the personal injury claim in Schedule B (Personal Property), as a contingent and unliquidated claim with an estimated value of \$10,000. After the time had passed for the filing of objections to exemptions under Bankruptcy Rule 4003, the debtor's personal injury attorney settled the case for \$23,000. Debtors filed a motion requesting the court to approve the settlement, and to authorize certain disbursements. The Standing Chapter 13 Trustee objected to approval of the settlement, contending, among other things, that the exemption was limited to the debtors' estimate of value of the exemption in the schedules, and that disbursing any proceeds to the debtors, exempt or not exempt, were impermissible as such funds constituted disposable income which, under the provisions of Chapter 13, must be used in funding debtors' plan.

The initial question before the court was whether the entirety of the settlement proceeds, the \$23,000, was covered by the debtors' claim of exemption or whether the exemption was limited to \$10,000. The court held that the debtors claimed 100% of the asset as exempt. This is to be distinguished from those situations where a debtor claims an exempt value as less than the current market value of the asset, in which case the debtor is limited to the stated value of the exemption, such as in the case where debtor claims \$1.00 as exempt, yet values an asset at higher value. In this case, the court found that the \$10,000 stated value of the personal injury claim was merely an estimate. The debtors unambiguously claimed 100% of the personal injury claim as exempt property. No objection was filed to either the validity or to the amount of the exemption within the time period permitted by Rule 4003. Therefore, the court held that the exemption extended to the gross settlement proceeds of \$23,000.

Having determined that the proceeds were exempt, the court next found that they were therefore not property of the estate. Since the property was not property of the estate, the court found that Fifth Circuit precedent provides that the bankruptcy court has no authority over distribution of proceeds that consist wholly of non-estate assets. The debtor may use his property, i.e., non-estate property, as he sees fit. For those reasons, the court found that it did not have jurisdiction to address the proposed disbursements of the settlement proceeds, and therefore denied the motion.

FIDICIARY DUTIES

Ginn v. Seidell (In re Allied Physicians Group, P.A.), 2003 WL 21149493; (N.D. Tex., May 16, 2003, Judge A. Joe Fish). **See case summary under topic "TRUSTEES" below.**

FORWARD CONTRACT

Mirant Americas Energy Marketing, L.P. v. Kern Oil & Refining Co. (In re Mirant Corp.), 310 B.R. 548; (Bankr. N.D. Tex. May 17, 2004, Judge Dennis Michael Lynn). **See case summary under topic "AUTOMATIC STAY" above.**

FRADULENT TRANSFER

The Cadle Company v. Pratt, 2004 WL 718977; (N.D. Tex., March. 31, 2004, Judge Sam A. Lindsay)

Issue: Whether the bankruptcy court erred in failing to deny the debtor's discharge pursuant to section 727(a)(2)(A), (a)(2)(B) and (a)(4)(A), where the debtor failed to disclose service as trustee of a trust, where the debtor failed to disclose a retained interest in residential property previously sold, where the debtor failed to disclose a joint bank account with son and use of wife's bank account, and where the debtor failed to disclose an alleged retained interest in a limited partnership.

Judgment creditor appealed a judgment of the bankruptcy court denying creditor's objection to discharge pursuant to section 727(a)(2)(A), (a)(2)(B) and (a)(4)(A). The district court affirmed the decision of the bankruptcy court because the judgment creditor failed to show intent to hinder, delay or defraud creditors with respect to any of debtor's assets or that the debtor made a false oath with fraudulent intent. The court found that many of the alleged assets that the debtor did not disclose were debtor's assets solely because of technical problems in transfer of which the debtor was unaware. Thus, the debtor could not have had the requisite intent to warrant a denial of discharge. The court similarly noted that many of the complained of monetary transfers were more than one year prior to the filing of bankruptcy and therefore could not have been made with fraudulent intent.

Homecomings Fin. Network, Inc. v. Litzler, 2004 WL 614845; (N.D. Tex., Feb. 25, 2004, Judge Sam A. Lindsay)

Issue: Whether value from a party other than the recipient of payments meets the "reasonable" equivalency" test of Section 548(a)(1)(B)(i).

Issue: Whether transfer of funds allegedly held in constructive trust are transfer of an interest of the debtor in property.

A chapter 7 trustee brought an adversary proceeding pursuant to section 548 to recover funds paid by the debtor. Prior to bankruptcy, the debtor entered into a seller/servicer contract with a third party mortgagee pursuant to which the debtor sold mortgages to the third party mortgagee. Debtor afterwards entered into a mortgage contract with a real property purchaser. The real property purchaser subsequently sold the property and paid the mortgage in full to the third party mortgagee. The third party mortgagee remitted the funds to the debtor. Approximately two months later, the debtor tendered the funds to a subsidiary of the third party mortgagee. After the debtor's transfer to the subsidiary, the third party mortgagee and its subsidiary entered into a mortgage service contract whereby the subsidiary would service the third party mortgagee's mortgages. The debtor then filed bankruptcy.

The bankruptcy court found that the transfer from debtor to the subsidiary/servicer was fraudulent pursuant to section 548 and granted judgment in favor of the trustee. On appeal to the district court, the servicer argued that the debtor received reasonably equivalent value indirectly from a third party, namely the third party mortgagee, and that the subsidiary/servicer was acting on behalf of the third party mortgagee in accepting payment. The district court held that the subsidiary/servicer lacked authority to receive payments on behalf of the third party mortgagee since the mortgage service contract did not exist at time of the transfer from the debtor to the subsidiary/servicer and in the alternative, even if the subsidiary was a legitimate loan servicer at the time of transfer, there was no mortgage to service since the underlying mortgage had been paid in full prior to the transfer from the debtor to the

subsidiary/servicer. The district court also noted that the transfer from the third party mortgagee to the debtor, on one hand, and the transfer from the debtor to the subsidiary/servicer, on the other hand, were two months apart. Therefore, the debtor could not have received reasonably equivalent value at the time of the transfer to the subsidiary/servicer under a theory of payment of indirect reasonably equivalent value.

With respect to whether the transfer from debtor to the subsidiary/servicer involved a transfer of an interest of the debtor in property, the subsidiary/servicer argued that the funds were held in constructive trust by the debtor for the benefit of the third party mortgagee. The court stated that, under Texas law, in order to establish a constructive trust, the movant must show the following: 1) a breach of a fiduciary relationship or, in the alternative, actual fraud, 2) unjust enrichment of the wrongdoer and 3) tracing of the property to an identifiable res. The subsidiary/servicer conceded that it could not show all the elements of a constructive trust but argued that under a more liberal standard, a constructive trust should be established to avoid unjust enrichment of the debtor.

The court found that, even assuming a liberal definition of constructive trust, because the subsidiary/servicer and the third party mortgagee did not have a contractual relationship at the time of the transfer from the debtor to the subsidiary/servicer, the subsidiary/servicer lacked authority to receive any funds allegedly held in constructive trust for the benefit of the third party mortgagee. The court also found that there was insufficient evidence that the funds were held in constructive trust by the debtor on behalf of the third party mortgagee or the subsidiary/servicer. Thus, the court found that a constructive trust did not exist and the funds were property of the estate of the debtor.

HOMESTEAD

Snyder v. Zayler, 309 B.R. 272; (E.D. Tex., April 27, 2004, Judge Leonard Davis)

Issue: Whether a debtor may claim as homestead a property transferred to her children in fraud of creditors, and as a sham transaction, where the debtor continues to reside in the property following the transfer, and does not otherwise abandon her interest in the homestead.

Nine months prior to bankruptcy, debtor deeded a residence and three tracts of land her children. Although the deeds purported to convey full legal title with no reservation of rights, debtor continued to live and reside on the property as she had done prior to the transfer. When debtor filed for Chapter 7 bankruptcy, she listed an “equitable interest in homestead -- previously transferred to children’s name” in her schedules. No objections were filed to the claimed homestead exemption within the 30-day period provided by Bankruptcy Procedure 4003. The Chapter 7 trustee filed an adversary proceeding against the transferees, but not against the debtor, to avoid the transfer to the children as a fraudulent transfer. The transferees did not file a response, resulting in the entry of a default judgment declaring that the tracts of land constituted property of the debtor’s bankruptcy estate, and that the debtor’s attempt to exempt the land was null and void by virtue of the previous transfer of the property.

On appeal to the district court, the court found that the trustee had failed to object to the debtor’s claimed homestead exemption within the 30-day time limit required by Bankruptcy Rule 4003. The court held that a trustee cannot contest the validity of a claimed exemption after the 30-day period has expired, even if the debtor has no colorable basis for claiming the exemption. Further, the court found that under Texas law, a conveyance of a homestead that has been simulated to shield the homestead from creditors is void, and a void transfer cannot constitute an abandonment of homestead right. The court agreed with the debtor that (1) the transfer of her homestead to her children was a sham transaction and therefore had no legal effect, (2) she still held a fee simple interest in the lots at the time of the bankruptcy filing, and (3)

the homestead exemption she could claim was to the fee simple interest. The district court therefore reversed the decision of the bankruptcy court, and rendered for the debtor as to the validity of her homestead exemption.

Jay v. Nesco Acceptance Corp. (In re Jay), 307 B.R. 864; (Bankr. N.D. Tex., March 10, 2004, Judge Robert L. Jones)

Issue: Whether subsequent lienholder was an innocent lienholder when grantor retained possession of property subject to lien.

The debtors acquired title to a certain tract of land and used such land to operate a service and convenience store. Thereafter, the debtors entered into a contract with a financier to construct improvements, namely a new service and convenience store, to the tract of land. In connection with the finance transaction, the debtors conveyed the tract to the financier and, along with other additional consideration between the parties, agreed to leaseback the property after the improvements were completed. Construction of the improvements was eventually completed and the debtors took possession of the property and began operating the new service and convenience store.

Approximately 16 months after the conveyance and after the debtors took possession of the property, the financier granted a lien on the property to a lender to secure a note. Thereafter, the lender sold its interests in the note and the lien to a third party purchaser. One day prior to the sale from the lender to the third party purchaser, the debtors filed a lis pendens covering the tract of land.

In a bifurcated trial, the bankruptcy court found that the conveyance from the debtors to the financier was a pretended sale of a business homestead and, under principles of equity, converted the deed to an improper mortgage lien against the tract of land. Thereafter, during the second trial, the third party purchaser, although it conceded that it was on notice of the homestead claim due to the filing of the lis pendens prior to its acquisition of the lien, argued that it was a bona fide purchaser for value since it succeeded to the position of the lender who was an innocent lienholder.

The court began its analysis by noting that generally, the shelter rule provides that “once a purchaser takes title to land without notice of an adverse party’s claim, subsequent purchasers for value in the chain of title are protected, regardless of their knowledge of a claim of an adverse party.” Once such a showing is made, the homestead claimant is estopped from invoking the claim of homestead against the subsequent purchaser. Thus, here, the validity of the third party purchaser’s lien depended on whether the lender held a valid lien as an innocent lender.

Under Texas law, a purported conveyance is void where the purported sale of homestead property is in violation of the Texas Constitution. A subsequent purchaser from the purported buyer, however, will trump the homestead claimant if the subsequent purchaser was a purchaser for value without knowledge of the facts giving rise to the homestead claim. “The same protections are afforded to an innocent lender who extends credit to the purported buyer without knowledge of the facts underlying” the homestead claim.

In the case at bar, the undisputed evidence showed that the lender lacked actual knowledge of the facts underlying the homestead claim. However, the court noted, the inquiry does not stop there. Texas law mandates that a lender is under a duty of inquiry that must be “prosecuted as far as a prudent man, having a due regard to the rights of others and to his own protection, would be bound to prosecute it.” A homestead claimant’s possession of property after a transfer places a lender upon inquiry as to whether the deed is absolute or is intended only as a mortgage. Thus, a prudent lender must “investigate the circumstances under which the purported sale was made, the status of the purchaser, the arrangements

made by the original owners for other housing, or any affirmative actions indicating abandonment.” The bankruptcy court, therefore, concluded that a third party purchaser or lender is under a duty of inquiry when the homestead claimant retains possession of the property subject to the lien being purchased. The third party purchaser or lender claiming the protection of the shelter rule bears the burden of showing, under these circumstances, that the duty of inquiry has been met. “Merely checking the record title” does not discharge the duty of inquiry.

Based on this standard, the bankruptcy court found that the third party purchaser failed to meet its burden of proving that the lender met the duty of inquiry since the record was devoid of evidence that the lender had made any inquiry into the circumstances surrounding the conveyance from the debtors to the financier. The debtors had retained possession of the property after the conveyance. The lender, had it conducted an inquiry, would have received constructive notice of the homestead claim. Thus, the debtors would not be estopped from asserting their homestead claim since the third party purchaser could not show that the lender was an innocent lender and therefore, it could not succeed to that position. Accordingly, the third party purchaser was not a bona fide purchaser and its claim for derivative protection under the shelter rule was denied.

JURISDICTION

L.D. Brinkman Corp. v. Anderco Carpet Co., Inc., (In re L.D. Brinkman Holdings, Inc.), 2004 WL 1304024; (Bankr. N.D. Tex., May 20, 2004, Judge Steven A. Felsenthal)

Issue: Whether personal jurisdiction in a federal bankruptcy adversary proceeding requires that the defendant has minimum contacts with the forum state, or whether bankruptcy nationwide service of process requires only minimum contacts with the United States.

Debtor filed an adversary proceeding against defendant to collect on a contract for the sale of goods. Defendant moved the court to dismiss a complaint for lack of personal jurisdiction under Rule 12(b)(2) of the Federal Rules. Defendant asserted that it had no contacts, other than the lawsuit, in the State of Texas and, as a result, may not be sued in the United States District Court for the Northern District of Texas. Defendant’s evidence showed defendant to be a California corporation, with its headquarters and only place of business in Los Angeles, California, and that defendant had not engaged in business in Texas. Defendant purchased vinyl flooring from the debtor, which was located in the debtor’s facilities in California. Defendant therefore argued that it had lacked minimum contacts with the State of Texas to meet the Fifth Amendment’s due process standards for personal jurisdiction.

The court found that to establish personal jurisdiction, it must be shown that defendant had minimum contacts with the forum and that the maintenance of the suit in the forum will not offend traditional notions of fair play and substantial justice. However when a federal court is attempting to exercise personal jurisdiction over a defendant in a suit based upon a federal statute providing for nationwide service of process, the relevant inquiry is not whether the defendant has minimum contacts with the forum state, but instead whether the defendant has had minimum contacts with the United States. The subject of bankruptcy law is exclusively a matter of federal law. With federal subject matter jurisdiction, which the court determined existed in this case, the determination of personal jurisdiction becomes a matter of federal contacts, not state contacts. The court found that the defendant had minimum contacts with the United States. The court further found that assumption of jurisdiction would not offend notions of fair play, as witnesses and documents could be easily transported, and because depositions could preserve testimony.

The bankruptcy process includes a provision for nationwide service of process to bring parties before the court under Bankruptcy Rule 7004(d). Having been properly served under Rule 7004(d), the court therefore held that it had personal jurisdiction over the defendant.

In re Martinez, 293 B.R. 387; (Bankr. N.D. Tex., May 21, 2003, Judge Robert L. Jones). **See case summary under topic (“EXEMPTIONS”) above.**

LIEN AVOIDANCE

In re Taylor, 297 B.R. 487; (Bankr. E.D. Tex., August 27, 2003, Judge Donald R. Sharp)

Issue: Whether a debtor whose Chapter 13 plan has been confirmed may subsequently modify that plan to provide for surrender of collateral securing an allowed secured claim of a creditor in full satisfaction of the secured portion of that claim and reclassify the deficiency as an unsecured claim.

Chapter 13 debtors confirmed a Chapter 13 Plan which included the claim of a creditor secured by an automobile to be paid over the life of the plan. Three weeks into the plan term the debtors voluntarily surrendered the vehicle to the creditor, complaining of mechanical failure. The creditor took possession of and sold it at auction. Debtors then filed the motion to modify their plan post-confirmation on the basis that the plan in its current form was not feasible and had to be modified to provide for the surrender of the car to the creditor. Debtors proposed to pay the creditor’s secured claim in the amount that the creditor had already received prior to the surrender of the vehicle, and to treat any deficiency in accordance with the treatment of other general unsecured creditors. The creditor filed a response, stating that the debtors should remain liable for the difference between the value realized by the auction sale and the outstanding principal amount of the secured claim under the confirmed plan.

The court found the issue before the court was a matter of first impression in the Fifth Circuit, and one upon which the Fifth Circuit had not ruled previously. Although the court found the case law split on the issue, the court found that the decision in this case was fact driven and specific. Upon confirmation, a plan is binding on the debtor and each creditor under section 1327(a). However, section 1329(a) creates a statutory exception to the binding effect of a confirmed chapter 13 plan because it authorizes certain post-confirmation modifications to such a plan. Under the facts of this case, after the filing of pleadings on this issue the creditor took possession of the vehicle. In so doing, it received the indubitable equivalent of its claim. It then liquidated its collateral and reduced the indubitable equivalent to cash proceeds. Thus, the court found that as a result of having sold the vehicle at auction the creditor received payment on its claim; in effect finding a novation between the parties. Unlike many of the reported decisions on this issue, debtor was not seeking to surrender a vehicle. It was already surrendered and sold. The court held that because there can be no secured debt if there is no collateral, the court had no alternative but to allow modification of the confirmed plan for the limited purpose of taking account of the payment received by the creditor by selling its collateral at auction. The court therefore held that the amount of secured creditor payments under the plan would be reduced to zero.

PROCEDURE

Seidel v. McLaughlin (In re Western Natural Gas, L.L.C.), 43 Bankr. Ct. Dec. 86, 2004 WL 1945312 (Bankr. N.D. Tex., Judge Steven A. Felsenthal)

Issue: Whether counts of a complaint should be dismissed for failure to state a claim under Federal Rule 12(b)(6).

A Chapter 7 bankruptcy trustee filed suit against certain directors, officers and/or shareholders of the corporate debtor, alleging that the defendants authorized and/or failed to protect the debtor from improper preferential and fraudulent transfers, that the defendants authorized improper loans to or on behalf of insiders, in violation of their fiduciary duties to the debtor, and that the defendants approved transactions resulting in a conflict of interest and a violation of their duty of loyalty and care to the debtor. The trustee further alleged claims for breach of trust fund duties, breach of fiduciary duty, negligence and gross negligence, exemplary damages and attorney's fees. One of the defendants filed a motion under Federal Rules 8(a) and 12(b)(6) to dismiss the complaint.

The district court reviewed the sufficiency of each count alleged in the complaint. The first count alleged a claim premised on the Texas trust fund doctrine. Texas law imposes certain fiduciary duties on an officer and/or director of a corporation. For a solvent corporation, the duty applies to the corporation and its shareholders. Upon insolvency, the fiduciary duty owed to the shareholders may shift to the creditors under the Texas trust fund doctrine when a corporation (1) becomes insolvent and (2) ceases doing business. Although the complaint alleged that the debtor was insolvent during all relevant times, the complaint failed to allege that the debtor had ceased doing business during the relevant times. The court therefore held that the count (for purposes of Rule 12(b)(6)) did not state a claim under the trust fund doctrine. In the second count, the complaint alleged that defendants were directors and officers of the debtor and, while acting in that capacity, breached their fiduciary duty to the debtor. However, the court found that the complaint did not state a short and plain statement of the claim as it pertains to the movant/defendant. The complaint did not specifically allege that he was an officer or director at the time of the transactions. As a result, the complaint failed to comply with Rule 8(a) and, consequently, did not state a claim for relief.

In count three, the court found that the complaint alleged claims for negligence and gross negligence, but did not lodge any specific allegation against the movant/defendant. As a result, the court found that the complaint did not comply with Rule 8(a) and, consequently, did not state a claim for relief. As to count four and five, for exemplary damages and attorneys fees, respectively, the court likewise dismissed. However, because Federal Rule 15(a) requires leave to amend to be granted freely, and because no party would be prejudiced, the court granted the trustee's request for leave to amend to appropriately state claims against the movant/defendant.

Weisbart v. Sanger Bank (In re Tilton), 297 B.R. 478; (Bankr. E.D. Tex., June 30, 2003, Judge Donald R. Sharp)

Issue: Whether a Chapter 7 trustee could avoid a bank's liens on real estate pursuant to section 544(a)(3) where more than 4 years had passed following the maturity date of a recorded note and deed of trust, where the bank had failed to record a written extension of the note and deed of trust.

Debtor executed a note to a bank, secured by real estate. The deed of trust was properly recorded. The note provided a maturity date in December 1995. In March 1998 the debtor and the bank executed documents to extend the note and lien, but failed to record the documents. Debtor filed for Chapter 7 bankruptcy in June 2001. The bankruptcy trustee filed a Complaint To Avoid Lien and for Declaratory Relief and Objection To Claim against the bank, alleging that the real property lien was avoidable under section 544(a)(1) or (3).

The bankruptcy court agreed with the trustee, and granted summary judgment avoiding the lien. The court found that the trustee acquired the power to avoid the lien under section 544(a)(1) as a judicial lien creditor and also under sub-section (a)(3) as a bona fide purchaser as of the commencement of the case. Under Tex. Civil Practice & Remedies Code sections 16.035(a) and 16.035(e) the statute of limitations on a note runs from the date of the maturity of the note. Where no extension or renewal agreement is recorded and lien debt appears four years past due, such agreement is void against a bona fide purchaser. The bank argued that a trustee in bankruptcy should be charged with implied knowledge of the unrecorded extension by inquiry notice thus defeating his status as a bona fide purchaser in good faith. The court disagreed, finding that in the instant case the recorded document affirmatively showed that it had matured in 1995. The absence of any document extending that maturity date or the absences of any action to enforce the security interest within the statutory period of four years created by Texas law was not ambiguous. The court therefore granted summary judgment avoiding the lien against the real property.

PROPERTY OF THE ESTATE

Brown v. Chesnut (In re Chesnut), 311 B.R. 446 (N.D. Tex., July 1, 2004, Judge John H. McBryde)

Issue: Whether a Chapter 13 debtor had a sufficient interest in property purchased by and titled only in his non-filing spouse as her separate property so as to trigger protections of automatic stay in the debtor's bankruptcy case.

Debtor married his wife when he was 24 years old with no assets, and when his wife was 50 years old and had accumulated assets prior to the marriage. During the pendency of debtor's first Chapter 13 bankruptcy case, which his wife did not join, wife acquired certain real property by a deed reciting that the property was being granted to her as her sole and separate property and estate. Wife signed a real estate lien note reflecting that the property was her separate property, and a title policy was issued reflecting that the property was her separate property. Debtor did not have, and had never had, any recorded interest in the property. Following default on the note, the secured lender gave appropriate notices and began the process of foreclosure. Just prior to the foreclosure sale, debtor filed his second Chapter 13 bankruptcy proceeding and gave notice of the filing to appellants. Debtor and his attorney informed lender's counsel that debtor claimed a community property interest in the property, and faxed copies of the two-page voluntary petition filed by debtor. Believing that the property was the wife's separate property, the lender went forward with the foreclosure sale without permission from the bankruptcy court in the debtor's Chapter 13 case.

Debtor filed an adversary proceeding against lender, alleging that they had wrongfully foreclosed on the property in violation of the automatic stay. Following trial, the bankruptcy court entered a judgment sanctioning appellants for having willfully violated the automatic stay and ordering them to pay \$10,000.00 into the registry of the court and to reconvey the property to the wife. Lender appealed to the district court.

On appeal, lender argued 1) the bankruptcy court erred in holding that appellants willfully violated the automatic stay; 2) the bankruptcy court erred in holding that debtor held an interest in the property; and 3) the bankruptcy court erred in failing to hold that debtor was estopped to claim an interest in the property. The district court held that the bankruptcy court erred in holding that the mere fact that debtor gave notice of his bankruptcy filing and said that he claimed an interest in the property was enough to stop the foreclosure sale. The bankruptcy court in effect ruled that property acquired during marriage is community property despite how it is titled. To the contrary, the district court ruled that property acquired during marriage acquires its status of separate or community at the time of its acquisition, and

that the act of the spouses in taking a conveyance of property in the name of the wife, limiting the title to her separate use, unmistakably evidences an intention that the same shall belong to her separate estate. Extrinsic evidence cannot be offered to contradict the express recitals in a deed without first tendering competent evidence that there was fraud, accident, or mistake in the insertion of the recitals in the deed. No such evidence had been presented before the bankruptcy court. The court found that at most, debtor could have a claim for economic contribution, which does not create an ownership interest in property.

Having found that the debtor's bankruptcy estate had no interest in the property, the district court found that there could have been no violation of the automatic stay. The district court therefore reversed the decision of the bankruptcy court.

Homecomings Fin. Network, Inc. v. Litzler, 2004 WL 614845; (N.D. Tex., Feb. 25, 2004, Judge Sam A. Lindsay). **See case summary under topic ("FRADULENT TRANSFER") above.**

SANCTIONS

Hassell v. United States (In re Hassell), 2004 WL 790227; (Bankr. N.D. Tex., February 20, 2004, Judge Harlin D. Hale)

Issue: Whether a complaint should be stricken under Rule 12(f) of the Federal Rules of Civil Procedure, and whether the debtor should be enjoined from filing further actions seeking to relitigate tax issues previously adjudicated in the bankruptcy court as well as other courts.

A debtor filed an affidavit of criminal complaint with the bankruptcy court, making extraordinary claims against a U.S. District Judge, various counsel for the Justice Department, and agents of the IRS. The IRS filed a motion to strike and also sought monetary sanctions and injunctive relief. The debtor's arguments before the court included general disagreements with the government's power to collect taxes, and contests over taxes already adjudicated by the bankruptcy court and other courts, including appeal, to which collateral estoppel applied. Based on the debtor's actions, the court struck the complaint under Rule 12(f) of the Federal Rules of Civil Procedure, and enjoined the debtor from filing in the bankruptcy court any pleadings which would attempt to relitigate his federal tax liabilities or challenge the amount thereof.

SECURED TRANSACTIONS

Quisenberry v. American State Bank (In re Quisenberry), 295 B.R. 855; (Bankr. N.D. Tex., June 30, 2003, Judge Robert L. Jones). **See case summary under topic "SETOFF" below.**

SETOFF

Quisenberry v. American State Bank (In re Quisenberry), 295 B.R. 855; (Bankr. N.D. Tex., June 30, 2003, Judge Robert L. Jones)

Issue: Whether a bank's loan documents granted it a security interest in the debtor's checking account.

Issue: Whether a debtor was entitled to recover from a bank the amount that the bank setoff exempt funds from the debtors' checking account against a deficiency on a truck loan.

Debtor obtained a loan from a bank secured by 2 trucks. Unable to make the scheduled payments on the truck loan, debtor voluntarily surrendered one of the trucks. Debtor later attempted to cash a check at the bank. The bank instead seized the check and applied it against the balance remaining on the truck loan as an exercise of the bank's setoff rights. After debtor filed a Chapter 13 bankruptcy petition, she has listed the check proceeds as an asset on her schedules, and claimed a portion to be exempt. No party in interest has filed an objection to debtor's claim of exemptions. Debtor filed an adversary proceeding against the bank requesting a turnover, under section 542, of funds exempted under section 522. The first question before the court was whether, and to what extent, debtor could avoid or recover the offset funds under sections 547(b) or 553(b).

The bank argued that by applying the funds against the truck loan, it did not merely exercise its general right of setoff, but instead foreclosed on an alleged security interest in debtor's checking account. The bank next argued that the recovery and avoidance provisions of section 547(b) and section 553(b) do not extend to valid prepetition foreclosures of security interests. The issue before the court was, therefore, whether the bank had a proper security interest in the checking account, which would be governed by Texas law. The bank alleged that its security interest may have arisen in one of two ways: First, by operation of law by virtue of its setoff rights, and second, by virtue of a consensual security interest in her checking account.

The court disagreed with the bank, holding first that the right to setoff is not the equivalent of a security interest or lien. Next, the bank reviewed the lien documentation to determine whether the bank had been granted a security interest in the debtor's checking account. In construing a security agreement, the primary role of the court is to ascertain the true intent of the parties, determined objectively. The court found that the "Collateral Description" section of the security agreement on the truck loan nowhere mentioned debtor's specific checking account or deposit accounts in general. The court therefore concluded that the parties did not intend for the bank to hold a security interest in debtor's checking account.

The court next addressed whether the Chapter 13 debtor had standing to bring the adversary proceeding against the bank. As an initial matter, sections 553(b) and 547(b) authorize the trustee to recover certain prepetition transfers. However, section 522(h) grants the debtor standing to recover a setoff of exempt property. The court therefore found that the debtor had standing to bring the action to recover the portion of the funds that were properly exempted. The court finally held that in performing the mathematical calculation contained in section 553(b), the debtor was entitled to recover from the exempt portion of the funds setoff by the bank within 90 days preceding bankruptcy.

SETTLEMENT

Gibbs & Bruns, L.L.P. v. Coho Liquidating Trust (In re Coho Energy, Inc.), 2004 WL 258222; (N.D. Tex., Feb. 9, 2004, Judge Ed Kinkeade)

Issue: Whether the bankruptcy court erred in requiring liquidating trust to obtain court approval for post-confirmation settlement.

Prior to plan confirmation, the bankruptcy court awarded attorneys' fees to appellant and other counsel. The debtor objected only to the award to the other counsel. The bankruptcy court subsequently

vacated its original order and reduced the fees awarded to both counsel. Appellant appealed and the district court vacated the order reducing the attorneys' fees awarded to appellant holding that the bankruptcy court lacked jurisdiction to reduce award to appellant. The debtor appealed the fee award to the Fifth Circuit Court of Appeals.

Prior to the district court's ruling on the reduction of attorneys' fees, the bankruptcy court confirmed a liquidating plan of reorganization whereby all of the property interests of the debtor were transferred to a liquidating trust and a trustee was appointed. After confirmation and the district court's ruling on attorneys' fees, the liquidating trust and appellant reached a settlement to resolve the attorneys' fees dispute. The liquidating trust requested release of the settlement funds from the court's registry; however, the bankruptcy court refused the request and directed the liquidating trust to file a motion to approve the settlement agreement pursuant to Fed. R. Bankr. P. 9019. The bankruptcy court subsequently denied the Rule 9019 motion and the parties appealed.

The district court found that the bankruptcy court abused its discretion by "requiring approval of the settlement and refusing to approve the settlement or release the settlement funds." The district court began its analysis by noting the basic tenets that upon confirmation of a Chapter 11 plan all property of the estate vests in the reorganized debtor and that a Chapter 11 plan is binding on all parties. The district court reasoned that because the liquidating plan provided that the trustee 1) could use, acquire and dispose of all property of the reorganized debtor "free of any restrictions imposed under the Bankruptcy Code," 2) had authority to "convey, transfer and assign any and all property" of the reorganized debtor, and 3) had "authority to settle all causes of action" against the debtor, the bankruptcy court "did not have the duty nor the power to interfere" with the settlement.

TAXES

United States v. Galletti, 124 S.Ct. 1548; (US, March 23, 2004, Justice Thomas)

Issue: Whether a proper tax assessment by the IRS against a partnership, under 26 U.S.C. §6501(a), is sufficient to extend statute of limitations to ten years to collect tax in a judicial proceeding under 26 U.S.C. §6502(a) from general partners who are liable for payment of partnership's debts as a matter of state law, where the partners individually were not assessed.

Under section 6501(a) of the Internal Revenue Code, employment taxes must be assessed within three years after the return is filed in order to extend the statute of limitations for collecting the tax by ten years under section 6502(a). In this case, debtors were general partners of a partnership that failed to pay federal employment taxes. The IRS timely assessed the partnership, but not the partners. After debtors filed for bankruptcy under Chapter 13, IRS filed proof of claims in their bankruptcy cases for the partnership's unpaid employment taxes. Debtors objected, arguing that the timely assessment of the partnership did not extend the 3-year limitations period against the general partners who had not been separately assessed within that period. The bankruptcy court and the district court agreed, and the Ninth Circuit affirmed, holding that the debtors were "taxpayers" that needed to be assessed in order to extend the limitation period.

On appeal, the Supreme Court reversed, holding that a proper tax assessment by the IRS against a partnership is sufficient to extend statute of limitations to ten years to collect tax in a judicial proceeding from general partners who are liable for payment of partnership's debts. The Court found that the partnership was the "employer," and that the Internal Revenue Code makes clear that the "employer" that fails to withhold and submit the requisite employment taxes is the liable taxpayer that must be assessed in order to extend the collection limitation period. The Internal Revenue Code does not require the IRS to

make separate assessments of a single tax debt against persons or entities secondarily liable for that debt in order for section 6502's extended limitations period to apply to judicial collection actions against those persons or entities.

TRUSTEES

Commercial Finish Group, Inc. v. Milbank, 2003 WL 22038328, (N.D. Tex., August 29, 2003, Judge Sam A. Lindsay).

Issue: Whether a Chapter 7 trustee should be paid the maximum amount of compensation under section 326(a), or whether such compensation should be awarded under section 330(a)(3).

Issue: Whether a Chapter 7 trustee should be reimbursed, under section 330(a)(1), for fees and expenses of a paraprofessional.

A Chapter 7 debtor's principal asset was an apartment complex. The Chapter 7 trustee operated and ultimately sold the property, achieving equity in the estate in the amount of \$262,000 and a reduction in claims of \$1,350,000. The trustee filed a final report and application for compensation under section 330(a), and requested \$102,000 as the compensation that would be permitted by section 326(a). The hourly lodestar amount would have been \$40,000. The trustee also applied for reimbursement for work done by his paraprofessional, accountant, and secretary, in the administering of the bankruptcy estate, including administrative work done for the trustee's operation of the property. The bankruptcy court granted the trustee's section 326(a) request, as well as the reimbursement for the actual and necessary expenses of the paraprofessional, including her overhead and secretarial costs.

On appeal, the district court first determined whether the bankruptcy court correctly awarded compensation to the trustee for his services as a trustee under sections 326(a) and 330(a)(3). The court concluded that the bankruptcy court had correctly held that the trustee could include in his commission the proceeds distributed by a title company to creditors from the sale of the property from the bankruptcy estate. The use of a title company to disburse money from the estate does not preclude payment under section 326(a), i.e., the money does not have to actually pass through the trustee's hands. However, the court next held that section 326(a) creates a ceiling on a trustee's compensation and not an entitlement to the maximum amount. Instead, the district court found that the applicable statute for setting a trustee's compensation is section 330(a)(3), and that a strong presumption exists that the lodestar figure represents a reasonable fee. Doubling a lodestar has occurred for only "rare and exceptional work." The district court therefore held that the bankruptcy court erred when it enhanced the trustee's compensation from the lodestar of \$40,000 to the requested \$102,000, because it did not overcome the strong presumption that the lodestar constituted reasonable compensation. Instead, the district court increased the trustee's hourly rate of \$250 to \$350 per hour as the customary compensation charged by comparably skilled practitioners. The district court therefore held that the appropriate fee would be \$56,000.

The court next held that the bankruptcy court properly awarded the trustee reimbursement for the paraprofessional's time under section 330(a)(1). Bankruptcy courts have wide latitude to set reasonable compensation within the strictures of section 330(a)(1). The court found no Fifth Circuit authority which allows or bars inclusion of a paraprofessional's work as an "actual, necessary expense" when it is secretarial or clerical work, but determined that the bankruptcy court's decision was within its wide latitude to set reasonable compensation because authority exists to support its reimbursement of secretarial and clerical expenses and evidence adduced at the evidentiary hearing provided necessary documentation for the reimbursement.

Ginn v. Seidell (In re Allied Physicians Group, P.A.), 2003 WL 21149493; (N.D. Tex., May 16, 2003, Judge A. Joe Fish)

Issue: Whether the bankruptcy court erred in granting summary judgment ordering a disgorgement of all fees of a liquidating Chapter 11 plan agent for various breaches of fiduciary duty.

The bankruptcy court approved a plan for the liquidation and distribution of corporate debtors' assets to their creditors, pursuant to which a plan agent was appointed. The plan agent was responsible for implementing the directives of the liquidation plan and was solely responsible for management and distribution of the debtors' assets. In a motion to show cause, the United States Trustee alleged that the plan agent had failed to comply with the terms of the liquidation plan and improperly authorized fees for himself and other professionals. Following a show cause hearing, the bankruptcy court entered an order requiring the plan agent to disgorge all fees previously paid and converted the case to Chapter 7. In connection with that ruling, the bankruptcy court held that the plan agent owed creditors a duty as a fiduciary under the liquidation plan, that the plan agent failed to hold the estate's assets in a depository approved by the United States Trustee and improperly lent \$300,000 of estate funds to a friend. It further found that the plan agent failed to comply with the terms of the liquidation plan regarding the payment of professional fees and that the plan agent improperly appointed professional associates as members of an advisory committee created by the liquidation plan.

The plan agent appealed the bankruptcy court's ruling and findings, which were affirmed on such appeal. The plan agent then appealed to the Fifth Circuit, which dismissed the appeal for lack of jurisdiction. The Chapter 7 trustee then filed a motion for summary judgment asking the bankruptcy court to find that the plan agent breached his fiduciary duty and therefore forfeited his compensation. The motion for summary judgment was granted by the bankruptcy court. The plan agent again appealed to the district court, this time by filing 2 appeals - one to seek review of the disgorgement order and findings, and the other to seek review of the bankruptcy court's summary judgment orders.

The court found that the first appeal, having already been appealed and affirmed by the district court, was subject to the doctrine of the "law of the case. The law of the case doctrine bars an appellate court from reexamining an issue of fact or law decided in a previous appeal. The primary goal of this doctrine is to maintain consistency and avoid needless reconsideration of matters once decided during the course of a single continuing lawsuit. With respect to the second appeal, the district court likewise affirmed the bankruptcy court. The plan agent argued that because the liquidation plan did not contain the words "fiduciary" or "trust," he could not be characterized as a fiduciary. The district court disagreed, finding that given the level of responsibility and control exercised by the plan agent over the assets of the debtors' estate and his decision to lend estate funds in violation of the express terms of the liquidation plan, the bankruptcy court properly concluded that the plan agent owed a fiduciary duty which he later breached.

Once a breach of fiduciary duty is found, Texas law does not require proof of injury or causation where the remedy sought is partial or complete forfeiture. An agent's breach of fiduciary duty should be deterred even when the principal is not damaged.

In re Network Staffing Services, Inc., 43 Bankr.Ct.Dec. 85, 2004 WL 1945314 (Bankr. N.D. Tex., July 16, 2004, Judge Steven A. Felsenthal)

Issue: The appropriate amount of fees and expenses to be awarded to a Chapter 11 trustee, under the facts of the case.

A Chapter 11 trustee filed an application for final trustee compensation and reimbursement of expenses, to which an objection was filed. The application requested compensation of \$76,706 plus expenses, with an agreed reduction to \$60,000. However, because the objector elected to contest his application, the trustee requested that he be awarded compensation based on section 326(a), which provides for the maximum compensation of a trustee based on the formula contained therein. In making its determination under section 326(a), the court found, however, that it must determine reasonable compensation not to exceed that limit. In evaluating the facts of the case, the court found that this was not a case that would warrant the award of the full commission under section 326(a). The court found that while assuming a chief executive officer of the debtor would earn \$115,000 per year, the trustee spent only about twelve percent of the year working as the trustee, justifying earnings of only \$13,800. The court therefore declined to award the section 326(a) commission.

Consequently, having rejected the section 326 commission, the court made a determination of a reasonable compensation for the trustee under section 330(a). To determine reasonable compensation, the court must determine the nature and extent of the services supplied by the attorneys, and must also assess the value of those services in relation to the customary fee and the quality of the work. These two factors comprise the components for the lodestar calculation. The court may then adjust the compensation based on the factors of sections 330(a)(3) and (4) case law standards. Under the present facts, the court found that a reasonable blended rate for the fees requested by the trustee was \$249 per hour. This rate, multiplied by the hours found by the court, plus the expenses requested, generated a total of fees and expenses in the amount of \$60,000, the trustee's original request as voluntarily reduced.