NOTABLE CASES FROM JUDGE HARLIN DeWAYNE HALE
United States Bankruptcy Judge for the Northern District of Texas
Dallas & Wichita Falls Divisions

1. In re WALL007 LLC, et al., 20-31131-HDH7 November 23, 2020 [Dkt. No. 287]

In this involuntary chapter 11 case, the Court issued an oral ruling disposing of four outstanding discovery motions and ordered "Petitioning Creditors" to appear for depositions to be taken in person, in the United States. The Petitioning Creditors were Chinese nationals residing in mainland China. The Court required that there be an agreement signed by counsel for the Petitioning Creditors that they would appear for their depositions. The Petitioning Creditors appealed those "Discovery Orders." Recognizing the fact that the "Alleged Debtors" were stuck in an involuntary bankruptcy that affected them and other parties as well, the Court ordered that the cases would be dismissed without prejudice if the Petitioning Creditors had not (1) filed a required Deposition Agreement or (2) obtained a stay of the Discovery Orders pending appeal.

The Court reviewed what petitioners must show in the filing of an involuntary bankruptcy. The Alleged Debtors were in the business of acquiring land in order to construct improvements necessary to create a residential subdivision. They entered into loan agreements with the Alleged Debtors. The Alleged Debtors failed to pay back the loans where required. The Alleged Debtors contended, among other things, that not all of the Petitioning Creditors voluntarily participated in the case and may not even be "real persons." And many of them resided in China. The Court and the parties "spent a great deal of time and effort trying to find a satisfactory method of verifying the identity and general participation of the Petitioning Creditors, but the efforts have fallen short." At further issue was whether or not the Petitioning Creditors were in possession of "wet ink signature petitions." Toward that end, the Alleged Debtors prepared a chart allegedly showing those signatures. However, the signatures from various sources didn't resemble the signatures of the Petitioning Creditors in these cases. Apparently, a slew of emails addressing the issue were generally in Chinese. This all led the Court to state that it believed "it is almost always true that a party that files an involuntary bankruptcy petition must be prepared to be deposed in order to provide evidentiary support for the petition..." Then there was the issue of whether or not the depositions should be taken in China. The Court determined that the depositions of the Petitioning Creditors were necessary and that conducting the depositions in the United States would be difficult but possible while conducting the depositions in China, even by video, might have been illegal.

To further complicate matters, while all this was going on one of the lenders that held a note and lien on some of the alleged debtors raw land filed a motion for relief from stay and sought to foreclose its lien. And as Judge so pithily put it, "the Alleged Debtors and other creditors are being adversely impacted while these cases remain parked." The Court therefore ordered that unless a Deposition Agreement was filed by December 4, 2020, or a stay of the Discovery Orders was obtained pending appeal, the case would be dismissed.

2. In re Rodriguez, 2020 WL 6737430 (Bankr. N.D. Tex. 2020)

Spencer Naquin filed complaints against Terra Elizabeth Rodriguez and Richard Rodriguez

seeking determinations that they were liable for barratry and that his claims against them were non-dischargeable in the chapter 7 that they subsequently filed. Mr. Naquin was involved in a car accident and was taken by ambulance to a hospital where he received treatment. He did not initiate contact with an attorney to seek legal assistance.

A week and a half later, Mr. Naquin received a voicemail at his work from an unidentified female who discussed the possibility of his engaging the law office of Jeremy C. Anderson for representation in connection with damages and claims arising out of the car accident. He returned that call but did not get the identity of the female caller who left the voicemail or the female with whom he spoke in the "return call." He did indicate that he would like to receive more information about how the process worked. Subsequently, Attorney Rodriguez sent Mr. Naquin several documents to sign including an Engagement Agreement for Anderson Law to represent him in connection with the wreck. As it turned out, Anderson Law filed a claim against Mr. Naquin's automobile insurer and was able to recover $2,500.00 for Mr. Naquin from which Anderson Law retained a contingent fee of $800.33. Thereafter, Terra Rodriguez and Richard Rodriguez filed their own bankruptcy case. Mr. Naquin asserted claims against them for barratry and sought a determination that those claims were non-dischargeable.

The Court discussed the criminal prohibition of barratry codified in section 38.12 of the Texas Penal Code. It also discussed civil liability for prohibited barratry as codified in section 82.0651 of the Texas Government Code. The civil barratry statute recognizes that non-attorneys can commit barratry. The Court found that Mr. Naquin failed to show that Richard Rodriguez ever solicited employment and that the only thing Naquin did was to request more detail about how the process would work.

Accordingly, the Court concluded that Mr. Naquin did not have a claim against Terra Rodriguez or Richard Rodriguez for barratry and, with no underlying claims, the Court didn't need to discuss whether or not those claims would be dischargeable in bankruptcy. The Court did note that "barratry claims are a somewhat awkward fit for sections 523(a)(2)(A) and 523 (a)(6) of the Bankruptcy Code, but it is not clear that they do not fit." Judgment was entered in favor of Mr. & Mrs. Rodriguez.

3. Tuesday Morning Corporation, et al, 20-3146-HDH11 September 18, 2020 [Dkt. No. 892]

In the Tuesday Morning Corporation chapter 11, Judge considered and denied two requests for the appointment of an official committee of equity security holders. However, at the conclusion of the hearing resulting in the second denial, he noted that he would *sua sponte* reconsider that ruling if the interest of the shareholders by virtue of subsequent events changed that analysis. He later determined that they had.

At the conclusion of the hearing on the Second Equity Committee's Motion, the debtors filed what was referred to as the "Milestone Stipulation" extending the deadline by which they were required to file either (a) chapter 11 plan, disclosure statement and a motion seeking approval of same or (b) a motion to approve a sale of substantially all of the debtors assets. The creditors committee swiftly objected to that Milestone Stipulation noting that there were at least three proposals from potential purchasers which would appear to provide a significant and meaningful

recovery to the debtors unsecured creditors. The debtors responded contending that they were "engaged in the parallel processes" of trying to put together their plan while at the same time determining whether or not a 363 sale would bring greater value to the estate. Apparently, they had entered into non-disclosure agreements with 40 prospective buyers.

The Court went through the factors that needed to be considered in determining whether or not to appoint additional committees of creditors or of equity security holders. Those four factors are: (1) the debtors are likely to prove solvent; (2) equity owners are adequately represented by stake holders already at the table; (3) the complexity of the cases; and (4) the likely cost to the debtors bankruptcy estates if an equity committee were to be appointed.

The Court went on to find that the complexity of the cases had not changed but the time frame in which the parties needed to evaluate and negotiate the range of exit strategies had been compressed and the complexity of the cases leaned in favor of the appointment of an equity committee. Also, the cost to the debtors estates official equity committee did not lean heavily for or against the appointment of an equity committee. And while the appointment of an equity committee would obviously add administrative expenses in the cases, it could also streamline the efforts of the shareholders and make them more efficient. Accordingly, the Court believed it necessary to appoint an equity committee in order to "insure that equity holders are able to participate meaningfully in the sale and plan processes in a streamlined and efficient way."

4. EFO Holdings, LP, 21-03091-HDH March 14, 2022 [Dkt. No. 15]

In this chapter 7 case, the Court described the matter before it as "deceptively complicated." The chapter 7 trustee filed an adversary proceeding seeking to declare certain legal malpractice claims as property of the bankruptcy estate and not property of the Debtor. Back in 2006, alleged mistakes made by Debtor's attorneys resulted in a judgment against the Debtor in November of 2012. A month later, the Debtor filed chapter 7. However, the judgment was appealed and the appellate process was not concluded until years later. The issue as framed by the Court centered on when the claims accrued under Florida law which was the applicable state law in the case. The Debtor argued that the allegedly wrongful conduct took place pre-petition and the adverse judgment was entered pre-petition but the malpractice claims did not accrue until post-petition and therefore belonged to the Debtor and not the bankruptcy estate. The question boiled down to whether or not the Debtor had a property interest in the cause of action at the time it filed bankruptcy where applicable state law appeared to recognize a property interest in legal malpractice claims prior to accrual.

The Court noted that Section 541 of the Bankruptcy Code creates the bankruptcy estate and includes "all legal or equitable interests of the debtor in property as to the commencement of the case." However, causes of action acquired after the commencement of the case belong to the Debtor. In determining when a cause of action arises, the Fifth Circuit had determined that it is a matter of accrual.

Under Florida law, the Debtor cited four cases that a claim for legal malpractice in the litigation context does not accrue until the litigation is concluded by final judgment and the time for filing post-judgment motions are in appeal has expired. The Court summarized those four

cases and concluded that the Supreme Court of Florida generally found that the date on which a cause of action for legal malpractice in the litigation context accrues and the date on which the statute of limitations begins to run are one and the same. However, the Court went on to cite another case that there may be a property interest in a malpractice claim in the litigation context even prior to the conclusion of an appellate process. Law Office of David J. Stern, P.A. v Sec. Nat'l Servicing Corp., 969 So. 2d 962 (Fla 2007). The Florida Supreme Court in Stern devoted its entire opinion to discussing whether an interest in the malpractice claim "was transferred years before the adverse outcome in the underlying litigation became final." At no point did any of the justices say there was nothing to be transferred or assigned. The Stern opinion made clear that while a cause of action for legal malpractice did not accrue prior to the note being assigned, there was clearly "some legal or equitable interest in a malpractice claim" to assign at that time. Therefore, Judge Hale concluded that Florida recognized a property interest in a malpractice cause of action that existed prior to the litigation being concluded and before the judgment became final. The claim belonged to the chapter 7 estate and not the debtor. The Court therefore denied the Debtor's motion to dismiss the trustee's adversary proceeding.

5. In re National Rifle Association of America and Sea Girt LLC, 628 D.R. 262 (Bankr. N.D. Tex. 2021)

The National Rifle Association of America ("NRA") filed a chapter 11. The NRA's filing resulted in a multiple Motions to Dismiss filed by numerous creditors, the IRS and the Attorney Generals from the District of Columbia and New York. Judge Hale framed the question before the Court as whether the NRA's filing was the result of an existential threat facing the NRA and the type of threat that the Bankruptcy Code was meant to protect against. The Court believed that it was not.

The Court found that the filing was not a good faith filing because it was filed to gain an unfair litigation advantage and to avoid a state regulatory scheme. Following the chapter 11 filing, the many parties involved in the case engaged in extensive discovery. The unsecured creditors committee sought the appointment of a trustee with "limited powers." It also wanted the appointment of a Chief Restructuring Officer. Sixteen states filed briefs in support of the NRA and the State of Texas submitted its own brief in support of the NRA. The movants generally sought three forms of relief: dismissal, the appointment of a Chapter 11 trustee, or the appointment of an examiner. The opinion engages in a good discussion of the Fifth Circuit's determination that dismissal "for cause" affords flexibility to the Bankruptcy Courts and can include the finding that the debtor's filing for relief was not in good faith. In re Little Creek Dev. Co., 779 F2d 1068 (5th Cir 1986). If a prima facie showing of a lack of good faith filing is made, the burden then shifts to the debtor to demonstrate good faith. In re Mirant Corp. 2005 Bankr. LEXIS 1686 (Bankr. N.D. Tex 2005). A chapter 11 is not filed in good faith "unless it serves a valid bankruptcy purpose."

Apparently, the NRA's chapter 11 filing was mainly because it wanted to get out of New York and stop the New York Attorney General's enforcement actions. The real purpose for the bankruptcy filing was not for financial reasons. Indeed the NRA's CFO who "was fully aware of the banking and insurance relationships testified that he was not aware of any reasons to file for bankruptcy." The Court found that the primary purpose of the bankruptcy filing was to avoid its potential dissolution as a result of the New York attorney general's enforcement action. The NRA

was financially healthy and the purpose of its filing was not like traditional bankruptcy case filings in which the debtor is faced with financial difficulties or a judgment that it cannot satisfy but "more like cases in which courts have found bankruptcy was filed to gain an unfair advantage in litigation or to avoid a regulatory scheme." And when it is determined that a bankruptcy case has been filed for the purpose of obtaining an unfair litigation advantage, it is not filed in good faith and should be dismissed. This was further exacerbated by the fact that the NRA was financially healthy. Based on the totality of the circumstances, the NRA's bankruptcy petition was not filed in good faith but instead was filed in an effort to gain an unfair litigation advantage in the New York attorney general's enforcement action and as an effort to avoid a regulatory scheme. That was cause for dismissal.

The Court went on to discuss lingering issues of secrecy and lack of transparency and the "surreptitious manner" in which Wayne LaPierre obtained and the way he exercised authority to file the bankruptcy. The Court order the case dismissed.

NOTABLE CASES FROM JUDGE STACY G. C. JERNIGAN
United States Bankruptcy Judge for the Northern District of Texas
Dallas Division

1. In re Highland Capital Management, L.P., Case No. 19-34054-SGJ-11; Adv. No(s). 21-03003, 23-03005, 21-03006, 21-03007 December 3, 2021 [Dkt. No. 110]

In this chapter 11 case involving "not your garden variety debtor," these adversary proceedings should have been "simple suits" by the chapter 11 Debtor, Highland Capital Management, L.P. ("Highland Capital"), to collect on large promissory notes owed to it. However, the proceedings eventually presented, among other issues, the question of whether the rejection of an executory contract that contains a typical mandatory arbitration provision can nonetheless require the rejecting Debtor to submit to such arbitration.

The Bankruptcy Court began its opinion by acknowledging that there is a strong federal policy favoring arbitration agreements and discussing the standard for evaluating the enforceability of arbitration clauses in the Fifth Circuit. As set forth in the cases of In re Gandy and In re Nat'l Gypsum, the Fifth Circuit instructed that a bankruptcy court may refuse to enforce arbitration clauses and may adjudicate the dispute itself when it finds that: (a) a matter is core or derives from rights under the Bankruptcy Code; and (b) enforcement of the arbitration provision would irreconcilably conflict with the purposes or goals of the Bankruptcy Code. 299 F.3d 489 (5th Cir. 2002); 118 F.3d 1056 (5th Cir. 1997).

However, the Bankruptcy Court pivoted its focus for the core of its analysis on a more discrete issue (and one that fewer courts have addressed), whether the Debtor was still bound by an arbitration provision that imposes specific performance on the Debtor when the contract containing the provision was an executory contract that the Debtor rejected in its confirmed chapter 11 plan. The Court relied heavily on Judge David Godbey's opinion in Janvey v. Alguire, 2014 U.S. Dist. LEXIS 193394 (N.D. Tex. Jul. 20, 2014), aff'd on different grounds at 846 F.3d 231 (5th Cir. 201), and helpful analysis of these issues from renowned University of Texas Law School Professor Jay Westbrook. Specifically, the Bankruptcy Court found compelling Westbrook's proposition that "an arbitration agreement is a classic executory contract, since neither side has substantially performed the arbitration agreement at the time enforcement is sought." Westbook, The Coming Encounter: International Arbitration and Bankruptcy, 67 UNIV. OF MINN. LAW SCHOOL 595, 623 (1983). As a result, the arbitration agreement could be rejected, and after such rejection, the injured party cannot insist on specific performance by the Debtor. Id. at 619. Ultimately, the Bankruptcy Court held that the agreement at issue and the arbitration clause within it were separate executory contracts that were duly rejected by the Debtor pursuant to section 365 of the Bankruptcy Code. As a result, the Debtor could not be forced to specifically perform by mandatorily participating in arbitration.

The Highland Capital cases are extraordinarily complex, contentious, and challenging, and the opinion declining to compel arbitration highlights only one of many noteworthy issues stemming from this case. Perhaps the most newsworthy result of the case has been the direct appeal of the Bankruptcy Court's confirmation order to the Fifth Circuit. The Appellants insisted, among other things, that the exculpation and gatekeeping provisions in the Debtors' chapter 11

plan were impermissible. In its confirmation order, the Bankruptcy Court found that the exculpation provision complied with applicable law, specifically the Fifth Circuit's decision in In re Pacific Lumber Co. 584 F.3d 229 (5th Cir. 2009). Such exculpation provision provides that a handful of estate fiduciaries will not be liable for their post-petition bankruptcy-related work unless their conduct amounts to bad faith, gross negligence, criminal misconduct, or willful misconduct. The Bankruptcy Court discussed that Pacific Lumber did not preclude exculpation in a particular chapter 11 case to parties that perform similar roles to a creditors' committee and its members, and found that the exculpated parties were in fact analogous to a creditors' committee in this case. The Bankruptcy Court also approved a gatekeeper provision that required enjoined parties to first seek approval of the Bankruptcy Court before commencing an action against the protected parties. Thereafter, if the Bankruptcy Court determines that the action is colorable, it may (if it has jurisdiction), adjudicate such action.

A three-judge panel of the U.S. Court of Appeals for the Fifth Circuit heard oral argument for the appeal on March 8, 2022. As of the date of these summaries, the Fifth Circuit has not rendered a decision. This decision, once rendered, could be very instructive regarding the bounds of permissible exculpation and gatekeeping provisions in chapter 11 plans in the Fifth Circuit.

2. Bailey Tool & Mfg. Co. v. Republic Bus. Credit (In re Bailey Tool & Mfg. Co.), 2021 WL 6101847 (Bankr. N.D. Tex. Dec. 23, 2021)

This case involved a "lender liability" suit commenced against Republic Business Credit, LLC (the "Lender"), a factoring company, after Bailey Tool and certain of its affiliates (the "Debtors"), filed for chapter 11. The Debtors' chapter 11 cases later converted to chapter 7. The chapter 7 trustee and the former owner of the Debtors, John Buttles, alleged over a dozen torts against the Lender, as well as breach of contract, arguing, among other things, that improper conduct by the Lender ultimately destroyed the business enterprise. In response, the Lender argued that the Debtors' business were "dead-on-arrival" and that the Lender did not cause their demise.

The Bankruptcy Court found that the Lender breached the factoring and inventory loan agreements (the "Agreements") by, among other things, (i) putting in place a procedure to only pay certain vendors and employees that the Lender deemed advantageous to enhance its collections, something not provided for in the loan documents; (ii) charging a termination fee and then continuing to take the position that the Agreements were not terminated, insisting that the Lender was entitled to a release before termination was deemed to have occurred, and thereafter refused to turn over funds collected for which it had never made any advances to the Debtors; (iii) demanding performance of delivering receivables from the Debtors after termination of the Agreements; and (iv) over-collecting and holding monies that belonged to the Debtors. The Bankruptcy Court also found the Lender breached its duty of good faith and fair dealing under applicable Louisiana law.

In addition, the Bankruptcy Court found that two torts had been established to have been committed by the Lender against the Debtors through a "lender liability" theory: fraud (through fraudulent misrepresentations) and interference with business and contractual relations. The Bankruptcy Court began its discussion by exploring the seminal case in Texas that addresses these torts in the "lending-relationship-gone-bad" context. In State Nat'l Bank v. Farah Mfg. Co., 678 S.W.2d 661 (Tex. Ct. App. 1984), the court stated that to maintain the action for interference with

a contract, it must be established that (1) there was a contract subject to interference, (2) the interference was willful and intentional, (3) the intentional act was a proximate cause of the plaintiff's damage, and (4) actual damage or loss occurred. With this background, the Bankruptcy Court found that the Lender did interfere with the Debtors' contractual and business relationships by telling certain customers to not pay the Debtors, injecting itself into corporate governance without the contractual right to do so, and intentionally and wrongfully withholding funds from the Debtors. The Bankruptcy Court also found that the Debtors established a claim for fraud, as the Lender made false representations that caused significant financial injury to the Debtors, including the loss of the value of the business.

Ultimately, the Bankruptcy Court entered an over $18 million judgment against the Lender (approximately $16.9 in damages to the trustee, and approximately $1.2 million in damages for Buttles personally), finding that, notwithstanding that the Debtors were "walking wounded" prior to their bankruptcy filing, the Lender did cause the failure of the Debtors based on the Lender's misconduct. While successful lender liability lawsuits are uncommon, this case exemplifies that they can still occur under the right fact patterns.

3. Alford Lee III v. Christopher Lee Weatherford, Case No. 21-30975-sgj-11; Adv. No. 21-03059 Jan. 19, 2022 [Dkt. No. 21]

This case involved a section 523(a)(6) nondischargeability issue where the plaintiff prevailed against the debtor with respect to a prepetition debt that was found to be the result of willful and malicious injury. Prior to filing a petition for chapter 11, the debtor and defendant in this adversary proceeding, Christopher Lee Weatherford ("Mr. Weatherford"), was involved in a bar brawl with the plaintiff, Alford Lee, III ("Mr. Lee"), whereby Mr. Weatherford threw punches at Mr. Lee and injured him in the process. According to Mr. Weatherford, the bar brawl began as an oral altercation that escalated into a physical fight with several people involved. Particularly, Mr. Weatherford admitted to "throwing punches" at Mr. Lee and claimed that he did so in an act of self-defense. As a result of the bar brawl, Mr. Lee sued Mr. Weatherford in state court for his injuries. Finding that Mr. Weatherford assaulted Mr. Lee as a matter of law, the state court entered a final judgment against Mr. Weatherford. In addition, the jury (i) concluded that Mr. Weatherford did not act in self defense and was actually 95% responsible for Mr. Lee's injuries, (ii) found by clear and convincing evidence that Mr. Lee's injuries were a result of Mr. Weatherford's malice, and (iii) awarded approximately $230,000 in damages.

After Mr. Weatherford filed his chapter 11 case, he scheduled Mr. Lee as a non-priority, unsecured creditor with a disputed claim in the amount of the state court final judgment. Mr. Lee sought a ruling of collateral estoppel with respect to the jury's verdict and summary judgment that the prepetition judgment was non-dischargeable under section 523(a)(6) of the Bankruptcy Code on account of Mr. Weatherford's willful and malicious conduct.

Relying on the Fifth Circuit's two-prong approach, the Court determined that there must be either an "objective substantial certainty of harm or a subjective motive to cause harm" in order for Mr. Weatherford's actions to constitute willful and malicious. See Miller v. J.D. Abrams Inc. (In re Miller), 156 F.3d 598 (5th Cir. 1998). In addition, Mr. Weatherford's actions must not have been "sufficiently justified under the circumstances." See Berry v. Vollbracht (In re Vollbracht), 276 Fed. Appx. 360, 362 (5th Cir. 2007). As to the first prong, relying again on Fifth Circuit

precedent, the Court reasoned that, as a matter of law, most punches to the face are substantially certain to cause injury. See id. (citations omitted). As to the second prong, the course of events that night at the bar coupled with the severity of Mr. Lee's injury led the Court to conclude that Mr. Weatherford subjectively intended to harm Mr. Lee. In particular, the Court noted that the state court jury allocated almost $60,000 of damages to physical impairment and disfigurement of Mr. Lee, a level of damages that nearly requires subjective motive to harm. Finally, the Court determined that Mr. Weatherford's actions were not "sufficiently justified by the circumstances" and that he was collaterally estopped from arguing self-defense because the state court jury had previously assigned Mr. Weatherford 95% of fault.

Ultimately, Mr. Lee's motion for summary judgment was granted and the state court judgment and damages awarded pursuant thereto were determined to be non-dischargeable under section 523(a)(6) of the Bankruptcy Code as a debt resulting from Mr. Weatherford's willful and malicious injury.

4. Terry Wayne Fator v. Marie Fator Sligh, Case No. 21-30915-sgj-7; Adv. No. 21-03052 Apr. 12, 2022 [Dkt. No. 68]

This case involved a section 523(a)(6) nondischargeability issue where the plaintiff and son of the debtor, Terry Wayne Fator ("Mr. Fator"), prevailed against his debtor mother, Marie Fator Sligh ("Ms. Sligh"), with respect to a prepetition debt that was found to be the result of willful and malicious injury.

In the years prior to filing a petition for chapter 7, Ms. Sligh and her son shared a tumultuous relationship. Mr. Fator won the popular television show "America's Got Talent" and became a highly sought after Las Vegas ventriloquist entertainer, he provided his mother with financial support, a place to live, and employment. Apparently, a few years went by and the mother-son relationship soured once again and Mr. Fator fired his mother and cut her off financially. Mr. Fator alleged that his mother then began to engage in extortionate, defamatory, and other unlawful conduct in an attempt to extract money from him. Such conduct included secretly recording Mr. Fator's phone calls, sending numerous letters containing threats to expose Mr. Fator, insinuating that Mr. Fator had something to do with his sister's death, and arranging for Mr. Fator to be served with process in front of many fans. As a result of his mother's behavior, Mr. Fator sued his mother in Nevada state court alleging invasion of privacy, false light invasion of privacy, and defamation, and received a judgment that (i) enjoined his mother from making any further contact with him and (ii) awarded him just over $50,000 in damages.

Following the Nevada state court judgment, Ms. Sligh sued Mr. Fator in the federal district court for the Eastern District of Texas, alleging, among other things, what appeared to be intentional infliction of emotional distress, breach of promise, elder abuse, harassment, bullying, defamation, and slander. Ms. Sligh also sought termination of the mother-son relationship, $1.4 million of compensatory damages which she would reduce if Mr. Fator issued a public apology, and funding for around-the-clock protection for the duration of her life. The federal court ultimately dismissed the action for lack of personal jurisdiction and failure to state a claim as it was merely an attempt to "air the family's dirty laundry."

After Ms. Sligh filed her petition for chapter 7, Mr. Fator sought summary judgment that the Nevada state court judgment was non-dischargeable under section 523(a)(6) of the Bankruptcy Code on account of Ms. Sligh's willful and malicious conduct. In granting Mr. Fator's summary judgment motion, the Court relied on several pieces of summary judgment evidence, including Ms. Sligh's own statements, the factual determinations underlying the Nevada state court judgment, and the various letters to Mr. Fator from Ms. Sligh and the various attorneys she went through for the matter. The letters contained allegations and accusations against Mr. Fator, including in relation to his sister's death, all of which Ms. Sligh threatened to publicize if Mr. Fator did not agree to a meeting with his mother and/or large monetary settlement proposals.

Relying on the Fifth Circuit's two-prong approach, the Court determined that there must be either an "objective substantial certainty of harm or a subjective motive to cause harm" in order for Ms. Sligh's actions to constitute willful and malicious. See Williams v. Int'l Bhd. Of Elec Workers Local 520 (In re Williams), 337 F.3d 504, 509 (5th Cir. 2003) (citations omitted). The Court found that the intent to cause willful and malicious injury for certain torts such as invasion of privacy, defamation by imputations of criminality or false statements that may affect a victim's livelihood, extortion, and abuse of process, can be inferred from the circumstances surrounding the injury and the egregiousness of the act. In such circumstances, the Court found that a "creditor seeking to establish a [section] 523(a)(6) violation need only prove . . . that it is more likely than not that [the alleged claim] occurred."

The Court held that, as a whole, the summary judgment evidence established extortion as a matter of law and Ms. Sligh's extortive conduct led to willful and malicious injury as a matter of law. First, Ms. Sligh had used threats and blackmail in an attempt to financially extort her son for money that she was not legally entitled to, all of which forced Mr. Fator to take legal action in response and incur unnecessary expense and inconvenience. In doing so, the Court found that Ms. Sligh inflicted a willful and malicious injury upon her son because her actions were "substantially certain to cause financial loss and injury" to him. See In re Kahn, 533 B.R. 576, 588 (Bankr. W.D. Tex. 2015); In re Gamble-Ledbetter, 419 B.R. 682, 699 (Bankr. E.D. Tex. 2009). In addition, the Court viewed the federal action filed in the Eastern District of Texas as "an obvious continuation of [Ms. Sligh's] extortionate scheme" that amounted to another willful and malicious injury.

Ultimately, Mr. Fator's motion for summary judgment was granted and the Nevada state court judgment and damages awarded pursuant thereto were determined to be non-dischargeable under section 523(a)(6) of the Bankruptcy Code as a debt resulting from Ms. Sligh's willful and malicious injury.

<u>NOTABLE CASES FROM JUDGE ROBERT L. JONES</u>
United States Bankruptcy Judge for the Northern District of Texas
Lubbock, Amarillo, Abilene & San Angelo Divisions

1. <u>In re Adamcik</u>, 2021 WL 3868251 (Bankr. N.D. Tex 2021)

Debtor filed a chapter 13 case. After confirmation of his chapter 13 plan, he converted the case to a chapter 7. The United States Trustee objected to his discharge alleging that he knowingly and fraudulently made a false oath in connection with the case, concealed property of the estate with intent to hinder, delay or defraud a creditor or an officer of the estate and as a result thereof his conversion of the case to chapter 7 was in bad faith. In the alternative, the UST claimed that the case should be dismissed with prejudice for two years as a bad faith filing.

Two weeks after his chapter 13 plan was confirmed, the debtor purchased a house in Lubbock. The purchase was owner financed. He also leased out a home that he had in Argyle for $3,000.00 a month. And within a few weeks after the case was converted to chapter 7, he received a severance payment of approximately $52,000.00 from the City of Denton as a result of him having been laid off from his job as a city employee. He didn't file amended schedules to reflect his purchase of the Lubbock home, his lease of the Argyle property and the resulting monthly income therefrom or his receipt of the severance payment. He also bought a lot in Crosby county for $400.00 which was never scheduled. At the time the UST's complaint was tried and filed, he lived and was employed in Hawaii.

The Court's opinion discusses the obligations of a debtor upon the conversion of a case pending under any chapter to chapter 7. The Northern District Local Rule 1019-1 requires that upon conversion, the debtor must file (1) a schedule of the assets remaining in his or her possession as of the date of conversion, (2) a schedule of assets and unpaid post petition debts, (3) and if the debtor is an individual, a statement of current monthly income and a means test calculation and, (4) a schedule of property acquired after the filing of the petition but before the conversion.

In dealing with the component parts of the UST's complaint, the Court first points out that exceptions to discharge under §727 are construed liberally in favor of the debtor and strictly against the objecting party in furtherance of the "fresh start" policy of the Bankruptcy Code. And the denial of a debtor's discharge should only be for "very specific and serious infractions." To prevail on an allegation that the debtor made a false oath or account, the Court discussed the five elements required to be proved by Section 727(a)(4)(A):

(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 was material to the bankruptcy case.

The debtor, through his attorney, insisted that he was not required to disclose any property acquired during the chapter 13 case because the chapter 7 estate consists of the debtor's assets at the time of the chapter 13 filing. Not so said the Court. There is "a continuing duty to disclose."

And if the Court determines that if the failure to disclose and the omission(s) happen to be material, then grounds exist to bar debtor's discharge. However, an objecting creditor or the UST has the burden to demonstrate by preponderance of the evidence that the debtor transferred or concealed property of the estate with the intent to hinder, delay or defraud a creditor and that this conduct occurred after the filing of the petition.

The issued boiled down to whether or not the conversion of the chapter 13 case to chapter 7 was in bad faith. The debtor said he converted the case because he lost his job and couldn't make the chapter 13 plan payments. The UST contended that shortly after conversion he got $52,000.00 of severance pay and cited a case out of the Eastern District where the debtor had lost his job and had inherited assets that could have been used to pay off his plan in full. The Court determined that based on the totality of the circumstances, the conversion of the case was meant to keep the inherited assets out of the hands of the creditors. Moser v. Mullican, 417 B.R. 389 (Bankr. E.D. Tex 2008).

In support of its request that the case be dismissed as a bad faith filing, the UST said the facts supported their allegation that the conversion of the case to chapter 7 constituted an abuse of the bankruptcy process. In re Little Creek Development Company, 779 F.2d 1068 (5th Cir. 1986).

The Court determined that debtor's conversion of the case was in bad faith. He failed to make the filings required by the Rules. He failed in his continuing obligation to disclose assets, but the "effect of his post-confirmation conduct on the bankruptcy estate is unclear." When it came down to it, the Court said that he couldn't find that the debtor had the requisite intent to defraud his creditors or the UST through a false oath or concealment of assets. However, the simple conversion of the case to chapter 7 the Court found was done in bad faith. And based on Section 348(f)(2), if a chapter 13 debtor converts to chapter 7 in bad faith, then the chapter 7 estate includes all of the debtor's property as of the date of conversion. Accordingly, the debtor was ordered to file an amended schedule of all assets that he acquired up to the date of his conversion to chapter 7, these assets to be administered by the Chapter 7 Trustee for the benefit of his creditors.

2. In re Stanke, 2022 WL 99498 (Bankr. N.D. Tex. 2022)

In this chapter 13 case, the Court confirmed the debtor's chapter 13 plan back in 2017 and then approved a modification in June of 2020. A month later in July of 2020, Mr. Stanke's mother died and he inherited a one-third interest in her home. Then at an unknown date thereafter, his grandfather died, and Mr. Stanke inherited a one-sixth interest in his home. When later preparing their certifications for entry of discharge, the debtors informed the Trustee of the inheritances. The Trustee, upon learning of the inheritances, advised that he would object to the discharge unless the plan was modified to pay to the unsecured creditors the value of the inheritances. The debtors agreed to do this and filed a subsequent modification calling for the payment of the net proceeds from the inheritances to be paid to the creditors. Nobody objected. Important fact: at the time the Trustee filed that modification, the debtors had paid all the payments required to be made under their confirmed chapter 13 plan as modified. Even though the plan modification was unopposed, the Court said "not so fast" and said it had an independent duty to assure that the plan modification complied with the requirements of the Code.

The following issues were raised:

(1) Can a chapter 13 plan be modified after completion of payments called for under the confirmed plan;

(2) Did the proposed modification violate Code Section 1325(b)(1)(B) that prohibits the Court from approving a plan modification that approved a plan period that expires after five years from the "applicable commitment period";

(3) Since the inheritances were to be received by Mr. Stanke more than 180 days after the filing of the case, did the inheritances become property of the chapter 13 bankruptcy estate? Did the debtors even have a duty to report the inheritances to the Trustee?

Answering the above questions in order, the Court found and held that:

(1) Since the Trustee didn't file his Motion to Modify the debtor's plan until after all payments called for under the confirmed plan had been made, the Court was time-barred from approving the proposed modification under §1329(a) notwithstanding the fact that all parties had agreed and no objections thereto were filed.

(2) Further, the Trustee's proposed plan modification violated the 60-month time limit requirement of §1329(c) and the debtor's plan to extend the payments beyond 60 months and delaying their discharges contravened the plain language of §1329(c), and the Court was barred from approving it.

(3) Acknowledging that only inheritances received within 180 days of filing become property of a bankruptcy estate per §541(a)(5) but that "all property of the kind specified" in §541 acquired after the commencement of the case becomes property of the estate, raised an issue that was difficult to answer. The Court noted that the Fifth Circuit had not answered the question and other courts came to different conclusions; however, the Court said that it didn't to decide this question here.

The Court noted that our District's "General Order" as regards all chapter 13 cases states that a debtor must notify a trustee of any material increase in income and "of the acquisition of any property." So if the inheritances, having been received both 180 days after the case was filed weren't even property of the estate, did they even have a duty to notify the Trustee much less turn over the inheritances for the benefit of the creditors.

In conclusion, the Court found that since the debtor had completed their plan payments prior to the time that the most recent modification was filed, they were entitled to receive their chapter 13 discharges.

3. In re Banner Resources, LLC, 2021 WL 2189085 (Bankr. N.D. Tex. 2021)

Bonsai Energy Partners, LLC, joined by three "trade creditors," filed an involuntary chapter 7 against Banner Resources, LLC. Banner Resources contested the involuntary petition. Bonsai purchased its claim from Elm Park Capital Management, LLC which had issued a $15,000,000 credit facility to Banner to finance its operations. The Court noted that if a petitioning creditor's claim has been acquired as the result of a "transfer," then the petitioning creditor must append a copy of all transfer documents to the involuntary petition and must include a signed statement "that it did not acquire the claim for the purpose of commencing the case." Rule 1003(a).

The Court found that Bonsai refused to comply with the clear requirement of Rule 1003(a) and "intentionally misrepresented on the petition" that there had been no transfer of any claim against the debtor by or to any petitioner.

Also, Banner contended that claims of each of the three trade creditors were the subject of a bonafide dispute. The Court said that it had to determine that fact on an objective basis following In re Sims, 994 F2d 210(5th Cir 1993). The petitioning creditor has the burden of showing no bona fide dispute exists after which the debtor must present evidence to show that a dispute exists. Banner claimed that the claims of the three trade creditors were the subject of bona fide disputes.

The Court addressed the notion of whether or not the alleged debtor was entitled to attorney's fees. The Court said that there is "presumption that the petitioning creditor acted in good faith in filing the involuntary petition in the district" (Synergistic Techs, Inc., 2007 WL 2264700 (Bankr., N.D. Tex 2007). The Court concluded that it is unusual to find that a creditor filed involuntary petition in bad faith and failed to do so in this case. The involuntary case was dismissed. The request for attorney's fees was denied.

4. In re Reagor-Dykes Motors, LP 2022 WL 120199 (Bankr. N.D. Tex. 2022)

In the high profile and time consuming (for multiple parties, lawyers and the Court) Reagor-Dykes, LP case, the Trustee of the Creditors Trust filed for avoidance and recovery of a preferential transfer against Broadway Festivals, Inc. He then moved for summary judgment. Broadway Festivals has for years hosted a "Fourth on Broadway" Independence Day fireworks show and celebration in Lubbock. It has solicited and received from local business and community organizations contributions to cover the costs. Reagor-Dykes sponsored the fireworks show in 2017 and signed on to again sponsor the show in 2018. In 2017, it received and paid an invoice for its sponsorship in the amount of $20,000.00 on May 24, 2017. It was invoiced for a sponsorship of the 2018 fireworks on May 14, 2018 in the amount of $25,000.00. However, that invoice was not paid until July 13, 2018 after the July 4th celebration. Reagor-Dykes filed a chapter 11 on August 1, 2018.

The Trustee and Broadway Festivals agreed that all of the elements of a preferential transfer under §547(b) were met except one. Broadway Festivals disputed the fact that the payment was made "on account of an antecedent debt." Broadway claimed that its payment was a "contemporaneous exchange." The Court said that it wasn't. Broadway also contended that it

received "new value." The Court said that it did not receive new value. However, the Court then analyzed the transaction in considerable detail to determine whether or not the payment was made in the "ordinary course of business" and satisfied that defense. The Court had two transactions to analyze in determining whether or not the second transaction and payment was made in the ordinary course of business. The first time Reagor-Dykes sponsored the show saw it paying before the event. The second time it sponsored the show, saw it paying after (but in close proximity to) the event. Accordingly, the Court concluded that Reagor-Dykes' $25,000.00 contribution to Broadway in 2018 was made in the ordinary course of business.

This case makes for great reading insofar as analyzing each and every element of an alleged preferential transfer and is a "must read" case for Trustees/debtors-in-possession as well as creditors who may find themselves on opposite factual sides of this issue.

5. In re Orosco 2020 WL 6054695 (Bankr. N.D. Tex. 2020)

The issue before the Court was approval and allowance of a late-filed claim. The debtors filed a chapter 13 at the end of April 2019. The bar date for filing a proof of claim was July 9, 2019. Ally Financial filed its proof of claim for $20,083.53 on July 10, 2019. A week later the chapter 13 Trustee filed a Notice of Claim File and filed and listed in the notice that Ally Financial's claim was filed late. The debtors then had until August 8, 2019 to file a claim on behalf of Ally Financial as provided for in Rule 3004. The debtor's chapter 13 plan was approved and treated Ally Financial's claim as if it had been timely filed but the confirmation order designated the claim as late filed and would be paid only after all timely and allowed claims had been paid.

Ten months later, Ally filed an identical proof of claim to the one originally filed and then filed a Motion to have it allowed and stated that the allowance of the late-filed claim would be in the best interest of the Debtors and their creditors. Absent from the Motion were any allegations of "cause" or "excusable neglect."

The Court engaged in a thorough analysis of the deadlines for filing proofs of claim and the ability (or not) to extend those deadlines. It also thoroughly discussed when the deadlines cannot be extended. In summary, the Court had to determine whether or not cause existed to allow a late-filed claim and whether or not the late filing was the result of excusable neglect. To decide the excusable neglect question, the Court must first consider (1) if there was neglect and, (2) if so, whether that neglect was excusable.

Also an issue in this case was the fact that the debtor's case was dismissed. In response to the dismissal, the debtors filed a Motion to Vacate the Dismissal and the case was reinstated on June 28, 2019 more than 50 days after dismissal.

The Court denied debtor's motion to allow its late-filed proof of claim on behalf of Ally since it failed to plead or offer any reason, much less excusable neglect, for the late-filing. However, the Court allowed Ally Financial's proof of claim as if timely filed since the case, after having been dismissed for over 50 days, was reinstated with no more than 11 days left for Ally Financial to timely file its claim. All's well that ends well.

<u>NOTABLE CASES FROM JUDGE MICHELLE V. LARSON</u>
United States Bankruptcy Judge for the Northern District of Texas
Dallas Division

1. <u>In re Essential Fin. Educ., Inc.</u>, 629 B.R. 401 (Bankr. N.D. Tex. 2021)

This chapter 7 case involved very convoluted facts. In short, the Debtor (Essential Financial Education) was the Franchisee under a franchise agreement with a Franchisor (OTA Franchise Corporation). The Debtor failed to keep up with its obligations under the franchise agreement including its royalty fees. The Debtor then began looking for a buyer to purchase all of its assets. Throughout the entire sale of Debtor's assets, the Franchisor asserted control over various terms of the sale that if not met, the Franchisor would not approve the sale. Finally, an agreement was reached between the Debtor, the Franchisor, and a purchaser. Upon closing, the buyer deposited $2.14 million into an escrow account of which the Franchisor obtained $859,216 for amounts allegedly owed from Debtor under the franchise agreement.

The trustee brought an adversary proceeding against the Franchisor to avoid and recover the $859,216 transfer. The opinion is the result of each parties' cross motions for summary judgment. Specifically, the Court addressed Trustee's causes of action for: (i) actual fraudulent transfers under § 544(b) and TUFTA; (ii) actual fraudulent transfers under § 548(a)(1); (iii) constructive fraudulent transfers under § 548(a)(1)(B); (iv) constructive fraudulent transfers under § 544(b) and TUFTA; and (v) preferences under § 547(b).

Resolving the causes of action in order, the Court held that the Trustee had established as a matter of law all elements of Counts one and two for actual fraudulent transfers under the Bankruptcy Code and TUFTA, except that there were genuine issues of material facts as to the Debtor's alleged fraudulent intent. While the Court found that many badges of fraud were present which would demonstrate the Debtor's fraudulent intent, the Debtor was able to demonstrate a legitimate business purpose for the challenged transfer surviving summary judgment.

With respect to counts three and four, the Trustee failed to carry his burden in proving the Debtor did not receive reasonably equivalent value and a fact issue remained as whether the Debtor was in fact insolvent.

Lastly, with respect to count five, the Trustee moved for summary judgment with respect to three of the Franchisor's affirmative defenses: (i) the transfers were contemporaneous exchanges of new value; (ii) the transfers were in the ordinary course of business; and (iii) the Franchisor provided new value.

First, the Franchisor failed to present any evidence of specific new value it provided to the Debtor with respect to new value. The transfer was made after the sale of all of Debtor's assets to satisfy Debtor's preexisting obligations. Second, the transfer was not in the ordinary course of business because the amount of the escrow transfer, more than $850,000, was the single largest payment between Debtor and franchisor, the method of transfer via escrow was a unique occurrence in the course of dealing between the parties, and the Debtor had never sold, or been required by franchisor to sell, assets to make any payment, past due or otherwise. Third, there was

no evidence of new value provided to the Debtor after the transfer was made as it was the last transfer between the parties.

2. In re JSAA Realty, LLC, Case No. 20-32504, 2022 WL 567730 (N.D. Tex. Bankr. February 24, 2022)

In considering, the confirmation of the Debtor's plan, the Court had to determine whether the plan fairly and equitably treated the claims of a trust, whether the plan was proposed in good faith, whether it was in the best interests of creditors, and whether it was feasible. The debtor owned a piece of real property and operated an adult video store on the property which the members of the Debtor wanted to renovate into an adult nightclub. In 2016, the Debtor entered into financing with a lender ("Sunshine") to complete needed renovations, and in 2020, the note was amended with an interest rate of 10%. The Debtor defaulted under the amended note and before the foreclosure sale filed chapter 11. During the case, a trust acquired Sunshine's claim, and began objecting to nearly every filing by the debtor creating what the Court termed a two-party dispute. In its plan, the Debtor proposed to pay the trust's claim over 60 months at 6% but increase the payment on an annual basis, with the trust to retain its lien on the property and all other security throughout the repayment period. The trust argued the interest rate was not commensurate with credit market available to the Debtor.

Absent evidence, the Court will not presume an oversecured lender is entitled to a contractual interest rate based on being a "hard money" loan. The trust argued that the interest rate should be the contractual rate of 10% and therefore, the Court had to consider how to determine the appropriate rate of post-confirmation interest in a plan repayment of an oversecured debt backed by real property. The Court noted that the district has consistently expressed a preference for a market-based approach for determining the appropriate interest rate post-confirmation and therefore, here, the Court consider the attributes of, and the relationship between the Debtor and its original lender, Sunshine. The trust argued that this relationship was that of a hard money lender and thus, subject to higher interest rates, but the Court found no evidence to support such a characterization. Therefore, the trust was not entitled to a hard money interest rate. Further, the Court noted that the amended note itself was problematic (unexplained addition to principal and hiked interest rate), and the trust stepped into the shoes of Sunshine. Finally, the Court noted that the very nature of the business (cash, no record keeping, etc.), supports the conclusion that there is no efficient market for this type of loan and therefore, an interest rate on the high end like 6% captures the risk factors.

The Court reviewed the Little Creek factors and determined that the only factors present in this case are the same facts present in hundreds, if not thousands of single asset real estate companies: one asset, few employees, few unsecured creditors, etc. Further, the Court noted that the plan provided a 100% return to creditors and a plan that pays creditors in full cannot fail the best interest of creditors test. Ultimately, the Court confirmed the plan and noted that while the trust may be in an unenviable position based upon the acts of Sunshine before it acquired the loan, the trust chose to acquire its claim post-petition and therefore "must sleep in the bed Sunshine made for it."

3. In re Parson, 632 B.R. 613 (Bankr. N.D. Tex. 2021)

In Parson, the Court considered how to deal with a pro se repeat filer who had clogged upon multiple bankruptcy courts with vexatious litigation and appellate practice since 2015. The chapter 13 trustee wanted a five-year bar for repeated abuses of the bankruptcy system, which included successive unsuccessful chapter 13 filings in which the Debtor displayed a penchant for vexatious, frivolous litigation designed to bog down the courts with innumerable pleadings and appeals. In her first case, the Debtor appealed virtually every order (including those in her favor) and moved to recuse the judge on specious grounds. After that case was dismissed for failure to make plan payments, she filed in another district, engaging in much of the same conduct including frivolous objections, appealing virtually every order, and filing four motions to recuse. After that case was dismissed, the Debtor filed this case engaging in much of the same conduct including motions to recuse, appeals of almost every order, and uncooperative behavior like refusing to touch an exhibit book provided by opposing counsel.

The Court carefully considered the motion to dismiss and found that the Debtor was intentionally misusing the Bankruptcy Code to avoid payment of her creditors and thus, there was cause under 11 U.S.C. § 1307(c) to dismiss her case for bad faith. As to the pre-filing injunction (i.e. dismissal with a bar to refiling), the Court again carefully laid out the Debtor's history of vexatious and odd behavior (like appealing the denial of her in forma pauperis applications where her own sworn schedules reflected that she was not indigent). The Court concluded that her action in this case and previous cases made a mockery of the bankruptcy process and therefore, it was exceedingly appropriate to dismiss her case with prejudice.

The Court considered the length of the filing bar and found that the requested five-year bar was an extreme remedy for a pro se filer and instead, ordered a three-year bar to filing unless the Debtor obtained prior relief from the order from the Court.

4. Reticulum Management, LLC v. Watters (In re Watters), Adv. Proc. No. 20-3088, 2021 WL 3744408 (N.D. Tex. Bankr. August 24, 2021)

In this dischargeability adversary, the plaintiff filed a complaint seeking a determination that an arbitration award was nondischargable under 11 U.S.C. § 523(a)(2)(A), (a)(2)(B), and (a)(6). The dispute arose out of the Total Operating, LLC ("Total Operating") company which was an oil field services company which the Debtor, a financial professional, provided debt financing services and eventually became a partial owner. In order to complete a construction project, Total Operating needed some cash, and the Debtor's father as well as another investor agreed to provide the bridge capital. The parties utilized the plaintiff as a pass through entity because of the related party transaction. But Total Operating's primary secured lender would not consent to a lien and therefore the parties decided to structure the financing as a Sale and Buyback Agreement ("SBA") where by the plaintiff purchased the right to receive future profits from the project from Total Operating for $500,000 and Total Operating retained a buyback on those profits for $535,000. Ultimately, the project stalled and Total Operating could not remit the receivables to the plaintiff or execute the buyback. After tensions became untenable, in an attempt to offer further assurances of repayment to the plaintiff, the debtor authorized the execution of a security agreement by Total Operating in favor of the plaintiff which purported be effective to the buyback date of the SBA.

Ultimately, the plaintiff filed a state court actions against Total Operating which then filed chapter 7. The plaintiff filed a lawsuit against the debtor for non-disclosure, fraud in the inducement, and negligent misrepresentations in connection with the SBA and the security agreement. The case was sent to arbitration and the arbitration panel entered an award against the debtor and his business partner for negligent misrepresentation (i.e. not fraudulent). Thereafter, the debtor and his business partner each filed chapter 7.

Witness Credibility. The Court noted both the time that had elapsed between these events and that the previous closeness of the parties had given way to vitriol and resentment amongst the witnesses. The Court took the time to evaluate the credibility of each witness.

Dischargeability. The Court evaluated the debtor's fraudulent intent in light of (a) the debtor's credible testimony regarding his intent, (b) the circumstantial evidence of his intent (he and his family stuck by the investments in Total Operating alongside the plaintiff), and (c) the documentary evidence (a presentation that was essentially a pitch book to encourage new financing did put a gloss on negative points, but the negative points were clearly conveyed). Next, the Court evaluated whether the plaintiff justifiably relied on the statements by the debtor. Notably, both principals of the plaintiff were highly educated and experienced lenders but never hired counsel or performed further inequity, research, independent verification, or other due diligence prior to executing the SBA. After finding a similar evidentiary gap to prove a §523(a)(2)(B) or (a)(6) claim, the Court concluded that it was obvious that the principal of the plaintiff harbored immense anger and the litigation costs in pursuing the debtor and his partner have outsized the controversy. But ultimately, there was no fraudulent scheme to defraud the plaintiff, no matter how forcefully the plaintiff tried to fit the square peg of the facts of this case into the round hole of nondischargeability.

5. Walters v. Davis (In re Davis), Ch. 7 Case No., Adv. No. 21-03057 (Bankr. N.D. Tex. March 1, 2021) [Dkt. No. 16]

Debtor was the former chairman of the board of Dean Foods Company. William Walters (Plaintiff in an adversary against the Debtor) was an associate of the Debtor to whom the Debtor was convicted of giving insider information. The Southern District of New York sentenced Debtor to a prison term of two years. Additionally, the same court ordered both Debtor and Plaintiff to pay restitution to their victims, jointly and severally, in the amount of $8,890,969.33. Plaintiff paid the full order of restitution; then filed a claim for contribution against the Debtor in state court. Debtor's chapter 7 bankruptcy subsequently followed.

After the bankruptcy case was filed, Plaintiff then commenced an adversary action against Debtor seeking an order from the Court that Plaintiff's contribution claim is not dischargeable pursuant to 11 U.S.C. §§ 532(a)(4), (13), and (19). Section 523(a)(4) excepts from discharge any debt "for fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny." Section 523(a)(13) excepts from discharge any debt "for any payment of an order of restitution issued under title 18, United States Code." Section 523(a)(19) excepts from discharge debts related to the violation of security law or order for payment of damages, fine, penalty, or restitution payment. Debtor responded by filing a motion to dismiss under Federal Rule of Civil Procedure 12(b) arguing that Plaintiff's allegations did not present a claim upon which the Court could grant relief. The Court agreed.

The Court held that a pre-petition claim for contribution from a joint tortfeasor does not fall within the exceptions of discharge of the Bankruptcy Code. The Court reasoned that the Fifth Circuit in Cowin v. Countrywide Home Loans has stated repeatedly that exceptions to discharge must be strictly construed. 864 F.3d 344, 349 (5th Cir. 2017). The Court then addressed each exception to discharge one by one ruling against Plaintiff. Plaintiff's claim was not based off fraud because Plaintiff was not defrauded. This was not a claim for restitution because the Plaintiff paid his own debt. And there was no violation of federal securities law because he was the joint tortfeasor. As a result, the Court granted Debtor's motion to dismiss granting Plaintiff leave to amend.

<u>NOTABLE CASES FROM JUDGE EDWARD L. MORRIS</u>
United States Bankruptcy Judge for the Northern District of Texas
Fort Worth Division

1. <u>In re All Saints Episcopal Church</u>, Case No. 21-42461-ELM, 2021 WL 6140265 (Bankr. N.D. Tex. Dec. 29, 2021)

As stated by Judge Morris, this bankruptcy case is but the latest chapter in a protracted property battle emanating out of the 2008 schism between the Protestant Episcopal Church in the U.S. (the "Episcopal Church") and the then-majority of the voting leadership of the Episcopal Diocese of Fort Worth (the "Fort Worth Diocese"). Initially, the Fort Worth Diocese was established and All Saints' Episcopal Church of Fort Worth ("Episcopalian All Saints") became a parish of the Fort Worth Diocese. Due to doctrinal differences, the Fort Worth Diocese elected to terminate its affiliation with the Episcopal Church and affiliate instead with the Anglican Church in North America (the "ACNA"). As a result, a majority of Episcopalian All Saints' leaders and members elected to cause its parish to reject the breakaway movement and remain in union with the Episcopal Church, while a minority of the parish's leaders and members elected to follow the breakaway group and reestabish as a new unincorporated association in union with the Fort Worth Diocese that they also named ("ACNA All Saints").

Subsequent disputes arose among the foregoing parties regarding the control of the Corporation of the Episcopal Diocese of Fort Worth (the "Diocesan Corporation") and the ownership of certain property held in trust by the Diocese Corporation for the benefit of local parishes (the "Diocesan Trust Property"). Ultimately, the Fort Worth Diocese and its local parishes obtained a judgment (the "Judgment") establishing that the Fort Worth Diocese and the Diocesan Corporation validly separated from the Episcopal Church and that the Diocesan Trust Property was held in trust by the Diocesan Corporation for the benefit of only those parishes in union with the Fort Worth Diocese, including ACNA All Saints. The Fort Worth Diocese, Diocesan Corporation and other aligned parties pursued enforcement of the Judgment and obtained possession of the church building that Episcopalian All Saints had used for years.

In addition, a new dispute arose with respect to the control of a separate Texas non-profit corporation also named All Saints Episcopal Church (the "Debtor"). Specifically, in October 2021, the Diocesan Corporation sent a letter to Frost Bank (the Debtor's bank) to claim control of the Debtor's Frost Bank accounts pursuant to the Judgment and a post-judgment enforcement order of the state court. In reaction, Frost Bank froze all of the Debtor's accounts. As a direct result, the Debtor's board of directors authorized the Debtor to seek chapter 11 bankruptcy relief, which the Debtor did.

Shortly thereafter, the Diocesan Corporation and ACNA All Saints (the "Movants") filed a joint motion to dismiss arguing that the bankruptcy case must be dismissed because it was never authorized by the "legitimate" members of the Debtor's board of directors - the individuals purportedly elected by the members of ACNA All Saints. The Movants sought dismissal of the case pursuant to section 1112(b)(1) of the Bankruptcy Code. The Movants asserted that "cause" for dismissal existed because the bankruptcy filing was not authorized by the Debtor's Vestry. In response, the Debtor claimed that its board was duly and legally elected in accordance with the governing organizational documents of the Debtor and that the filing was duly authorized by such

board.

The Court thoroughly reviewed the history of the parties and their relationships. It further discussed that a non-profit corporation, such as the Debtor, is entitled to obtain relief under chapter 11 of the Bankruptcy Code. However, being a legal construct, a corporation may only take such action that is authorized by its legally appointed agents. If, as of the time of the bankruptcy filing, those purporting to take action on behalf of the corporation lacked authority under applicable state law to authorize the filing, then cause exists for dismissal of the case under section 1112(b)(1) of the Bankruptcy Code.

Since the Debtor was a Texas non-profit corporation, the Court clarified that neutral, secular principles of Texas law were to be applied to the judicial resolution of issues involving the governance of Texas corporations.

Notably, pursuant to the Debtor's Articles, the organizing members of the Debtor - being members of Episcopalian All Saints - elected to provide for the Debtor's management by a board of directors with the number of directors to be determined by the Debtor's bylaws (subject to a minimum of three and a maximum of fifteen members). An initial slate of twelve directors was appointed pursuant to the Articles. The Debtor's Bylaws were subsequently amended and provided that the Debtor will be managed by a board of directors, referred to as the "Vestry". Members of the Vestry were to be elected from confirmed communicants of Episcopalian All Saints in good standing. Further, the Bylaws provided that a majority of the Vestry constitutes a quorum for purposes of conducting business and contemplates the Vestry's approval of any action by a majority vote of those present.

After the above-referenced split, the vast majority of the Debtor's Vestry elected to remain with the Debtor. However, five of the fifteen-member Vestry decided to resign and their vacancies were filled in accordance with the Bylaws. From then until the Debtor's bankruptcy filing, members of the Debtor's Vestry were elected also in accordance with the Bylaws.

The Court examined the applicable provisions of the Texas Business Organizations Code ("TBOC") for guidance and found that the Debtor's Bylaws were consistent with the relevant provisions of TBOC. Specifically, they provided for a majority of the Vestry to constitute a quorum for purposes of conducting business, contemplated the Vestry's approval of any action by a majority vote of those present, and permitted the Vestry's approval of any action by unanimous written consent in lieu of a meeting.

The Movants principally relied on the assertion that the bankruptcy filing was unauthorized because when the state court found ACNA All Saints to be the continuing All Saints' Episcopal Church in the Judgment, it thereby also effectively determined that ACNA All Saints was the only one that would have legal authority to institute these proceedings. Thus, the state court determinations were binding in this proceeding due to res judicata and collateral estoppel principles according to the Movants.

The Court determined that neither of these principles applied as the elements of each were not present. First, the Debtor was never a party to the state court litigation. Further, these

arguments failed for additional reasons: (i) neither the composition of the Debtor's Vestry nor control of the Debtor was ever a claim or issue presented for determination by the state court; (ii) neither of these matters was actually litigated in the state court action; and (iii) neither of these matters was essential to resolution of the claims and issues actually presented for determination in the action. Instead, the state court action related to the composition of the leadership and the control of the Fort Worth Diocese and the Diocesan Corporation and the ownership of the Diocesan Trust Property held in trust by the Diocesan Corporation. Therefore, the state court Judgment had no res judicata or collateral estoppel effect on the issue of whether the Debtor's bankruptcy filing was legally authorized.

The Court then circled back to the fact that the Debtor's bankruptcy filing was properly authorized under Texas law. Following the departure of the small number of the parishioners and Debtor Vestry members, Episcopalian All Saints and the Debtor continued on with their business without the involvement of those who elected to depart. Further, as of the Debtor's petition date, the members of the Debtor's Vestry were elected at annual meetings in accordance with the Bylaws. Therefore, the filing of the chapter 11 bankruptcy was authorized by the duly and lawfully elected members of the Debtor's Vestry. As a result, the Court denied the Movants' request for dismissal of the case.

2. In re Axline, 618 B.R. 454 (Bankr. N.D. Tex. 2020)

The Debtors filed their joint chapter 13 plan (the "Plan") and the chapter 13 trustee (the "Trustee") objected to confirmation of such plan. Following resolution of a number of the Trustee's objections, the remaining objection centered on whether the Plan satisfied the "disposable income test" of section 1325(b)(1)(B) of the Bankruptcy Code.

Dr. Axline started his own medical practice after having lost a significant amount of money in Forest Park Medical Center. Following his failure to satisfy required tax payments going back to 2011, the IRS filed a tax lien against the Debtors home and thus, the Debtors sought bankruptcy protection.

The Debtors' Schedules disclosed that they received monthly income of roughly $18,356.80 and had monthly expenses of roughly $16,328.42 (which include the Debtors' mortgage payment and Lexus vehicle payments (as more particularly described below)), for monthly net income of $2,028.38. The Debtors further disclosed that their annualized current monthly income was greater than the median family income of a household of the same or lesser size in Texas making them "above-median-income" debtors for purposes of calculating the amount of their disposable income for chapter 13 plan purposes. The applicable plan commitment period was 60 months. Lastly, the Debtors calculated that they had no monthly disposable income that they were required to contribute to their chapter 13 plan.

In the Plan, the Debtors proposed to make payments to the Trustee in the total amount of $120,565 over the life of the Plan. With respect to their mortgage, the Debtors proposed to make their monthly mortgage payment of $5,499 directly to their mortgage holder, First United Bank & Trust Company ("First United"). With respect to their car leases with Toyota Lease Trust, the Debtors proposed to assume those leases and pay Toyota Lease Trust directly for the associated lease payments. The Plan further provided that unsecured creditors would not receive a

distribution.

The Trustee objected to the Plan and asserted that the Debtors erroneously calculated the amount of their monthly disposable income by impermissibly deducting from their monthly income mortgage and vehicle lease expenses in excess of the IRS Local Standard expense allowance levels. The Trustee specified that only the lesser of (a) the amount of the mortgage and vehicle lease allowances provided for in the IRS Local Standards incorporated by section 707(b)(2)(A)(ii) and (b) the debtor's actual mortgage and vehicle lease payments may be deducted from a debtor's monthly income in calculating monthly disposable income. Thus, capping the Debtors' mortgage and vehicle lease expenses results in the Debtors having $5,320.52 in monthly disposable income.

The Debtors argued that the Trustee failed to recognize the secured debt expense deduction provisions of section 707(b)(2)(A)(iii), which are separate from the expense deduction provisions in section 707(b)(2)(A)(ii). And, they asserted that where a debtor's actual expenses are higher than the associated IRS Local Standards, the debtor's actual expenses are fully deductible because the IRS Local Standards do not provide a limitation to a debtor's expenses, but rather provide expense allowances designed to guarantee minimum baseline expense deductions to the debtor.

The Court concluded that both the Debtors and the Trustee misinterpreted the provisions of section 707(b)(2) in calculating the Debtors' monthly disposable income. The Court explained its holding by stating the requirement that the Debtors' Plan must commit all disposable income projected to be received by the Debtors during the life of the Plan towards the payment of unsecured creditors. However, in determining whether the amount of income spent by a debtor "for the maintenance or support of the debtor or dependent" (as provided under section 1325(b)(2)) was "reasonably necessary", Congress provided that the Court must examine section 707(b)(2) (specifically stated in section 1325(b)(3)).

Section 707(b)(2) sets out the "means test" for determining whether a debtor's chapter 7 filing is presumptively abusive. Notably, the Court found that section 1325(b)(3)'s cross-reference to section 707(b)(2) (which assists in determining whether the debtor's monthly expenditures are reasonably necessary and thus, may be deducted from monthly income in the disposable income calculation) was designed to ensure that the same type of abuse that would warrant dismissal of a chapter 7 case is not present in a chapter 13 case due to a debtor's failure to commit all disposable income towards the payment of unsecured creditors.

Secured Debt Payments are not Capped by the IRS Local Standards. The initial question before the Court was whether deductible secured debt payments under section 707(b)(2)(A)(iii) (the "Secured Debt Clause") are capped in amount by the IRS Local Standards incorporated by section 707(b)(2)(A)(ii) (the "Living Expenses Clause"). The Court concluded that the secured debt payments are not capped because:

(a) the expense deductions in the Secured Debt Clause are separate and distinct from the expense deductions in the Living Expenses Clause;

(b) none of the language within the Living Expenses Clause serves as a limitation on the Secured Debt Clause, and none of language within the Secured Debt Clause provides that its language is limited by the Living Expenses Clause; and

(c) the Living Expenses Clause includes a "notwithstanding" proviso that monthly expenses allowed under that clause shall expressly exclude payments for debts.

Living Expenses are Capped by the IRS Local Standards. The Court concluded that absent proof of "special circumstances" warranting the allowance of expenses in excess of the IRS Local Standards, the IRS Local Standards do serve as a cap on such expenses. Specifically, section 1325(b)(3) dictates that amounts reasonably necessary to be expended for the maintenance or support of a debtor or a dependent shall be determined in accordance with section 707(b)(2). This is, thus, a mandatory provision that cannot be modified into a permissive one. In addition, if the Court were not to apply the cap, then that would render the "special circumstances" provision impotent. Therefore, the cap of the IRS Local Standards must apply to the Living Expenses Clause.

Application to the Debtors' Payments. As to the Debtors' mortgage payment to First United, the Court found that that was a secured debt obligation under the Secured Debt Clause. As a result, the IRS Local Standards were in applicable. The Debtors' monthly payments to Toyota Lease Trust were a little trickier to determine. Although Toyota Lease Trust filed proofs of claim that asserted a secured claim for the balance of the lease payments, the proofs of claim also identified the claims as being based upon leases and did not reflect that the Debtors were the owners of the vehicles. In addition, the Debtors treated the vehicles as unexpired leases subject to lease assumption under the Plan. Because of this, the Court determined that the lease payments did not relate to secured debts covered by the Secured Debt Clause, but instead were expenses covered by the Living Expenses Clause. This characterization resulted in the lease payments exceeding the IRS Local Standards, which the Debtors did not present any evidence demonstrating special circumstances under section 707(b)(2)(B). Therefore, the Court denied confirmation of the Debtors' Plan due to the Debtors' failure to contribute all of their disposable income to unsecured creditors.

3. Brown v. Douglas (In re Specialty Select Care of Center of San Antonio, LLC), Case No. 17-44248-ELM, 2021 WL 3083522 (Bankr. N.D. Tex. July 21, 2021)

The Chapter 7 Trustee in this case initiated an adversary proceeding against various non-debtor related third parties. The Trustee's complaint asserted a number of causes of action against the parties, including avoidance and recovery of fraudulent transfers pursuant to 11 U.S.C. 548(a)(1)(A) and 550; avoidance and recovery of constructive fraudulent transfers pursuant to 11 U.S.C. 548(a)(1)(B) and 550; avoidance and recovery of actual and constructive fraudulent transfers under the Texas Uniform Fraudulent Transfer Act and 544(b)(1) and 550; avoidance and recovery of preferential transfers pursuant to 11 U.S.C. 547 and 550; breach of fiduciary duty; gross negligence/exemplary damages; objection to the proof of claim; and recharacterization of the proof of claim.

Following the commencement of the adversary proceeding, the defendants filed their motion to dismiss the complaint pursuant to Federal Rules 8(a), 9(b) and 12(b)(6). Although the Trustee opposed the dismissal, he requested leave to amend the complaint to the extent the Court agreed with the defendants' assertions regarding dismissal.

The Court engaged in a thorough evaluation of the causes of action and whether they

sufficiently satisfied the pleading requirements under the relevant rules. As to actual fraud, the Court found that the Trustee failed to substantiate his allegations that the defendants received transfers from the debtor that were above market value for such services. The Court held similarly as to the constructive fraud counts - the Trustee failed to provide evidence of the essential element that the debtor received less than reasonably equivalent value. Those causes of action were, thus, not supported by the allegations, thereby warranting dismissal.

With respect to the majority of the remainder of the claims, the Court specifically went through each cause of action and explained its reasoning. Ultimately, the Court believed that the Trustee did not satisfy the notice and pleading requirements for several other causes of action. The Court clarified that in each respective section asserting a claim, it is necessary to set forth the specific factual allegations in support of such claim. Importantly, the Court recognized that pleadings must tie together the elements of a claim to the factual allegations. The failure to adequately do so will result in dismissal.

Although the Court did dismiss a couple of causes of action with prejudice, most of the claims were dismissed subject to the right of the Trustee to further amend and replead the counts in the complaint.

4. In re Johnson, 2021 WL 825156, Case No. 19-42063-ELM (Bankr. N.D. Tex. March 1, 2021)

In this chapter 7 case, the individual debtors (a married couple) requested that the Court convert their case to a joint case under subchapter V of chapter 11. The Court specifically considered two pivotal questions: (i) whether an individual who previously owned and managed certain now-defunct businesses and who, on account of such ownership and involvement, has mostly business-related debts, is "engaged in" commercial or business activities for purposes of eligibility under subchapter V; and (ii) whether an employed officer of a non-debtor business entity, having no ownership in or ultimate control over the non-debtor business entity, is engaged in "commercial or business activities for purposes of eligibility under subchapter V.

To qualify as a small business debtor eligible for relief under subchapter V, one must, among other things, be "engaged in commercial or business activities" or be an affiliate of such a debtor. In resolving the disputes here, the Court looked at the language of the statute itself. Specifically, the Court examined the meaning of "engaged in" and "commercial or business activities". As to "engaged in", the debtors argued that the fact that Mr. Johnson's prior ownership and management of certain now-defunct entities qualified him as a person "engaged in" commercial or business activities. The Court applied the ordinary meaning of "engaged" to the language of section 101(51D) and held that a person "engaged in" commercial or business activities is a person occupied with or busy in commercial or business activities - not a person who at some point in the past had such involvement.

Further, the Court stated that section 101(51D) is designed to identify those debtors who are in particular need of the benefits of small business debtor treatment, benefits that are largely designed to facilitate expediency and minimize cost. Such benefits are essential to the ability of a small business debtor to successfully reorganize as a going concern. They are not essential to a small business that is no longer occupied with/busy in any commercial or business activities.

The Court also looked towards the fact that Congress had used the same language in the eligibility provisions applicable to subchapter IV (railroads) of chapter 11 and chapter 12 of the Bankruptcy Code. In those cases, courts have applied a contemporary analysis to the "engaged in" terminology, limiting eligibility to those currently occupied with/busy in the respective operations.

As to the scope of the words "commercial or business activities" in section 101(51D), the Court disagreed with the Debtors' assertion that Mr. Johnson's day-to-day management of a non-debtor entity and his role as its President equated to individual engagement in "commercial or business activities". The Court again examined the text of the statute. In applying the ordinary meaning of "commercial or business activities" to the language in section 101(51D), the Court determined that a person engaged in "commercial or business activities" is a person engaged in the exchange or buying and selling of economic goods or services for profit. Since Mr. Johnson was simply an employee of the non-debtor entity with heightened obligations to the company, Mr. Johnson did not qualify as a small business debtor.

And, even if Mr. Johnson had qualified as a small business debtor, his wife, also a debtor, did not qualify as an affiliate of him for purposes of section 101(51D).

In conclusion, the Court held that neither of the Debtors qualified as a small business debtor under the statutory provisions and thus, neither was eligible for relief under subchapter V of chapter 11 of the Bankruptcy Code.

5. Tiburon Land and Cattle Resources, L.P. v. Stephens, et. al (In re Stephens), Adv. Proc. No. 21-04040, 2022 WL 527745 (Bankr. N.D. Tex. Feb. 22, 2022)

The Court considered the *Motion to Remand* filed by Plaintiffs who sought remand of the removed causes of action from state court on the basis of untimely removal or, in the alternative, permissive abstention and equitable remand. In denying the Motion to Remand, the Court explained definitively why Fed. R. Bankr. P. 9027's 90-day time limit for removed actions controls the removal of claims or causes of action related to a bankruptcy and found against abstention/remand where there had been a jury verdict reached in state court.

In Tiburon, a group of geologist, lawyers, and oil and gas investors entered into a participation agreement to develop oil and gas assets in Fisher County, which turned out to be very successful culminating in a sale of assets to Devon Energy Production Company, L.P. ("Devon"). After the closing, Devon informed some of the group members that it was interested in acquiring more acreage. The informed members sought termination of the original participation agreement, which all but two members agreed to. Thereafter, the informed members moved forward with the acquisition of additional Fisher County leases and sale to Devon, leaving the other members out of the deal. When the sale was uncovered, one of the members who had not consented to termination sued the informed members, and the other non-consenting member eventually intervened, asserting causes of action for breach of contract, breach of fiduciary duty, and fraud.

After a three-week jury trial, the state court jury rendered a verdict in favor of plaintiffs and the state court entered a final judgment on the claims of the member's LLC (i.e. not the individual's claims). On appeal, the appellate court remanded to permit plaintiffs to pursue

recovery individually based upon the jury's findings. On remand, the plaintiffs moved for an injunction precluding disposal of assets and for severance so that some of the claims could be paid from the supersedes bond posted by defendants. After the state court granted these motions, one of the defendant members filed a subchapter 5 case for himself and his companies. On the 90th day after commencement of the individual case, the debtor defendants jointly removed the claims asserted in the proofs of claims filed in the bankruptcy cases.

Fed. R. Bankr. P. 9027's 90 day time period for removal of causes of action controls. The plaintiffs asserted that the removal was untimely because it was outside of the 30-day period set out in 28 U.S.C. § 1446 and the debtors argued that Fed. R. Bankr. P. 9027's 90-day period controls. The Court explained that 28 U.S.C. § 1446 regulates removal of civil actions, not the removal of claims and causes of action in a civil action. The latter is regulated by 28 U.S.C. § 1452 which contains no such deadlines, and therefore, Fed. R. Bankr. P. 9027 fills the gap.

Permissive Abstention and Equitable Remand. The Court noted the fourteen (14) factors applicable to both doctrines and considered each. First, as to the effect on the efficient administration of the estates, the Court noted that there would be no material gain in efficiency on remand—it could do what the state court would have to on remand—and on the flip side, a remand would lead to the loss of control of adjudication of claims against the estate by the debtor. Also interestingly, in the context of burden on the court's docket, the Court determined that because there already had been a jury verdict, the proceeding before it was much simpler and in the context of a jury trial right, this was a non-issue since there already was a jury trial. Further, in considering the forum shopping factor, the Court noted that while the filing may have been on the eve of judgment, the Court was not troubled because the filing had a purpose other than forum shopping (to protect the property subject to execution). After weighing each factor, the Court found against abstention and remand.

6. Neary v. Lindeman (In re Lindeman), Adv. Proc. No. 19-04103-ELM, 2022 WL 1241427 (Bankr. N.D. Tex. April 19, 2022)

In this chapter 7 case, the U.S. Trustee (and an intervening creditor) objected to Debtors' discharge due to their failure to engage in the bankruptcy process in an "honest, forthright, and timely manner." Specifically, the U.S. Trustee objected to Debtors' discharge pursuant to §§ 727(a)(4)(A) and 727(a)(3), arguing that the Debtors knowingly and fraudulently made a false oath or account in connection with the Bankruptcy Case and failed to keep and preserve books and records from which the Debtors' business and transactions may be ascertained. In a thorough opinion of the Debtors devious conduct, the Court granted Trustee's objections to discharge.

Prior to the petition date, Debtors (a married couple) owned and operated a home remodeling business after attending a real estate flipping seminar. Following the seminar, the Debtors organized a real estate entity under which the Debtors would conduct their business. What followed was Debtors' calculated efforts to stay above water by forming new entities, taking on new creditors by the month, and eventually conducting business in their own name to stave off bankruptcy. They flopped.

The Debtors struggled to achieve financial gains early on and the first entity was in financial trouble. As a result, they organized a second entity where assets were transferred to

continue their real estate business. To try and remain more competitive, the Debtors formed a third entity to handle construction only. Last, and after struggling with all of their other three entities, the Debtors began conducting business in their own name. Ultimately, the asset shifting was not enough and the Debtors filed for bankruptcy.

Worse, the Debtors' bankruptcy filings were not accurate. The Court—in a comprehensive opinion—went through filing by filing that was inaccurate and discussed every opportunity the Debtors had to correct the falsities. For example, the Debtors omitted several entities they had an interest in as codebtors, omitted entities they had received income from, understated gross income by more than $1 million, and failed to disclose payments made to insiders. Debtor affirmed the accuracy of the filings many times under oath including the initial filing of their bankruptcy petition, schedules, and statement of affairs, at their 341 meeting, the U.S. Trustee's 2004 Examination, and after filing their amended schedules correcting only minor inaccuracies.

All in all, the Court found that Plaintiffs had made a false oath or account with respect to information in Debtors' bankruptcy filing and with respect to an accounting of the Debtors' businesses that was provided to the U.S. Trustee. The Court noted that the Debtors were initially successful in convincing the chapter 7 Trustee to designate the case as a "no asset" case in which there would be no reason to delve into the Debtors' undisclosed assets and other formed entities. As a result, the Court granted Trustee's denial of Debtors' discharge for Debtors' conduct.

7. ZPower, LLC v. Widex (In re ZPower Texas, LLC), Adv. Proc. No. 20-04026 (N.D. Tex. Bankr. May 3, 2021) [Dkt. No. 46]

In ZPower, the Debtor manufactured microbatteries for medical hearing devises and the plaintiff and its affiliates manufactured and distributed hearing aids worldwide. The Debtor and plaintiff entered into a supply agreement in 2017, which contained an insolvency provision that provided for the immediate termination by the other party by written notice, and had an arbitration provision which provided for any dispute arising out of in connection with the agreement to be arbitrated by The Danish Institute of Arbitration (the "DIA").

In 2020, ZPower filed chapter 11 with a $2 million plus prepetition accounts receivable due from the defendant. Immediately thereafter, the defendant sent an email to customers stating it would no longer sell ZPower rechargeable hearing aids and refused to purchase any of ZPower's products it had forecasted. As a result, ZPower discontinued production, and filed the adversary proceeding asserting: anticipatory repudiation, intentional violation of the automatic stay, and breach of contract relating to the receivable. The defendant moved to dismiss arguing that the dispute must be brought before the DIA or dismissed for failure to state a claim.

Enforceable arbitration provisions do not divest a court of jurisdiction. The Court rejected the argument that the arbitration clause deprives the Court of jurisdiction; rather, the Federal Arbitration Act ("FAA") may prevent the Court from exercising the subject matter jurisdiction it has over an arbitrable dispute. So while the FAA may require a court to stay all proceedings to compel arbitration, that is not a divestiture of the Court's subject matter jurisdiction. Therefore, a 12(b)(1) motion based upon an arbitration clause divesting subject matter jurisdiction must be denied.

Arbitration provisions are not enforceable for automatic stay violations (but that doesn't necessarily apply to related claims). To avoid the arbitration clause, the Debtor argued that the intentional violation of the automatic stay is outside of the clause because it involves core statutory bankruptcy rights and any other counts must be tried therewith to avoid piecemeal litigation. The FAA provides that it may be override by a contrary congressional command and the Debtor argued the Bankruptcy Code is just that with respect to stay violations. The Court explained that jurisprudence instructs that courts can decline to enforce the arbitration provision if (i) the proceeding adjudicates statutory rights conferred by the Bankruptcy Code, and(ii) requiring arbitration will conflict with the purposes of the Bankruptcy Code. The Court found that the first requirement was easily met as to stay violations. As to the second, the Court determined that requiring the arbitration of violations of the automatic stay conflicts with the purposes of the Bankruptcy Code as the automatic stay is perhaps the single most important and fundamental protection provided to a debtor in bankruptcy. Therefore, based upon the inherit conflict between arbitration and the underlying purpose of the automatic stay, there is a waiver of remedies for disputes involving the applicability, violating, or enforcement of the automatic stay. But while the violation of automatic stay claim was not subject to mandatory arbitration, the other counts were and therefore, the Court stayed the proceeding until those counts were determined by arbitration.

NOTABLE CASES FROM JUDGE MARK X. MULLIN
United States Bankruptcy Judge for the Northern District of Texas
Fort Worth Division

1. In re Preferred Care, Inc., 17-44642-mxm-11, March 22, 2019 [Dkt No. 1675]

This case involved a motion to enforce a settlement agreement. The Debtors are part of a network of 108 skilled nursing, assisted and independent living and mental health facilities, and filed voluntary chapter 11 bankruptcy petitions on November 13, 2017, in the wake of approximately 163 pending lawsuits against some or all of the Debtors. During the Debtors' cases, the Debtors filed a motion to approve a settlement between the Debtors, Thomas D. Scott (an officer, director, partner, manager of, and/or direct or indirect owner of an interest in, each of the Debtors), Robert J. Reik (an officer of one of the Debtors and a manager of other Debtors), and certain of Mr. Scott's affiliated entities. The settlement agreement provided for a global settlement and release by the Debtors and their bankruptcy estates of all claims and causes of action against Scott, Reik, and Scott's affiliated entities. The Bankruptcy Court's order approving the settlement agreement barred and enjoined any party from asserting any released claim against Mr. Scott and the other released parties.

After entry of the Bankruptcy Court's settlement order, five separate state-court lawsuits were filed, all of which name Mr. Scott individually as a defendant and seek to hold him individually liable for his acts and omissions resulting in alleged injury to residents at the Debtors' facilities. As a result, Mr. Scott filed a motion to enforce the injunction provided in the settlement order and enjoin the state court lawsuits from proceeding. The determinative issue before the Bankruptcy Court was whether the claims asserted against the released parties in the state-court lawsuits were derivative or direct claims. If such claims were the former, and were derivative of the Debtors' claims, the claims would be enjoined from proceeding.

The Bankruptcy Court ultimately denied the motion to enforce and explained that the state-court claims did not stem from a depletion of the Debtors' asserts or other harm to the Debtors, and thus were direct claims owned by the claimants. In support of this conclusion, the Bankruptcy Court found a recent Fifth Circuit decision, In re Buccaneer Resources, L.L.C., instructive, a case in which the Fifth Circuit concluded that a former officer's tortious-interference claim against a secured lender was a direct claim and not a derivative one where the injury pursued did not stem from the depletion of estate assets. 912 F.3d 291, 295 (5th Cir. 2019). Finally, the Bankruptcy Court noted that it was not tasked with determining the legal and factual merits of the claims against the released parties. Instead, the Bankruptcy Court determined that the complaints did not allege or rely on harm to the Debtors, and thus were not property of the Debtors' estates.

After entry of the Bankruptcy Court's decision denying his motion to enforce, Mr. Scott appealed the denial to the District Court for the Northern District of Texas. The District Court affirmed the Bankruptcy Court's order. Mr. Scott then appealed to the Court of Appeals for the Fifth Circuit. Ultimately, the appeal was dismissed on March 31, 2021, after the parties reached a settlement.

2. YYP Group, Ltd. v. McKnight, 19-4080-mxm-11, January 26, 2021 [Dkt. No. 51]

This case involved an award of civil damages for violation of a stay order entered in the CGE Real Estate Holdings, LLC chapter 11 bankruptcy case. The dispute at the center of the adversary proceeding involves residential real property that is located in Dallas, Texas and is owned by the Debtor, CGE Real Estate Holdings, LLC ("CGE Holdings"). CGE Holdings executed a note payable to YYP Group, Ltd. (the "Plaintiff") secured by a lien on the property. As further security for the note, Aaron Cain McKnight ("McKnight") signed a guaranty. McKnight also lived on the property but did not pay rent. After CGE Holdings defaulted on the note, the Plaintiff accelerated the note and posted the property for a foreclosure sale.

Prior to such foreclosure sale, CGE Holdings filed for chapter 11 protection. The Plaintiff filed a motion to lift the automatic stay and proceed with the sale, and the parties eventually agreed to the terms of a stay order that provided CGE Holdings and McKnight with two months to sell or refinance the property and pay off the note. The stay order also provided that if the parties were unsuccessful in paying off the note by that time, the Plaintiff was authorized to proceed with a foreclosure sale of the property and the parties were prohibited from seeking injunctive relief in any attempt to delay the foreclosure sale. After CGE Holdings and McKnight were unsuccessful in paying off the note by the deadline in the sale order, the Plaintiff again posted the property for a scheduled foreclosure sale.

This time prior to the foreclosure sale, McKnight filed a state court lawsuit seeking a temporary restraining order and injunction against the Plaintiff, which the state court issued. After appeal by the Plaintiff, the Court of Appeals for the Fifth District of Texas in Dallas reversed the state court and ordered that the lawsuit be dismissed. The Plaintiff then filed an adversary proceeding asserting that McKnight should be held in civil contempt for violating the stay order.

The Bankruptcy Court first noted that it may enforce its own orders under section 105 of the Bankruptcy Code and its inherent civil contempt power before discussing the elements of civil contempt, which are: (1) a court order was in effect, (2) the order required certain conduct by the respondent, and (3) the respondent failed to comply with the court order. In this case, there was no dispute that the stay order was in effect. Instead, McKnight argued that he was not subject to it. Based on the uncontroverted evidence submitted by the Plaintiff, which McKnight failed to rebut, the Bankruptcy Court found that McKnight had actively participated in the CGE Holdings bankruptcy case as well as the negotiations culminating in the stay order, yet willfully violated the stay order by filing and prosecuting the state court lawsuit.

As a result of McKnight's willful violation of the stay order, the Bankruptcy Court determined that McKnight should be sanctioned $186,000 in attorney's fees and $288,000 in unrealized rental income from the property that McKnight continued to occupy.

3. In re Life Partners Holdings, Inc., No. 15-40289-mxm-11, Aug. 22, 2019 [Dkt. No. 4405]

This chapter 11 case involved an analysis of the amendment (the "2017 Amendment") to section 1930(a)(6) of the Bankruptcy Code, which increased the United States Trustee (the "U.S. Trustee") quarterly fee schedule effective January 1, 2018. Prior to the 2017 Amendment, the payment of quarterly fees to the U.S. Trustee under section 1930 of the Bankruptcy Code ranged

between $6,500 and $30,000, at the absolute maximum. After the 2017 Amendment, the payment of quarterly fees had the potential to increase when a chapter 11 debtor's quarterly disbursements meet or exceed $1 million and the U.S. Trustee System Fund balance fell below $200 million in the most recent fiscal year.

Life Partners Holdings, Inc. and certain of its subsidiaries ("LPH") filed their chapter 11 cases in 2015, and their chapter 11 plan (the "Plan") was confirmed in 2016 and went effective just before the end of the year. Pursuant to the Plan, a trust (the "Position Holder Trust" or the "PHT") was established to administer life insurance policies for investors and, according to the order confirming the Plan, the trustee of the PHT is required to "(a) continue to pay all fees due and payable pursuant to [section 1930] until the closing, conversion, or dismissal of the Chapter 11 Cases, and (b) provide the required post-confirmation reporting to the U.S. Trustee until the Chapter 11 Cases are closed." As a result of the 2017 Amendment, the PHT paid just under $655,000 in U.S. Trustee quarterly fees for the first three quarters in 2018, compared with the mere $56,000 in U.S. Trustee quarterly fees paid for all four quarters in 2017.

The issues the Court faced in this case were whether (i) the 2017 Amendment is applicable to chapter 11 cases filed prior to its enactment, (ii) the 2017 Amendment is unconstitutional, and (iii) such issues must have been brought via an adversary proceeding. Acknowledging that other courts had recently ruled on this same issue, the Court relied on a large portion of the legal analysis and conclusions from such cases. <u>See</u> <u>In re Buffets, LLC</u>, 597 B.R. 588 (Bankr. W.D. Tex. Feb. 8, 2019); <u>In re Circuit City Stores, Inc.</u>, No. 08-35653-KRH, 2019 WL 3202203 (Bankr. E.D. Va. July 15, 2019).

In rejecting the U.S. Trustee's assertion that the 2017 Amendment should apply to all disbursements made in all cases, regardless of when filed, beginning in the 2018 fiscal year, the Court relied on <u>Buffets</u> and determined that "while the increase applies only to disbursements made on or after January 1, 2018, nothing in the statute or legislative history indicates that Congress intended the 2017 Amendment to apply to pending cases as of the amendment date." The Court highlighted the fact that the 2017 Amendment was to apply to "ongoing" chapter 11 cases but that it was unclear whether such term was meant to include only those cases that were opened after the enactment of the 2017 amendment or whether cases pending at that time were also contemplated. In prior versions of section 1930 of the Bankruptcy Code, Congress clarified its intended application by the inclusion of express language in the statute; however, as noted by the Court, Congress did not include similarly specific language in the 2017 Amendment. Notably, such express language *was* included in amendments made to Chapter 12 of the Bankruptcy Code, which were made as part of the same legislation that enacted the 2017 Amendment. As such, the Court concluded that the lack of such clear language coupled with the astronomical increase in quarterly fees was enough to call in to question the applicability of the 2017 Amendment to cases that were pending when the 2017 Amendment became effective.

Next the Court held that, even if the 2017 Amendment applied to cases that were pending, including the LPH chapter 11 cases, the 2017 Amendment is unconstitutional for being in violation of the Uniformity Clause and the Bankruptcy Clause. The Court found that the 2017 Amendment was not uniform because chapter 11 debtors in Bankruptcy Administrator ("BA") Program districts are not required to pay the increased U.S. Trustee quarterly fees if their cases were filed before

October 1, 2018, whereas chapter 11 debtors in U.S. Trustee districts would be required to pay regardless of when their cases were filed. In support of such finding, the Court relied on the permissive language in section 1930(a)(7) of the Bankruptcy Code, which provides that debtors in BA districts *may* be required to pay uniform fees. In other words, had the LPH cases been filed in a BA district, the 2017 Amendment would never have applied.

In so holding, the Court rejected the U.S. Trustee's arguments (i) that any difference in the applicability of the quarterly fees is rationally justified even under the Uniformity Clause and (ii) that the 2017 Amendment does not fall within the Bankruptcy Clause because, among other reasons, the quarterly fees required under section 1930 of the Bankruptcy Code are given administrative claim status and consequently impact the amount of funds available for distribution to a debtor's creditors.

Lastly, the Court concluded that even if the 2017 Amendment is constitutionally uniform, its application in cases that were filed prior to its enactment would be in violation of the Due Process Clause. Specifically, as applied to the LPH cases, the 833% increase in maximum quarterly fees came after the Plan was negotiated and confirmed and after the PHT was charged with making distributions to creditors, such that the parties in LPH were deprived of the choice to restructure debts in a manner that would have avoided the increased quarterly fees.

Ultimately, the Court held that the 2017 Amendment did not apply to the LPH cases, and even if it did apply, it would be unenforceable because it is unconstitutional. The Court converted to an adversary proceeding the issues of whether any U.S. Trustee quarterly fees previously paid in accordance with the 2017 Amendment could be recovered by the PHT and the recalculation of any such fees owed.

The Fifth Circuit abated this opinion, however, the Supreme Court of the United States recently heard oral arguments on similar issues in the Circuit City case and that ruling is pending.

4. In re Bainbridge Uinta, LLC, No. 20-42794 (MXM) (Bankr. N.D. Tex. 2020)

In In re Bainbridge Uinta, LLC, Judge Mullin approved third-party releases with an "opt-out" structure over the objection of the United States Trustee. The debtors were an upstream oil and gas company that had operated in Utah's Uinta Basin since their acquisition of Three Rivers field from Ultra Petroleum in 2018. Like many upstream oil and gas companies, the debtors experienced significant liquidity constraints that were exacerbated by significant declines in crude oil demand and prices due to the outbreak of Covid-19 and the inability of the members of the Organization of Petroleum Exporting Countries and Russia to agree on production levels. After the tumultuous drop in oil prices, the debtors began shutting in wells and reducing operating expenses before ultimately filing chapter 11 petitions in the United States Bankruptcy Court for the Northern District of Texas.

The debtors proposed a sale process under section 363 of the Bankruptcy Code and a liquidating plan to distribute the sale proceeds and remaining estate assets. The debtors' plan provided an "opt-out" mechanism whereby non-voting creditors were deemed to have consented to third-party releases unless such creditor opted out of such release by properly returning the opt out form. The Office of the United States Trustee objected to the third-party releases and the

debtors' opt-out mechanism, arguing that Fifth Circuit's In re Pacific Lumber Co. case requires express consent for third-party releases, which it argued opt-outs inherently cannot provide. 584 F.3d 229 (5th Cir. 2009).

A central issue in determining the permissibility of opt-out procedures is determining whether silence may constitute consent. Drawing an analogy to federal class action suits, which can bind potential beneficiaries who fail to take action, Judge Mullin held that inaction may constitute tacit consent if sufficient notice was provided. During the June 25, 2022, hearing, Judge Mullin emphasized that "facts matter. . . . It must be established in every case whether these type of opt-out provisions satisfy the due process requirements for them to be enforceable."

Ultimately Judge Mullin held that the plan's opt-out mechanism constituted consent and, therefore, was not subject to Pacific Lumber's bar (which prohibits only *nonconsensual* third-party releases). However, opt-out mechanisms must describe the releases in the ballot and opt-out form in bold and conspicuous text, and parties must be afforded sufficient due process. Although not dispositive, creditors opting out of the third-party releases is good indicia that a debtor has satisfied its due process requirements and provided a conspicuous warning regarding the effect of silence.

5. In re Jessica Garcia Trejo, No. 17-42439 (MXM) (Bankr. N.D. Tex. 2020)

Debtor filed a chapter 7 case seeking to discharge $90,598.80 in federal student loans. Debtor, as a mother to two disabled daughters, had not held a full-time job in the last fifteen years because she was required to spend most of her day caring for her daughters due to their disabilities. In 2017, her daughters' conditions worsened and Debtor quit her part-time job to care for them. During that time, she relied solely on her daughters' Supplemental Security Income ("SSI") benefits ($1,470/month), food stamps ($210/month), and occasional assistance from local churches. Her monthly expenses totaled $1,750.

Generally, student loans are not subject to discharge, except as provided by section 528(a)(8) of the Bankruptcy Code. To discharge student loan debt, the Debtor had to demonstrate that the debt would impose an "undue hardship" on the Debtor and the Debtor's dependents if such debts were not exempted under section 523. The Fifth Circuit has adopted the Brunner test as the standard to determine whether an "undue hardship" exists. Brunner v. New York State Higher Education Services Corp, 831 F.2d 395 (2d Cir. 1987). The Brunner test requires:

> (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.

With respect to the first element, merely tight finances is insufficient; a debtor must show that its necessary expenses exceed its income. Here, the Court held that the Debtor had demonstrated that since 2017, her monthly necessary expenses were $1,750 whereas her monthly

income was only $1,680, reflecting a $70 deficit. The Debtor also demonstrated that she lacked the ability to create discretionary income that could go toward repaying the loans.

With respect to the second element, the Fifth Circuit looks to whether there are extenuating circumstances that affect the debtor's future earning potential, and whether these circumstances existed when the debtor first applied for the loans or have been exacerbated since. Here, when the Debtor took out her first loan, she had no reason to anticipate that the disabilities of her two daughters would severely worsen in the future. The Debtor was unable to attain a job because she was required to stay at home to care for her disabled daughters. Thus, the Debtor demonstrated that she is unable to take even a part-time job without risking the health of her daughters for the foreseeable future, and that this situation will persist for a significant portion of the repayment period.

With respect to the third element, the Fifth Circuit looks to three factors: (i) whether the debtor's default is the result of factors beyond her control; (ii) the debtor's efforts to obtain employment, maximize income, and minimize expenses; and (iii) the debtor's repayment efforts, including whether any payments were made and whether the debtor pursued forbearance, deferment, or otherwise attempted to renegotiate the terms of the loan.

The Court concluded that the Debtor met inquiries (i) and (ii) due to the uncontroverted evidence that because of the steep decline in her daughters' conditions, which was beyond her control, Debtor was required to quit her part-time job to look after them, curtailing her ability to obtain employment, increase income, or decrease expenses.

Regarding inquiry (iii), the Fifth Circuit has held that mere failure to make a payment by itself does not establish a lack of good faith because there may be a complete lack of funds to make even a single payment. In such cases, the court examines where the debtor pursued forbearance, deferment, or otherwise attempted to address the loans. The Court concluded that Debtor made sufficient efforts, as evidenced by her numerous phone calls to the lenders and her successful obtainment of several payment deferrals and forbearances. The Board of Education argued that deferments and forbearances are only short-term solutions and that Debtor was unable to credibly prove that she sought any long-term solutions to her loans. The Court here did not treat the failure to seek long-term solutions as fatal to Debtor's case, and instead concluded that Debtor satisfied the final prong, allowing her to discharge all of the federal student loan debt pursuant to section 523(a)(8).

6. In re Silver State Holdings, Assignee—7901 Boulevard 26 LLC, No. 19-41579-MXM, Adv. Pro. No. 19-4043-MXM (Bankr. N.D. Tex. Dec. 17, 2020)

In this complicated case, the sole member, manager, and director ("Morash") of 7901 BLVD 26, LLC ("7901") caused 7901 to contract with Valley Ridge Roofing and Construction, LLC ("Valley Ridge") to repair roof damage on a rental property (the "Property") owned by 7901. There was a dispute over the contract balance and, after arbitration, judgment was entered in favor of Valley Ridge against 7901. This judgement lien was subordinate to county tax liens for $100,000, a $3.4 million lien held by Frost Bank, and an $180,000 third-priority government lien.

In response to Valley Ridge's attempt to collect on its judgment, Morash formed Silver State Holdings ("Silver State") and caused it to acquire the City's claim and its $180,000 third-priority government lien, then caused Silver State to foreclose on the Property, effectively wiping out Valley Ridge's lien. In response, Valley Ridge filed an involuntary bankruptcy petition against 7901. Silver State then filed its' own bankruptcy petition and sold the Property under section 363 of the Bankruptcy Code. Valley Ridge brought claims for preferential transfer, actual and constructive fraudulent transfer, wrongful foreclosure, breach of fiduciary duty, conspiracy, and aiding and abetting.

The Court's opinion discusses avoidability of prepetition transfers based on theories of preference and actual and constructive fraudulent transfer. Section 547(b) of the Bankruptcy Code governs the situations under which a Bankruptcy Court can avoid a prepetition transaction as preferential. Sections 24.005(a)(1) and 24.006(b) of the Texas Business and Commerce code and Section 544 of the Bankruptcy Code govern avoidability based on theories of actual and constructive fraudulent transfer.

In order to avoid a transaction as preferential, the plaintiff must show that the transfer was:

(1) to or for the benefit of a creditor;

(2) for or on account of an antecedent debt owed by the debtor before such transfer was made;

(3) made while the debtor was insolvent;

(4) made—

(A) on or within 90 days before the date of the filing of the petition; or

(B) between ninety days and one year before the date of the fling of the petition, if such creditor at the time of such transfer was an insider: and

(5) that enables such creditor to receive more than such creditor would receive if—

(A) the case were a case under chapter 7 of this title;

(B) the transfer had not been made; and

(C) such creditor received payment of such debt to the extent provided by the provisions of this title. 11 U.S.C. 547(b).

The Court found that the foreclosure met all of these factors because 7901 was insolvent at the time of the foreclosure and Silver State received more due to the transaction than it would have under chapter 7. In response to Valley Ridge's arguments, Silver State argued that:

- 7901 could not be insolvent because the Property was worth more than the liens against it.

- The Court disagreed, holding that if the total debts exceed the total value of the assets—even if the total liens against the Property were less than the value of the Property—7901 was nevertheless insolvent.

- A secured creditor that recovers its own collateral does not receive a preference.
    - The Court distinguished this argument because Silver State was an oversecured third-priority creditor that would not have recovered under a chapter 7 case.

- Under BFP v. Resolution Trust Corp., 511 U.S. 531 (1994) ("BFP"), a regularly conducted, noncollusive foreclosure sale cannot be avoided as a preference because as a matter of law Silver State paid reasonably equivalent value for the Property, which is the same result that would have occurred in a chapter 7.
    - The Court disagreed because in a chapter 7, the first priority creditor would have foreclosed leaving Silver State with nothing. Therefore, the reasoning of BFP was not applicable because Silver State would not have recovered in chapter 7.

- Under BFP, public policy requires that preference law give way to the finality of state-law foreclosure sales.
    - The Court disagreed because the plain language of Section 547 was not ambiguous and must be enforced. The BFP court only needed to consider the public policy because the language in the statute it was interpreting was ambiguous.

Valley Ridge also argued that the foreclosure was an actual fraudulent transfer under Section 548(a)(1)(A) which allows the trustee to avoid any transfer "of an interest of the debtor in property, or any obligation . . . incurred by the debtor that was made or incurred on or within 2 years before the date of the filing of the petition, if the debtor voluntarily or involuntarily—(A) made such transfer . . . with actual intent to hinder, delay or defraud any entity to which the debtor was or became, on or after the date that such transfer was made or such obligation was incurred, indebted . . ." The Court found that several badges of fraud applied and therefore the foreclosure was an actual fraudulent transfer, and as such, the good-faith transfer exception did not apply. The Court applied a similar analysis, finding that the foreclosure was an actual fraudulent transfer under Bankruptcy Code Section 544 and Texas Business and Commerce Code Section 24.005(a)(1).

Valley Ridge argued that the foreclosure was also a constructive fraudulent transfer under Texas Business and Commercial Code Section 24.006(b), which provides that "[a] transfer made by a debtor is fraudulent as to a creditor whose claim arose before the transfer was made if the transfer was made to an insider for an antecedent debt, the debtor was insolvent at that time, and the insider had reasonable cause to believe the debtor was insolvent." The Court found that these factors also applied. However, the other constructive fraudulent transfer statutes, Bankruptcy Code Section 548(a)(1)(B) and Texas Business and Commercial Code Section 24.006(a), include a requirement that the transfer was not for a reasonably equivalent value, a conclusion which was foreclosed by BFP's holding that a noncollusive, regularly conducted foreclosure sale results in reasonably equivalent value as a matter of law. Therefore, the Court found that the foreclosure was not a constructive fraudulent transfer under these two statutes.

The Court ultimately allowed Valley Ridge to recover the value of the property but not to seek breach of fiduciary duty claims against Morash because those claims belonged to 7901 and could not be pursued by a creditor.

7. In re Darren Scott Matloff, No. 19-44253-MXM, Adv. Pro. 19-04127-MXM (Bankr. N.D. Tex. March 24, 2022)

Darren Scott Matloff ("Matloff") created a business to develop and distribute Propel-brand remote-controlled helicopters and drones. In 2016, Triumphant Gold Limited ("TGL") entered into a loan agreement with Matloff to fund his business. Matloff personally guaranteed his company's obligations under the loan agreement. In 2019, Matloff's business and Matloff personally filed for bankruptcy relief: the business in chapter 11, and Matloff in chapter 7. TGL sought a judgment that its claim against Matloff is nondischargeable under Sections 523(a)(2), (4), and (6) and Sections 727(a)(2-5) and (7) of the Bankruptcy Code.

Section 523(a)(2) of the Bankruptcy Code allows a debt to be declared nondischargeable if it is a debt "for money . . . or an extension, renewal, or refinancing of credit, to the extent obtained" through methods including false pretenses or fraud. TGL alleged that Matloff made several false or fraudulent representations about the structure of the business and its finances either orally or in writing. The Court found that TGL's witnesses were not persuasive with respect to their testimony regarding fraud or false pretenses and therefore did not find the debt nondischargeable on this basis.

Section 523(a)(4) of the Bankruptcy Code allows a debt to be declare nondischargeable "for fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny." Courts generally focus on whether the debtor was acting in a fiduciary capacity and whether the debtor's actions consciously disregarded a substantial and unjustifiable risk that would violate a fiduciary duty. Such a fraud would involve moral turpitude or intentional wrong. The Court found that there was no fiduciary duty owed by Matloff to TGL at the time of the loan, therefore there was no claim under Section 523(a)(4).

Section 523(a)(6) of the Bankruptcy Code allows a debt to be declared nondischargeable "for willful and malicious injury by the debtor to another entity or to the property of another entity." This section requires "a deliberate or intentional injury, not merely a deliberate or intentional act that leads to injury." Kawaauhau v. Geiger, 523 U.S. 57, 61 (1998). An injury is willful or malicious where there is either "(1) an objective substantial certainty of harm arising from a deliberate or intentional action or (2) a subjective motive to cause harm by a party taking a deliberate or intentional action." Ward Family Found. V. Arnette (In re Arnette), 454 B.R. 663, 700 (Bankr. N.D. Tex. 2011). The Court found that TGL failed to allege any particular injury to itself or its property in connection with the debt or present evidence at trial of any such injury, therefore there was no claim of nondischargeability under Section 523(a)(6).

Section 727(a)(2) provides that a debtor's discharge may be denied if "the debtor, with intent to hinder, delay, or defraud a creditor or an officer of the estate charged with custody of property under this title, has transferred, removed, destroyed, mutilated, or concealed, or has permitted to be transferred, removed, destroyed, mutilated, or concealed . . . property of the debtor, within one year before the date of the filing of the petition. Such a claim has four elements: "(1)

transfer of property, (2) belonging to the debtor, (3) within one year of the filing of the petition, (4) with intent to hinder, delay, or defraud a creditor." Robertson v. Dennis (In re Dennis), 330 F.3d 696, 701 (5th Cir. 2003). The Court found that in its complaint, TGL failed to identify any specific transfers that were allegedly made by Matloff of his property within one year of his bankruptcy filing. TGL subsequently made such an allegation, however the Court found that TGL failed to offer credible evidence to satisfy its burden to meet the required factors.

Section 727(a)(3) provides that a debtor's discharge may be denied "if the debtor has concealed, destroyed, mutilated, falsified, or failed to keep or preserve any recorded information, including books, documents, records, and papers, from which the debtor's financial condition or business transactions might be ascertained, unless such act or failure to act was justified under all the circumstances of the case." The Court found that there was no evidence that Matloff caused any of his personal records to be concealed, destroyed, mutilated, or falsified or that Matloff failed to keep any accounting of his personal obligations, assets, or investments, and, therefore, TGL was not entitled to nondischargeability of its claims under Section 727(a)(3).

TGL alleged through Section 727(a)(7), incorporating Section 727(a)(2), that Matloff as an insider, violated the provisions of Section 727(a)(2). The Court found that this argument was moot with respect to certain transaction because TGL previously failed to prove that it deserved any relief under Section 727(a)(2). With respect to all other alleged fraudulent transactions, the Court found that TGL failed to prove that the transactions occurred with the intent to hinder, delay, and defraud TGL or any of Matloff's or the business's other creditors.

Similarly, TGL alleged through Section 727(a)(7), incorporating Section 727(a)(3), that Matloff failed to maintain the business's records. The Court found that there was no evidence that anyone caused the records to be concealed, destroyed, mutilated, or falsified and dismissed that claim.

TGL next alleged through Section 727(a)(7), incorporating Section 727(a)(4), that Matloff as an insider of his company committed false oaths in connection with his company's bankruptcy case. The Bankruptcy Court found that TGL failed to offer adequate credible evidence to satisfy its burden to establish that Matloff knowingly made a false statement under oath, with fraudulent intent, that materially related to the bankruptcy case; the Court found similarly that TGL failed to meet its burden with respect to another subsidiary.

Finally, TGL alleged that Matloff's claim of exemptions in the stock and interests of his business and interests in the Matloff Family Trust should be limited to the combined cash amount set forth in 11 U.S.C. § 522(d)(5). The Court found that at trial TGL presented no evidence on the question of exemption claims. Therefore, TGL failed to satisfy its burden and the objection was overruled.

8. In re Ray Douglas Griffith, No. 19-44562-MXM, Adv. Pro. 20-4038-MXM (Bankr. N.D. Tex. June 10, 2021)

After Ray Douglas Griffith ("Griffith") defaulted on his mortgage loan to Lone Star, FLCA ("Lone Star"), he filed a Chapter 13 bankruptcy to prevent foreclosure of the real property securing the loan. The Court dismissed this bankruptcy filing because he failed to file certain required

documents. Griffith filed a motion to reinstate his bankruptcy case, but before this happened, Lone Star foreclosed on the property and sold it to a third party buyer.

Griffith brought several claims against Lone Star, most of which were dismissed at the summary judgment level. This decision concerns his two surviving claims—breach of contract and wrongful foreclosure—both of which ultimately allege that Lone Star failed to provide proper notice of the foreclosure sale.

First, Griffith brought a claim alleging breach of contract based on the noticing procedures in his loan documents. Under Texas law, to prove an allegation of breach of contract, a plaintiff must show: (i) the existence of a valid contract, (ii) performance or tendered performance by the plaintiff, (iii) breach by the defendant, and (iv) damages sustained by the plaintiff as a result of the breach. The Court found that Griffith failed to establish the element of breach by the defendant because by orally requesting that Lone Star send various notices to his P.O. box, Griffith had waived the requirement in the deed of trust that notice be sent to his home address. Therefore, there was no breach of contract.

Griffith also brought a claim of wrongful foreclosure which requires establishing: (1) a defect in the foreclosure sale proceedings; (2) a grossly inadequate sale price; and (3) a causal nexus linking the alleged defect and the grossly inadequate sale price. Holding similarly that Griffith waived the requirement that notice of foreclosure be sent to his home address, the Court found that there was no defect in the foreclosure sale proceedings and therefore there was no wrongful foreclosure. Any remaining counterclaims regarding disposition of the property in the event the court found wrongful foreclosure were therefore moot.

These case studies were curated by our wonderful Judges in the Northern District of Texas, and reviewed and summarized by Adia Coley, Rebecca Matthews, Eli Medina, Emma Sanzotta, Sara Zoglman (all of Vinson & Elkins); Joseph Austin, Katherine Hopkins, and Amelia Hurt (all of Kelly Hart); and R. Byrn (Byrnie) Bass, Jr.