<u>REVIEW OF 2014 BANKRUPTCY OPINIONS FROM THE 5TH CIRCUIT</u>

In re Galaz, ___ F3d ___, 2014 WL 4197213 (5th Cir. 2014)
The royalties from "The Ohio Players," a 1970's funk band, were owned by Artist Rights Foundation, LLC (50% owned by a married couple). The couple divorced, and wife was assigned a 25% interest in LLC [as an "economic interest holder," not a "member"]. The ex-husband – as manager of the LLC – later transferred all of LLC's rights to a Texas limited partnership in 2005, and dissolved the LLC in 2006. Ex-wife filed Chapter 13 and sued to set aside fraudulent transfer. Most of opinion relates to jurisdiction/power of bankruptcy court to enter judgment, but 5th Circuit also discussed the Uniform Fraudulent Transfer Act. To recover under UFTA, the plaintiff must have been a "creditor" at the time of the transfer (or shortly thereafter). The 5th Circuit held that ex-wife <u>was</u> a creditor under UFTA, because she was entitled to distributions when the LLC was dissolved.

In re Frost, 744 F.3d 384 (5th Cir. 2014)
Debtor owned a homestead when he filed Chapter 13, and during the bankruptcy, he filed motion to sell and then sold it, generating $81,000 in net proceeds. The Bankruptcy Court held $41,000 in escrow, and disbursed the other $40,000 to the debtor. Prior to the end of the six-month exemption window, the debtor spent $23,000 of the net proceeds for purposes other than purchasing another homestead. The Trustee objected. Debtor argued that all exemptions are fixed as of bankruptcy filing ("snapshot" rule), but 5th Circuit disagreed, citing a 2001 case where the homestead had been sold 3 months pre-petition. The Court held (i) there a difference between a "homestead" and the "sales proceeds of homestead," and (ii) the $23,000 spent by Frost constituted property of the estate.

In re Kim, 748 F3d 647 (5th Cir. 2014) [homestead acquired <u>prior</u> to BAPCPA being enacted]
In re Thaw, 769 F3d 366 (5th Cir. 2014) [homestead acquired <u>after</u> BAPCPA had been enacted]
In both cases, a homestead was acquired within 1,215 days prior to bankruptcy, and the trustee asserted that the dollar "cap" of §522(p) applied. The 5th Circuit held that (i) the non-debtor spouse's homestead interest can be sold, and (ii) the non-debtor spouse's homestead interest is limited by the dollar "cap" of §522(p). [In *Kim*, the non-debtor spouse did "not adequately brief" her 5th Amendment "takings" claim, and failed to assert her rights under §363(j).]

Matter of Pledger, No. 14-50023, ___ F3d ___ (January 23, 2015)
Subcontractor supplied concrete for 3 jobs to a contractor; the contractor who was later paid in full. But the contractor failed to pay subcontractor anything, and the owner of the contractor then filed Chapter 7. The subcontractor filed a non-dischargeability complaint, based on the Texas Trust Fund Statute (TEX. PROP. CODE §162.031): a contractor who "intentionally or knowingly or with intent to defraud" fails to pay a subcontractor. But the Court holds that (i) a contractor may legally pay "overhead" expenses, (ii) "overhead" expenses can include amounts to complete other construction jobs, not just the job that the unpaid subcontractor had provided goods and services for, and (iii) the subcontractor-creditor seeking non-dischargeability of debt has burden of proof on all elements.

Williams v. FDIC (In re Positive Health Mgmt.), 769 F.3d 899 (2014)
Defendant was a recipient of a fraudulent transfer under Section 548(a)(1) for transfers made with the "actual intent to hinder, delay, or defraud." It invoked the defense under Section 548(c) for good faith transferees who provide value. The bankruptcy court found that the transferee had given value worth more than it received. The Fifth Circuit held that the bankruptcy court improperly measured the value provided by the transferee from the transferor's perspective. In particular, it measured value based on the debtor's gain rather than the value defendant gave up. Adopting an alternative valuation in the case which met the proper standard, the Fifth Circuit found that the transferee had provided value, but worth less than what it received. The Fifth Circuit held that under Section 548(c) value is not synonymous with reasonably equivalent value. But the statute provides a defense to the transferee only "to the extent" it gave value. Thus, when the transferee provides less value than it receives, netting is necessary and the transferee is liable for the difference in value between what it received and what it gave.

Janvey v. Brown, 767 F.3d 430 (2014)
Plaintiff in the case was the court-appointed receiver for Stanford International Bank. It brought claims under the Texas Uniform Fraudulent Transfer Act ("TUFTA") to recover funds paid to holders of certificates of deposit as part of a Ponzi scheme. The defendants were those who received back their principal and interest – "net winners" in the Ponzi scheme. The court first decided certain choice of law and limitation issues. Turning to the merits, the Fifth Circuit held that the receiver had standing to bring a TUFTA case because the company's principals who authorized the transfers were properly viewed as the debtor and the company itself as a defrauded creditor. This is because the knowledge and effects of the fraud of the principal in Ponzi scheme are not imputed to the captive company. Next, the Fifth Circuit held that interest payments made to the defendants were not for reasonably equivalent value because they were made pursuant to an unenforceable contract. On the other hand, the defendants did receive reasonably equivalent value for the return of principal because they had actionable claims for fraud and restitution. Finally, the court held that certain defendants could not invoke an exemption for funds held in an IRA because they failed to provide evidence that they had a legal right to funds that were proceeds of a fraudulent transfer.

Orrill, Cardell & Beary, L.L.C. v. Kaye (In re Kaye) (unpublished 2014)
The district court held that the bankruptcy court should have calculated an attorney's contingent fee with reference to one-half of the debtor and her ex-husbands community property and remanded the case to the bankruptcy court. The debtor appealed the remand order. The Fifth Circuit held that the remand order was not appealable because it was not final. In particular, it required the bankruptcy court to perform a judicial function, i.e. to determine the value of the one-half former community property, rather than a purely ministerial function.

Graham Mortgage Corporation v. Goff (In re Goff) (unpublished 2014)
Debtor was discharged for failing to maintain records. On appeal, the Fifth Circuit held first that a grant of summary judgment was appropriate because the debtor failed to present competent summary judgment evidence after the creditor presented evidence that established that certain documents were missing. The debtor admitted to giving away a computer containing relevant financial statements. Next, the Fifth Circuit affirmed denial of a motion for reconsideration filed

by the debtor based on documents he later obtained from the trustee. The court noted that the debtor failed to explain why he did not obtain the documents through discovery or obtain an extension of the discovery period. Finally, the court affirmed the lower court's finding that the failure to maintain records was not justified given that the debtor was sophisticated and the only justification he provided – his testimony – was not credible. The court distinguished *8400 N.W. Expressway, LLC v. Morgan (In re Morgan)*, 360 B.R. 507 (Bankr. N.D. Tex. 2007) because in that case, the debtor's testimony was credible, and the debtor provided voluminous documentary evidence.

Credit Union Servs., LLC v. Green Hills Dev. Co., LLC (In re Green Hills Dev. Co., LLC), 741 F.3d 651 (5th Cir. 2014)

The Debtor, Green Hills, entered into construction loan agreement with Credit Union Services (CULS) to develop land in Mississippi. Green Hills also had bond obligations to a municipal utility district. When the note matured the balance was $8,074,348.57 and Green Hills also had fallen behind on its bond obligations to the MUD.

Before CULS commenced collection proceedings, Green Hills filed a lender liability suit in Texas state court, alleging a laundry list of business torts and DTPA violations. CULS moved for summary judgment on the debt and on all of Green Hills' claims. Summary judgment was granted only on the DTPA claims.

While the Texas litigation was proceeding, CULS filed an involuntary bankruptcy petition (as sole petitioning creditor) in the Southern District of Mississippi. Green Hills moved to dismiss, arguing that this was a 2 party dispute and that CULS' claim was subject to bona fide dispute as to liability or amount.

The bankruptcy court dismissed the petition, holding that there was insufficient evidence that the debtor was generally not paying its debts as they became due and that relief under § 303(h)(1) was improper because the debt to CULS was subject to bona fide dispute, despite having held that the debt was <u>not</u> subject to bona fide dispute for standing purposes under § 303(b).
BAPCPA amended § 303(b), adding the phrase "as to liability or amount." Pre BAPCPA opinions had denied standing only when there was a bona fide dispute as to liability. Congress changed the meaning of the statute with the added phrase. Thus, a bona fide dispute as to liability <u>or</u> amount is now sufficient to deny a creditor standing to bring an involuntary petition.
In considering whether there is a bona fide dispute the bankruptcy court must determine whether there is an objective basis for either a factual or a legal dispute. The petitioning creditor has the burden of proving a prima facie case that there is no bona fide dispute, after which the debtor must present evidence to rebut the prima facie case.

The 5th Circuit found the record from the state court litigation, which involved numerous hearings over 19 months in which the lender's summary judgment motions had been denied, persuasive in demonstrating a bona fide dispute existed as to liability and amount: "[A] creditor whose claim is the object of unresolved, multiyear litigation should not be permitted to short circuit that process by forcing the debtor into bankruptcy." *Id.* at 659.

The Court also rejected CULS' contention that the existence of unresolved counterclaims by a debtor is insufficient to constitute a bona fide dispute.

Flooring Sys. v. Chow (In re Poston), 765 F.3d 518 (5th Cir. 2014).
The bankruptcy trustee filed a preference action under § 547 to recover a pre-bankruptcy transfer of funds to a receiver for Poston. Flooring Systems had recovered a judgment against Poston and the state court appointed a receiver under the Texas Turnover Statute, Tex. Civ. Prac. & Rem. Code § 31.002, on August 2, 2007.

The funds at issue were in Poston's bank account at Plains Capital Bank. Under Tex. Civ. Prac. & Rem. Code § 31.002(g), "[w]ith respect to turnover of property held by a financial institution in the name or on behalf of the judgment debtor as customer of the financial institution, the rights of a receiver appointed under Subsection (b)(3) do not attach until the financial institution receives service of a certified copy of the order or receivership…"

The bank was not served with a copy of the receivership order until November 20, 2007. Poston filed a chapter 11 proceeding on January 31, 2008.

The question before the Court was "when Mr. Poston transferred the interest in his bank account at Plains Capital Bank." If the transfer occurred when the receiver was appointed in August 2007, it would be outside the 90 day preference period. The 5th Circuit affirmed the lower courts' findings that the receiver's rights to the funds did not attach until the certified copy of the turnover order were served on the bank on November 20, 2007. As that occurred within 90 days, the transfer was avoidable as a preference.

Collins v. Ebert (In re Maranatha Constr. Co.), 559 Fed. Appx. 415 (U.S. App. LEXIS 6252, 5th Cir. April 4, 2014)
Creditors sought to establish that they had standing to pursue veil piercing claims against a bankrupt corporation that had fraudulently transferred assets to a new corporation and had failed to disclose the existence of that corporation.

Citing *In re S.I. Acquisition, Inc.*, 817 F.2d 1142, 1152 (5th Cir. 1987), the Court held that to the extent veil piercing claims involve allegations that shareholders of the debtor misused the corporate form and rendered the debtor unable to meet its financial obligations, those claims are property of the estate. The creditors failed to allege any personal harm arising out of the transfer. Instead the only harm is the general harm suffered by all creditors. *In re Schimmelpenninck*, 183 F. 3d 347, 359-60 (5th Cir. 1999). The Court rejected the creditors' reliance on *Shandong Yinguang Chem. Indus. v. Potter*, 607 F.3d 1029 (5th Cir. 2010), because in that case the Court expressly did "not address [who] owned the right to pierce the corporate veil." *Id.* at 1036.

Morton v. Yonkers (In re Vallecito Gas, LLC), 771 F.2d 929 (5th Cir. 2014)
Vallecito Gas purchased an oil and gas lease located on Navajo Nation land in New Mexico. Subsequent assignments of overriding royalty interests in the lease were made to various parties. None of the assignments were approved by the Navajo Nation as required by the Navajo Nation Code.

The Chapter 11 Trustee for Vallecito Gas sought to sell the lease free and clear of any interests other than the Navajo Nation's royalty interest as lessor. The Trustee also sought to invoke the approval provisions of the Navajo Code to void the transfers of overriding royalty interests:

> No overriding royalty interest may be created by any transfer authorized hereby without the written consent of the Minerals Department of the Navajo Nation nor shall such overriding royalty be approved if it is determined by the Minerals Department that it will have such an adverse economic impact that it may prevent full recovery of the mineral reserves.

The Navajo Code provisions may not be used by the Trustee to void transfers of overriding royalty interests. The "Navajo Code contemplates approval as a means to protect the Navajo Nation from exploitation," and there is no indication that the Trustee "falls within the scope of its protection." *Id.* at 932. The Court also observed that the Trustee was standing in the shoes of the seller, not the buyer, and that only a buyer might conceivably have the right to contend that the seller had not delivered good title as a result of the lack of approval.