CASE LAW UPDATE

San Antonio Bankruptcy Bar Association
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Presentation By:

THE HONORABLE CRAIG A. GARGOTTA
United States Bankruptcy Court, Western District of Texas

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***In re Brown*, No. 17-52324-CAG, 2018 WL 2425968 (Bankr. W.D. Tex. May 23, 2018).**

Issues: Whether the bankruptcy court should certify a direct appeal to the Fifth Circuit on the issue of whether the court exceeded its authority when it imposed conditions on a chapter 13 plan in connection with confirmation.

Facts: Chapter 13 debtor filed a plan proposing to pay unsecured creditors 100% over sixty months, despite having enough disposable income to pay unsecured creditors in full before sixty months. Chapter 13 trustee objected to debtor's plan, arguing that debtor was required to dedicate all monthly disposable income to the plan, or that debtor must agree that his discharge is conditioned on all claims being paid in full. The court determined that debtor could either keep the plan term at sixty months on the condition that unsecured creditors receive 100%, or he could pay the all disposable income into the plan with excess income paid to unsecured creditors, and after unsecured creditors were paid in full, he could modify the plan. Arguing that the bankruptcy court exceeded its authority when it imposed conditions on plan confirmation, Debtor submitted a notice of appeal to the district court. Debtor then requested that the bankruptcy court certify a direct appeal to the Fifth Circuit on the issue.

Holding: Debtor's request to certify a direct appeal of the issue to the Fifth Circuit was denied. The question for certification did not implicate the court's jurisdiction, nor did any circumstances show why the bankruptcy court's conditions required an appeal to not begin at the district court. Although there was no controlling Supreme Court or Fifth Circuit decision, an appeal of the case to the Fifth Circuit would not resolve debtor's perceived conflict between two district court opinions. Finally, an immediate appeal would not materially advance the bankruptcy case.

***Satija v. Robert* (*In re Robert*), No. 14-01021-HCM, 2017 WL 5007146 (Bankr. W.D. Tex. Oct. 31, 2017).**

Issues: Whether the court should deny chapter 7 debtors' discharge under 11 U.S.C. §§ 727(a)(4)(A), (a)(3), and/or (a)(5) after debtors made multiple false statements under oath in their schedules, statement of financial affairs, and at their meeting of creditors.

Facts: Chapter 7 trustee sought to deny debtors' discharge under 11 U.S.C. §§ 727(a)(4)(A), (a)(3), and (a)(5) based on contentions that debtors made false oaths in their bankruptcy case, concealed or failed to preserve financial documents necessary to determine their financial condition, and failed to satisfactorily explain the loss of assets. The court found that debtors failed to disclose in their original schedules and original and amended statement of financial affairs their interests in multiple bank accounts, cash, ownership of time shares, stock, several life insurance policies, rental income, investment income, consulting income, and payments for the benefit of insiders.

Holding: Debtors made numerous false oaths that were knowingly false and material to their case. The multiple and cumulative nature of the false statements demonstrated a reckless disregard for the truth that was sufficient to establish fraudulent intent. As such, trustee's objection to discharge was granted under § 727(a)(4)(A).

***In re Pustejovsky*, 577 B.R. 671 (Bankr. W.D. Tex. 2017).**

Issue: Whether a chapter 13 debtor has an absolute right to dismiss a case under 11 U.S.C. § 1307(b) where the debtor has acted in bad faith and failed to disclose property of the estate.

Facts: Chapter 13 debtor failed to schedule assets, failed to seek approval to employ special counsel, delayed producing financial records, failed to produce discovery to a related probate case, and failed to fully list creditors. Furthermore, debtor's initial plan was not confirmed and debtor subsequently failed to submit a feasible plan. Debtor sought to dismiss her chapter 13 case under § 1307(b).

Holding: A debtor's right to dismiss under § 1307(b) is conditional because it is subject to a bad faith exception under § 1307(c). Despite the presence of the term "shall" in § 1307(b), § 1307(c) permits a court to convert or dismiss a case for "cause" and courts have found that lack of good faith constitutes cause. Furthermore, by operation of §§ 1307(b), (c) and 105(a), the court was able to *sua sponte* convert the case to chapter 7.

***Ortiz-Peredo v. Viegelahn (In re Ortiz-Peredo)*, 587 B.R. 321 (W.D. Tex. 2018).**

Issue: Whether worker's compensation settlement funds, which debtors exempted under 11 U.S.C. § 522, were "disposable income" within the meaning of 11 U.S.C. § 1325(b) and therefore required to be paid to unsecured creditors through chapter 13 debtors' plan under § 1325(b)(1)(B).

Facts: Debtors filed for chapter 13 bankruptcy. On their amended Schedule C, debtors listed an exemption in a total safety worker's compensation claim filed in 2014. Debtors' amended Schedule C reflected that the lawsuit had been valued at $22,500.00 with a recovery of $8,632.85 after litigation costs (the "Settlement Funds"). Debtors filed an amended chapter 13 plan that did not include payment of the Settlement Funds into the plan. Chapter 13 trustee objected to the amended plan, arguing that the Settlement Funds were "disposable income" within the meaning of 11 U.S.C. § 1325(b)(2) and therefore were required to be paid to unsecured creditors through the plan. The bankruptcy court found that the Settlement Funds were disposable income to be applied to payments to unsecured creditors under § 1325(b)(1)(B).

Holding: The exempt status of the Settlement Funds did not exclude those funds from the calculation of disposable income. All sources of funds, including settlement funds, are income under § 1325. As such, the district court required that debtors include the Settlement Funds as income to be paid to unsecured creditors through their chapter 13 plan.

***In re Kara*, 573 B.R. 696 (Bankr. W.D. Tex. 2017).**

Issue: Whether, in Texas, an inherited individual retirement account (IRA) from a non-spouse qualifies as a valid use of state exemptions under 11 U.S.C. § 522(b)(2).

Facts: Debtor inherited an IRA from her aunt and argued that the inherited IRA was exempt property.

Holding: The claim of exemption in the inherited IRA is a valid use of state exemptions under § 522(b)(2). The inherited IRA did not qualify as "retirement funds" within the meaning of the bankruptcy exemption under § 522(b)(3)(C). Because Texas is an opt-in state—meaning that debtors that are Texas residents may elect to use either state exemptions or the federal exemption scheme—the Debtor's inherited IRA did receive exempt status under Texas Property Code § 42.0021(a) which specifically identifies inherited IRAs as exempt property.

***Viegelahn v. Randolph Brooks Fed. Credit Union (In re Guiles)*, 580 B.R. 466 (Bankr. W.D. Tex. 2017).**

Issues: Whether a trustee can avoid a security interest that (1) secures two different loans and (2) is subject to a security agreement that contained a future advances clause where the funds from the first loan are used to pay off the balance of the second loan.

Facts: Chapter 13 debtor obtained two loans from the same creditor, both of which were secured by the debtor's vehicle. Creditor issued the first note and properly perfected its interest by noting its lien on the certificate of title. Almost four years later, creditor issued the second note. Debtor used money from the second note to pay off the remaining balance of the first note. Creditor did not change the lien date on the certificate of title. The security agreement between debtor and creditor on the second note contained a future advances provision, which stated the following:

> You are giving this Interest to secure repayment for our loan as well as any other amounts you now owe the Credit Union in the future. The collateral also secures your performance of all other obligations under your loan, this security agreement and any other agreement you have with the Credit Union

Chapter 13 trustee brought an avoidance action, arguing that the second loan created a new, unperfected security interest rather than a future advance.

Holding: As evidenced by the future advances provision in the security agreement, the second note operated as future advance for which creditor had a properly perfected security interest. Therefore, creditor's lien remained properly perfected. Repayment of the first note neither satisfied the indebtedness nor demanded release of the security interest.

***In re Hutchings*, No. 17-51137, 2017 WL 4174394 (Bankr. W.D. Tex. Sept. 19, 2017).**

Issue: Whether a debtor could avoid a creditor's judgment lien against her homestead when the judgment lien was recorded for debtor's default on a promissory note that provided funds to debtor to discharge a constitutional home equity lien encumbering the homestead.

Facts: Debtor received a home equity loan from a lender ("Lender") that was secured by her homestead. Later, debtor hired New Leaf to build a home. After a dispute arose between debtor and New Leaf, the parties reached a settlement agreement at arbitration, which provided that New Leaf would buy back the new home and provide debtor with financing to refinance her existing home equity loan with Lender. Shortly thereafter, New Leaf informed debtor that it would be unable to refinance the home equity loan under the Texas Finance Code. After further arbitration, the arbiter ordered New Leaf to provide the debtor with $70,000 to refinance her loan with Lender. New Leaf complied, sending $70,000 to debtor's attorney, who sent the funds to Lender. Debtor then executed an unsecured promissory note for $70,000 in payable to New Leaf. Debtor defaulted under the promissory note, and New Leaf obtained a default judgment.

Debtor filed for chapter 7 bankruptcy and moved to avoid New Leaf's lien as an impairment on exempt property under 11 U.S.C. §§ 522(f) and 506(d). New Leaf argued that because its loan to debtor was used to refinance debtor's existing constitutional home equity loan with Lender, it was entitled to step into the shoes of Lender under the doctrine of equitable subrogation.

Holding: Because Lender's lien involved a home equity loan for which the debtor was primarily liable, and because New Leaf was legally obligated to refinance the loan, New Leaf stepped into the shoes of Lender and assumed its rights against the debtor. New Leaf was entitled to equitable subrogation of the entire amount of the loan.

***In re Marquez*, No. 17-60594, 2017 WL 5438306 (Bankr. W.D. Tex. Nov. 13, 2017).**

Issue: Whether a chapter 7 debtor may retain a mobile home subject to a security interest without redeeming the property or reaffirming the debt.

Facts: Chapter 7 debtors filed a statement of intent indicating that they intended to retain a mobile home that was subject to a lien and to continue making payments without reaffirming the debt. Secured lender sent reaffirmation agreement to debtors, but debtors refused to sign. Secured lender moved the court to compel the debtors to make a selection under 11 U.S.C. § 521(a)(2) to either surrender, redeem, or reaffirm their debt on the mobile home.

Holding: Post-BAPCPA, there is no "ride-through" option. As such, when debtors chose to retain the mobile home, § 521(a)(2) required them to choose between surrender, redemption, and reaffirmation. Moreover, debtors were required to amend their Statement of Intention within thirty days, to perform their stated intention within forty-five days, and that debtors' discharge was suspended until the amendment and performance were complete.

***In re Diaz*, 586 B.R. 588 (Bankr. W.D. Tex. 2018).**

Issue: Whether a chapter 13 debtor could strike through a provision of the Western District of Texas's District Form Chapter 13 Plan that requires debtor to turn over a portion of income taxes received in excess of $2,000 and, instead, deal with anticipated tax refunds by pro-rating one-twelfth of any such refunds as monthly income.

Facts: The Western District of Texas issued a Consolidated Standing Order for the Adoption of a District Form Chapter 13 Plan, which adopted a form chapter 13 plan ("Form Plan") to be used throughout the Western District of Texas. As part of the Form Plan, the Western District included a provision on treatment of tax refunds that required debtors to turn over any portion of income taxes received in excess of $2,000.

Chapter 13 debtor submitted a version of the Form Plan that struck through the section on tax refunds and, instead, pro-rated debtor's annual tax refunds by allocating one-twelfth of the tax refund as income on Schedule I. Chapter 13 trustee objected to the plan, arguing that debtor could not alter the Form Plan and that tax refunds are disposable income under § 1325(b).

Holding: Pursuant to Fed. R. Bankr. P. 3015.1, a bankruptcy court may adopt a form chapter 13 plan. Therefore, because the Western District adopted a form chapter 13 plan, the court could not confirm debtor's plan when it failed to comply with the requirements mandated by the local form plan. Moreover, the section of the local Form Plan requiring turnover of tax refunds in excess of $2,000 were consistent with the court's view that tax refunds are disposable income under § 1325(b)(2).

***Viegelahn v. Lopez (In re Lopez)*, 897 F.3d 663 (5th Cir. 2018).**

Issue: Whether chapter 13 debtors, who voluntarily dismissed their case, were entitled to return of sale proceeds on their homestead after debtors failed to reinvest proceeds after six months and retained the proceeds for three years.

Facts: Chapter 13 debtors sold their homestead postpetition without court approval and retained the proceeds for three years before the court and parties in interest learned of the sale, leading to a dispute between Debtors and chapter 13 trustee as to what would be done with the proceeds. To prevent the proceeds from being distributed to creditors, debtors moved to voluntarily dismiss their case. The bankruptcy court granted that motion and ordered the chapter 13 trustee to return all funds in her possession. The district court found that the proceeds should have been distributed to creditors under debtors' chapter 13 plan. Moreover, the district court held that even if the proceeds would ordinarily vest in the debtors upon dismissal, "cause" existed under 11 U.S.C. § 349(b) to order the proceeds to be distributed to the creditors.

Holding: Under § 349(b)(3), the chapter 13 trustee was required, upon voluntary dismissal of debtors' case, to return to debtors the proceeds from postpetition sale of their homestead. The Fifth Circuit found that it did not need to decide whether a finding of "cause" existed under § 349(b) because, considering the record, the Court was "not 'left with definite and firm conviction' [under the clear-error standard] that the bankruptcy court erred in determining there was no 'cause' to order that the homestead proceeds be kept from the [d]ebtors."

***In re Tejeda*, 586 B.R. 831 (Bankr. W.D. Tex. 2018).**

Issue: Whether a lack of privity between a creditor and a debtor prevents the creditor from participating in the debtor's bankruptcy case.

Facts: Non-debtors executed a note with a mortgage company that was secured by real property. The mortgage company assigned the note to a different creditor ("Creditor"). Non-debtors then entered into a wraparound mortgage on the real property with the chapter 13 debtor (the "Wraparound Mortgage"). The Wraparound Mortgage was a contract solely between non-debtors and debtor; debtor had no contractual obligations to Creditor, and there was no privity of contract between debtor and Creditor.

Creditor filed a proof of claim in debtor's chapter 13 case on the real property. Chapter 13 trustee objected to debtor including Creditor's claim in its plan, arguing that the lack of privity between debtor and Creditor made the claim invalid.

Holding: A lack of privity of contract between debtor and Creditor would not prevent Creditor from participating in the bankruptcy case. Creditor's lien against debtor's real property secured a right to payment. Therefore, Creditor had a "claim against property of the debtor" in accordance with 11 U.S.C. § 102(2).

***In re First River Energy, LLC*, No. 18-50085, 2018 WL 4445154 (Bankr. W.D. Tex. Sept. 14, 2018).**

Issue: Whether services performed by a professional hired in a chapter 11 bankruptcy case were necessary and reasonable for the estate, thus permitting the court to grant the professional's application of compensation for services rendered and reimbursement of expenses.

Facts: Debtor filed a voluntary petition for relief in the Delaware Bankruptcy Court on the same day that two producers initiated a Texas state court suit against the debtor where a receiver was appointed. Also on the same day, the receiver filed a chapter 11 petition in the United States Bankruptcy Court for the Western District of Texas on the same day that the Delaware bankruptcy case and the State Court Suit were filed. The Delaware Bankruptcy Court *sua sponte* transferred the case to the Western District, and the case remained in the Western District.

Armory Strategic Partners, LLC ("Armory") served as financial advisor to a chapter 11 debtor ("Debtor"), and Scott Avila of Armory was designated as the Debtor's Chief Restructuring Officer. Armory filed an Application of Compensation seeking $288,932.50 for professional services rendered and $23,380.67 for reimbursement of expenses ("Fee Application"). Creditors objected to the Fee Application on nine grounds: (1) fees related to Case Administration, Claims, Creditor Interaction, Disclosure Statement/Plan, First Day Motions, Litigation, Schedules/Statement of Financial Affairs, and United States Trustee Reporting were outside the scope of the services that Armory was to perform under the court's retention order; (2) Armory did not adequately explain time billed for preparing cash flow projections; (3) Armory's cash management services were unnecessary; (4) the court's retention order did not permit Armory to provide "financial advice" because it precluded Armory from performing as financial advisor; (5) Armory should not have performed work related to claims; (6) the Fee Application failed to explain time spent preparing Monthly Operating Reports; (7) fees related to preparation of the Fee Application were excessive and unnecessary; (8) Mr. Avila's travel and appearance at hearings was unnecessary; and (9) an expense of $183.99 related to the category of "Other" was unreasonable because Armory provided no explanation for the expense. No party objected to Armory's fees and expenses related to the Debtor's Delaware filing and receivership.

Holding: All fees and expenses requested in Armory's Fee Application were reasonable except for those fees related to the Debtor's Delaware filing and the receivership. Fees requested in relation to Armory's work performed in the categories of Case Administration, Claims, Creditor Interaction, Disclosure Statement/Plan, First Day Motions, Litigation, Schedules/SOFA, and U.S. Trustee Reporting were within the scope of the services that the court permitted Armory to perform pursuant to the retention order. Time entries submitted for Armory's preparation of cash flow projections and Monthly Operating Reports were consistent with Armory's description of its tasks. Armory's time billed for performing cash management activities and providing "financial advice" were not unreasonable and fell within Armory's authorized scope of work. Because fees requested for preparation of the Fee Application accounted for 4% of the total requested fees, the court saw no basis for reducing fees. Mr. Avila traveled to and appeared at hearings based on bankruptcy counsel's request, so the court did not reduce fees or expenses. The "other expense," which the court later determined was for purchase of a computer monitor for auction, was not unnecessary or unreasonable. Fees associated with Debtor's Delaware filing were denied because such fees only benefited debtor's board and its officers and thus were not necessary and reasonable for the benefit of the bankruptcy estate.