

SAN ANTONIO BANKRUPTCY BAR ASSOCIATION
2021 CASE UPDATE

THE HONORABLE RONALD B. KING, CHIEF U.S. BANKRUPTCY JUDGE,
WESTERN DISTRICT OF TEXAS

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UNITED STATES SUPREME COURT

City of Chicago v. Fulton, 592 U.S. ___, 141 S. Ct. 585 (2021) (Alito, J.).

Summary: The Supreme Court is set to determine whether an entity that passively retains possession of property of the estate has an affirmative obligation under the Bankruptcy Code to return that property to the estate upon the filing of the bankruptcy petition.

The case arose out of four separate bankruptcy cases consolidated on appeal. In each case, the City of Chicago had impounded the debtor's vehicle for failure to pay traffic fines. After the debtors filed their chapter 13 petition, the City refused to return their vehicles, claimed that it needed to maintain possession to continue perfection of its possessory liens on the vehicles, and stated that it would only return the vehicles after the fines had been paid in full. In each case the bankruptcy courts held that the City violated the automatic stay by "exercising control" over property of the bankruptcy estate, ordered the City to return the debtors' vehicles, and imposed sanctions on the City for violating the automatic stay. On appeal, the Seventh Circuit noted that it had previously addressed the issue in *Thompson v. General Motors Acceptance Corp.*, 566 F.3d 699 (7th Cir. 2009), in which the court held that a creditor must comply with the automatic stay and return a debtor's vehicle upon filing of a bankruptcy petition. In *Thompson*, the Seventh Circuit rejected the argument that passively holding an asset did not satisfy the Bankruptcy Code's definition of "exercising control" and held that retaining possession of the car was a violation of the automatic stay under 11 U.S.C. § 362(a)(3). Further, the Seventh Circuit in *Thompson* held that § 362(a)(3) worked in tandem with § 542(a), which requires that a creditor in possession of property of the estate "shall deliver" such property to the estate unless it is of inconsequential value or benefit to the estate, to draw back the right of possession into the estate without requiring the debtor to first bring a turnover action. The Seventh Circuit applied *Thompson* to the case at hand and ignored the City's request to overrule *Thompson*. After determining that no exceptions to the automatic stay applied, the Seventh Circuit held that the City's retention of the debtors' vehicles violated the automatic stay. The Seventh Circuit thus (re)joined the Second, Eighth, Ninth, and Eleventh Circuits in holding that passive retention of property of the estate violates the automatic stay, with the Tenth and D.C. Circuits on the other side of a circuit split on the issue.

The Supreme Court disagreed with the Seventh Circuit's ruling. Justice Alito, writing for a unanimous Court (with the exception of Justice Barrett, who took no part in the consideration or decision of the case), looked to the "most natural reading" of the terms "stay," "act," and "exercise control" in § 362(a)(3). The term "stay," according to Justice Alito, commonly describes an order that "suspend[s] judicial alteration of the status quo." An "act" is "[s]omething done or performed" or "a deed." To "exercise" means "to bring into play" or "make effective in action," and to exercise something like control is "to put in practice or carry out in action." Based on these definitions, Justice Alito concluded that § 362(a)(3) halts any affirmative act that would alter the status quo as of the time of the filing of a bankruptcy petition. Justice Alito acknowledged that, in certain contexts, omissions can qualify as acts and that the term "control" can mean "to have power over." He went on to say, however, that the terms "act" and "exercise" communicate more than merely having power and that § 362(a)(3) implies that something more than merely retaining power is required to violate the stay.

Justice Alito also looked to § 542, which provides that an entity in possession of property of the bankruptcy estate “shall deliver to the trustee, and account for” that property. According to Justice Alito, reading § 362(a)(3) to include merely retaining possession of a debtor’s property would make it a blanket turnover provision that would render § 542 largely superfluous. Further, Justice Alito points out that § 542 does not mandate turnover of property that is “of inconsequential value to the estate.” If § 362(a)(3) were read to prohibit passive retention of property of the estate, however, it would require turnover of such property all the same and would undermine that exception in § 542. Thus, the Supreme Court concluded that mere retention of estate property after the filing of a bankruptcy petition does not violate § 362(a)(3). The Court’s holding, however, explicitly did not address how the turnover obligation of § 542 operates.

UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

McCoy v. United States (In re McCoy), 810 F. App’x 315 (5th Cir. 2020) (per curiam), *cert. denied*, 141 S. Ct. 2794 (June 21, 2021).

Summary: The United States Supreme Court denied a Texas woman’s petition for writ of certiorari to review the circuit split in the tests used to resolve student loan discharge actions. The Fifth Circuit applied the *Brunner* test and held that a chapter 7 debtor suffering from severe health issues failed to show that repayment of her student loans would impose an “undue hardship” on her and thus could not discharge the loans.

Debtor Thelma McCoy incurred over \$345,000 of debt in pursuit of advanced degrees beginning in her forties. She consolidated her loans and entered an income-based repayment plan but was unable to pay. McCoy subsequently filed for bankruptcy in the Southern District of Texas seeking relief from her student loan debt. At the time of her bankruptcy filing, her repayment plan required payments of zero dollars per month due to low income, and her repayment obligation would remain zero post-bankruptcy should her income not improve. McCoy’s repayment plan allowed for debt forgiveness twenty-five years after the first payment under the plan. Such forgiveness would have tax implications, though, as any forgiven amount would be subject to whatever tax laws were in effect at the time of forgiveness.

Under § 523(a)(8), student loan debt is generally not dischargeable in bankruptcy unless failure to discharge the debt would impose an “undue hardship” on the debtor. The Bankruptcy Code does not define “undue hardship,” but the Fifth Circuit has adopted a test to determine whether a debt imposes undue hardship. Under the test, which was set forth in *Brunner v. N.Y. State Higher Educ. Servs. Corp.*, 831 F.2d 395, 396 (2d Cir. 1987), the debtor must show that: (1) the debtor cannot maintain a minimal standard of living if forced to repay the loans; (2) additional circumstances exist indicating that this state of affairs is likely to persist for a significant portion of the repayment period; and (3) the debtor has made good-faith efforts to repay the loans. McCoy argued that her age—62—and her severe mental and physical disabilities were “not likely to recede or resolve,” and constituted “two major additional circumstances” that satisfied prong two. The bankruptcy court held, and the Fifth Circuit affirmed, that McCoy did not satisfy the second prong.

The Fifth Circuit rejected McCoy’s arguments and noted that her critical health issues stemmed from a car accident and a facial-burning incident that occurred before she took out the bulk of the

loans and did not prevent her from obtaining a doctorate and various forms of employment. Thus, the Fifth Circuit held that the bankruptcy court did not clearly err in its determination that McCoy had not satisfied the second prong.

Deutsche Bank Tr. Co. Ams. v. U.S. Energy Dev. Corp. (In re First River Energy, L.L.C.), 986 F.3d 914 (5th Cir. 2021) (Jones, J.).

Summary: In a lien priority contest involving Oklahoma and Texas upstream producers against secured lenders, the secured lender with a perfected earlier lien took priority over the Texas upstream producers but not the Oklahoma upstream producers due to differences in Oklahoma's and Texas's laws on oil liens.

First River Energy, L.L.C. filed for chapter 11 bankruptcy in Delaware in January 2018. The debtor operated as a midstream service provider organized in Delaware but headquartered in San Antonio, Texas. In the month prior to filing for bankruptcy, the debtor purchased oil from Texas and Oklahoma upstream producers and resold it to downstream producers. The upstream producers' sales of oil to the debtor were governed by identical agreements, each including a warranty provision whereby the producers warranted that the oil sold "shall be free from all royalties, liens, encumbrances and all applicable foreign, state and local taxes."

The debtor did not pay the upstream producers, so the upstream producers asserted liens created by statute under Texas and Oklahoma law. The producers' proofs of claim asserted that they held statutorily created first-priority, perfected purchase money security interests in the proceeds of the oil pursuant to either Texas Uniform Commercial Code § 9.343 or Oklahoma Lien Act § 549. Deutsche Bank Trust Company Americas, acting as agent for various secured lenders, asserted a competing security interest in the sale proceeds based on a credit agreement executed under Delaware law in July 2015 between the debtor and the Bank. The Bank's security interest was perfected by filing UCC-1 financing statements in Delaware in July 2015, with routine updates to maintain continuous perfection.

The Delaware bankruptcy court transferred the case to the Western District of Texas, and the Bank initiated an adversary proceeding seeking a declaration of first priority in the proceeds from the debtor's sale of oil. The bankruptcy court entered an order granting in part and denying in part the Bank's motion for summary judgment. The court held that (1) the producers did not waive their security interests through the warranty provisions in their sale agreements with the debtor, (2) the Delaware UCC is the body of law that governs the priority dispute, (3) the Texas producers' purchase money security interests under Texas Uniform Commercial Code § 9.343 are subordinate to the Bank's security interest, but the Oklahoma producers' statutory liens prime the Bank, and (4) the producers' counterclaims and affirmative defenses were dismissed. The bankruptcy court certified the producers' appeal for direct review by the Fifth Circuit.

The Fifth Circuit affirmed and addressed the "pivotal" issue involving "special laws enacted in Texas and Oklahoma whose purpose was to facilitate and ensure payment to the states' oil and gas producers for sales of their production." *Id.* at 921. The Texas producers relied on Texas Uniform Commercial Code § 9.343, a nonuniform UCC provision, which "grants a first priority purchase money security interest in oil and gas produced in Texas as well as proceeds

in the hands of any ‘first purchaser,’” such as the debtor. *Id.* The security interest perfects automatically and exists for an unlimited time. Section 9.343(p), however, provides that the “rights of any person claiming a security interest or lien created by this section are governed by the other provisions of this chapter except to the extent this section *necessarily displaces* those provisions.” *Id.* (emphasis in original).

The Oklahoma Lien Act creates a statutory lien that is not connected with the UCC. Section 549.3 of the Act states: “To secure the obligations of a first purchaser to pay the sales price, each interest owner is hereby granted an oil and gas lien to the extent of the interest owner’s interest in oil and gas rights.” *Id.* at 922. Further, an oil and gas lien “exists in and attaches immediately to all oil and gas . . . and continues uninterrupted . . . in and to all proceeds” until the interest owner has received the sales price. *Id.* at 923. The lien created under the Oklahoma statute is not a UCC Article 9 security interest but instead arises as part of a real estate interest.

The Fifth Circuit affirmed that substantive Delaware UCC law governed the priority disputes. Delaware UCC law requires the filing of a financing statement to perfect security interests in proceeds and priority is determined by the first-to-file rule. The Texas producers were “out of luck” because Delaware UCC law does not recognize priority for the unfiled, unperfected security interests in proceeds under Texas Uniform Commercial Code § 9.343. Next, the Fifth Circuit held that the Oklahoma producers were entitled to a first-priority statutory lien in the proceeds from the debtor’s sale of oil produced in Oklahoma. The Delaware UCC does not preempt statutory liens created by other states. Because of this “thorny conflicts of law issue” that “undermines the efficacy of [the] non-standard UCC provision intended to protect Texas oil and gas producers,” Texas producers must beware “the amazing disappearing security interest” by filing financing statements and the “Texas legislature should take note.” *Id.* at 917.

In re Barragan-Flores, 984 F.3d 471 (5th Cir. 2021) (Owen, C.J.).

Summary: A chapter 13 debtor’s plan ran afoul of 11 U.S.C. § 1325(a)(5) where the debtor elected to “surrender” and “cram down” two different motor vehicles that each cross-collateralized two secured claims.

At the time of his chapter 13 bankruptcy filing, Lucio Barragan-Flores had outstanding balances on two car loans with Evolve Federal Credit Union. The debtor used the loans to purchase a GMC Sierra and a Toyota Camry. The loans were cross-collateralized, so both vehicles were pledged as collateral for each loan. The debtor’s chapter 13 plan proposed (1) to retain the Sierra and “cram down” the “Sierra Loan,” and (2) to surrender the Camry as collateral for the “Camry Loan.” Evolve objected to the plan on grounds the basis of this “partial surrender” of collateral. Evolve argued that the cross-collateralization provisions in the loan agreements prevented the debtor from surrendering the Camry and retaining the Sierra. The bankruptcy court approved the plan. The district court reversed, however, holding that the debtor could not elect to surrender one of the vehicles as collateral for the Camry Loan and retain the other vehicle.

On appeal to the Fifth Circuit, the debtor argued that the plain language of § 1325(a)(5), which requires a debtor to select an option “with respect to each allowed secured claim,” permits the debtor to select a different option for each car loan regardless of the cross-collateralization provisions. Evolve argued that the use of “or” in § 1325(a)(5) means that the debtor may not select different options for different collateral securing the same claim.

The Fifth Circuit affirmed the district court’s holding and agreed that the debtor “must either cramdown or surrender all of the collateral securing the Camry Loan, *i.e.*, the Sierra and the Camry.” *Id.* at 474. While the text of § 1325(a)(5) allows debtors to select a different option for each secured claim, it does not allow the debtor to select different options for different collateral securing the same claim. The Fifth Circuit cited *Williams v. Tower Loan of Mississippi*, in which the Fifth Circuit held that a chapter 13 debtor’s plan could not be approved because the “plain language of [§ 1325(a)(5)] does not give the debtor the right to adopt a combination of the options offered in (B) and (C).” *Williams v. Tower Loan of Miss. (In re Williams)*, 168 F.3d 845, 847 (5th Cir. 1999).

Holland v. Westmoreland Coal Co. (In re Westmoreland Coal Co.), 968 F.3d 526 (5th Cir. 2020), *cert. denied*, 2021 WL 2044552 (May 24, 2021) (Costa, J.).

Summary: The Supreme Court denied certiorari to review the Fifth Circuit’s holding that § 1114 of the Bankruptcy Code allows for the modification of a coal company’s obligations under the Coal Industry Retiree Health Benefit Act of 1992, also known as the Coal Act. The denial leaves in place a circuit split over the application of the Anti-Injunction Act to adversary proceedings related to Coal Act obligations.

Section 1114 allows for a modification in the payment of retiree benefits if the court finds that certain criteria have been met. Section 1114 defines “retiree benefits” as “payments to any entity or person for the purpose of providing or reimbursing payments for retired employees [for certain benefits] under any plan, fund, or program . . . maintained or established in whole or in part by the debtor” 11 U.S.C. § 1114(a). The Fifth Circuit, in an opinion authored by Judge Gregg Costa, held that because financial support fell within the ordinary meaning of “maintain,” Westmoreland’s payment of premiums “maintained” the Coal Act plans, at least in part. The Fifth Circuit also held that Westmoreland’s Coal Act obligations fell within § 1114’s definition of “retiree benefits,” and that Westmoreland was thus able to modify its Coal Act obligations under § 1114.

As Judge Costa noted, this holding is in line with every other court that has addressed this question regarding § 1114 and the Coal Act. However, the Supreme Court’s denial of certiorari left in place a circuit split over what Judge Costa referred to as a “threshold question” regarding whether the Anti-Injunction Act barred modification of Coal Act premiums under § 1114.

The Anti-Injunction Act states that “no suit for the purpose of restraining the assessment or collection of any tax shall be maintained in any court by any person.” 26 U.S.C. § 7421(a). Thus, when the AIA applies to a lawsuit, it divests courts of subject-matter jurisdiction over the dispute. According to Judge Costa, the key question was whether a Coal Act premium is a “tax” under the AIA. To answer that question, Judge Costa looked to the Supreme Court’s

decision in *National Federation of Independent Business v. Sebelius*, 567 U.S. 519 (2012), which held that something is a tax under the AIA only when Congress intended it to be. Judge Costa then analyzed whether the Coal Act’s language indicated Congressional intent that the premiums be taxes for AIA purposes and concluded that they did not. Specifically, Judge Costa pointed to the Coal Act’s use of the term “premiums” rather than “taxes,” the use of the word “tax” elsewhere in the Coal Act, and the Coal Act’s subtitle in the Internal Revenue Code of “Coal Industry Health Benefits” while other subtitles expressly describe their contents as taxes.

Judge Costa then turned to the Supreme Court’s holding in *South Carolina v. Regan*, 465 U.S. 367 (1984), that the AIA only applies when Congress has provided an alternative avenue for an aggrieved party to litigate its claims on its own behalf. On the other hand, *Regan* also held that when no alternative avenue for federal-court jurisdiction exists, the AIA will not bar a suit to restrain tax collection. Judge Costa, agreeing with the Eleventh Circuit’s decision in *In re Walter Energy, Inc.*, 911 F.3d 1121 (11th Cir. 2018), held that, because a bankruptcy court is the only place a debtor can use § 1114 to modify Coal Act obligations, there is no alternative avenue for a party to litigate such claims, and the AIA does not bar adversary proceedings to do so.

Official Comm. of Unsecured Creditors of Walker Cty. Hosp. Corp. v. Walker Cty. Hosp. Dist. (In re Walker Cty. Hosp. Corp.), 3 F.4th 229 (5th Cir. 2021) (Jolly, J.)

Summary: A committee of unsecured creditors disputed last-minute modifications to a chapter 11 sale order, but the Fifth Circuit held that the committee’s objection was moot because the committee failed to seek a stay of the sale prior to closing.

Walker County Hospital Corporation, the largest healthcare provider in Walker County, faced closure and filed for chapter 11 bankruptcy in order to auction off its assets and operations. Walker County Hospital District and Community Hospital Corporation formed a joint venture known as Huntsville Community Hospital to serve as stalking-horse bidder. However, the committee of unsecured creditors believed that the stalking-horse bid undervalued the hospital’s assets and would leave little for the unsecured creditors. The committee entered negotiations with the debtor and the stalking-horse bidder and reached a settlement to govern the sale of the hospital’s assets and operations by which the committee received more favorable terms of sale for the debtor in exchange for the committee’s agreement not to bring objections.

After the sale order was entered, the sale process hit some snags that delayed closing and required the stalking-horse purchaser and the debtor to enter into various side agreements to keep the hospital running. In light of these side agreements, the debtor filed an emergency motion to amend the sale order to adjust the purchase price downward and grant the stalking-horse purchaser an administrative-expense claim. The motion asserted that, without the requested relief, there would be no deal, and the hospital would have to cease operations. Citing the critical importance of a timely consummation of the sale, the debtors requested a waiver of the fourteen-day stay required by FED. R. BANKR. P. 6004(h).

Approximately a day later, the court entered an order amending the sale order granting the debtor the requested relief effective immediately and authorizing the debtor and the purchaser to close the sale immediately. The order also explicitly required any party objecting to the order to file an appeal and pursue a stay within the time prescribed by law and prior to the closing date or risk mootness of the appeal. The sale closed less than twenty-four hours after the entry of the order. The committee of unsecured creditors did not seek a stay at any point, but it did appeal the amended sale order about two weeks later and claimed that various bankruptcy rules were not followed and that its procedural due process rights had been violated. The purchaser then moved to dismiss the appeal on the basis that it was mooted by 11 U.S.C. § 363(m).

Section 363(m) provides that “reversal or modification on appeal . . . of a sale or lease of property does not affect the validity of a sale or lease . . . to an entity that purchased such property in good faith . . . unless . . . such sale or lease were stayed pending appeal.” The district court agreed with the purchaser that the committee’s appeal was statutorily moot under 11 U.S.C. § 363(m). The Fifth Circuit affirmed and held that, under Fifth Circuit precedent, a failure to obtain a stay is fatal to a challenge of a bankruptcy court’s authorization of the sale of property. Thus, because the amended sale order cannot be separated from the original sale order, § 363(m) foreclosed the committee’s appeal of the amended order. The Fifth Circuit thus summed up its holding: “In short: no stay, no pay.”

Edwards Family P’ship, L.P. v. Johnson (In re Cmty. Home Fin. Servs., Inc.), 990 F.3d 422 (5th Cir. 2021) (Elrod, J.)

Summary: A bankruptcy court awarded fees to a chapter 11 debtor’s counsel for work performed prior to the appointment of a trustee. Creditors appealed to the district court. After a delay of two and a half years, the district court vacated the fee award. The Fifth Circuit reversed and remanded the district court’s judgment on the basis that the district court improperly assessed the benefit of counsel’s services to the estate from hindsight rather than assessing the reasonableness and likely benefit at the time the services were rendered.

The debtor’s counsel initiated a series of adversary proceedings against the debtor’s two largest creditors in order to challenge the priority of certain claims. After the court learned that the debtor’s president transferred most of the company’s cash to a Panamanian account and fled the country, the court appointed a chapter 11 trustee. Debtor’s counsel then withdrew from the case and subsequently sought fees for the services performed in connection with the adversary proceedings prior to the appointment of the trustee. The bankruptcy court awarded the fees and noted that the services “were necessary to the administration of the bankruptcy case and reasonably likely to benefit the bankruptcy estate.” The two aforementioned creditors appealed, and the district court vacated the fee award on the grounds that the decision by debtor’s counsel to pursue the adversary proceedings “was not a good gamble.” Debtor’s counsel and the chapter 11 trustee then appealed the district court’s decision to the Fifth Circuit. Debtor’s counsel and the creditors settled the fee dispute, and counsel was dismissed from the appeal. The creditors then moved to dismiss the appeal as moot, but the trustee opposed the motion on the grounds that the trustee had an ongoing duty throughout the pendency of the bankruptcy case to represent the estate in the award of fees.

The Fifth Circuit agreed. Generally, the test for standing in bankruptcy cases depends on pecuniary interest. The Fifth Circuit noted, however, that trustees can never establish that they are pecuniarily affected by a bankruptcy order and thus never have pecuniary interests in cases. Instead, according to the Fifth Circuit, a trustee's standing comes from the trustee's duties to administer the bankruptcy estate and to enforce the bankruptcy law in the public interest. Because the payment of fees to debtor's counsel affected the administration of the bankruptcy estate, and because the trustee remained tasked with ensuring that only proper payments were made from the estate, the Fifth Circuit held that the trustee had standing and that the case was not moot. Furthermore, the Fifth Circuit noted that the district court was wrong to vacate the bankruptcy court's fee award "based on its own retrospective assessment of the propriety of the adversary proceedings." Instead, the district court should have looked at the reasonableness of pursuing the adversary proceedings from the time the services were provided.

UNITED STATES DISTRICT COURT

USA Sales, Inc. v. Office of U.S. Trustee, No. 5:19-cv-02133-JWH-KKx, 2021 WL 1226369 (C.D. Cal. April 1, 2021) (Holcomb, J.)

Summary: A district judge in the Central District of California held that the 2017 amendment to 28 U.S.C. § 1930(a)(6), which increased the amount of fees owed by chapter 11 debtors to the Office of the United States Trustee, did not apply to cases commenced prior to the amendment's enactment and that the amendment violated the Bankruptcy Clause of the Constitution. This holding stands in opposition to that of the Fifth Circuit in *In re Buffets, L.L.C.*, 979 F.3d 366 (5th Cir. 2020).

Debtor USA Sales, Inc. filed for chapter 11 bankruptcy in May 2016. In late 2017, Congress amended 28 U.S.C. § 1930(a)(6), the statute that sets the rates of quarterly fees owed by chapter 11 debtors to the Office of the United States Trustee. The 2017 amendment increased the cap on these fees from \$30,000 per quarter to the lesser of \$250,000 or 1% of the debtor's total quarterly disbursements for debtors whose disbursements exceed \$1 million in a quarter. The 2017 amendment took effect on January 1, 2018, at which point the U.S. Trustee began applying the new fee calculation to both new and pending cases. In the case of USA Sales, quarterly fees increased from \$13,000 per quarter prior to the amendment to an average of \$87,493 per quarter after the amendment. USA Sales's case was eventually dismissed in November 2019 pursuant to the terms of a structured dismissal. USA Sales then concurrently filed suit against the U.S. Trustee in the Central District of California and asserted two claims for relief: first, that the 2017 amendment is unconstitutional; and second, that the 2017 amendment should apply to cases commenced prior to the amendment's enactment.

Judge John W. Holcomb of the Central District of California began by addressing USA Sales's second claim, that the 2017 amendment should not apply to cases commenced prior to its enactment. Noting the established principle that legislation should be applied prospectively unless Congress specifies otherwise, Judge Holcomb identified two questions for deciding whether a statute should apply retroactively: first, whether Congress has expressly indicated that the statute should apply retroactively; and second, whether the statute has an improper retroactive effect.

As for the first question, Judge Holcomb found nothing in the text of the 2017 amendment that demonstrated a clear congressional intent that the statute be applied retroactively. The amendment's language states that it applies to quarterly fees "for disbursements made in any calendar quarter that begins on or after" the amendment's enactment. 2017 BJA, Pub. L. No. 115-72, § 1004(c). Judge Holcomb, finding that this was not an unambiguous statement of intent, then pointed out that Congress was "undoubtedly aware that it must explicitly state its intent" to apply legislation retroactively because it had done so elsewhere in the act as well as in prior amendments to 28 U.S.C. § 1930(a). Thus, Judge Holcomb concluded that Congress had not explicitly indicated that the statute should apply retroactively.

Judge Holcomb then turned to the question of whether the 2017 amendment had retroactive effect. He framed the question as one that required the court to determine what conduct triggered liability for the fees: commencing a chapter 11 case or making disbursements. Judge Holcomb pointed out that the Fifth Circuit in *Buffets*, as well as most bankruptcy courts, focused on the term "disbursements" in 28 U.S.C. § 1930(a)(6)(B) as the conduct that triggers the application of the amended fee schedule. Judge Holcomb, however, disagreed and noted that the Fifth Circuit in *Buffets* did not consider the preceding language in § 1930(a), which sets "commencing a case" as the prerequisite condition for the application of the subsequent enumerated paragraphs. Thus, according to Judge Holcomb, § 1930(a) makes clear that the act of commencing a chapter 11 case is the conduct to which liability attaches. Focusing instead on disbursements as the relevant conduct would render the phrase "commencing a case" in § 1930(a) superfluous. At the commencement of a chapter 11 case, § 1930(a)(6) establishes the obligation to pay and establishes a closed universe of quarterly fees from the petition date until the case is converted or dismissed. Thus, Judge Holcomb reasoned, a debtor's expectations regarding quarterly fee liability are fixed as of the commencement of the case, and these expectations allow the debtor to make informed decisions about how to proceed with the chapter 11 case. Once a case is commenced, the conduct of calculating and paying quarterly fees is purely administrative. Because Judge Holcomb concluded that commencing a case is the conduct that triggers fee liability, he then concluded that application of the 2017 amendment to chapter 11 cases pending on the date of enactment would be impermissibly retroactive because it would increase debtors' liability for the past conduct of commencing a case under chapter 11. As such, Judge Holcomb held that 28 U.S.C. § 1930(a)(6)(B) as amended in 2017 cannot be applied to chapter 11 cases that were commenced on or before the date of enactment.

Judge Holcomb then turned to USA Sales's constitutional claims. He first addressed the Bankruptcy Clause, which requires bankruptcy laws to be geographically uniform. In doing so, Judge Holcomb noted that of the 94 judicial districts nationwide, only 88 participate in the U.S. Trustee program. The other six, all located in Alabama and North Carolina, instead participate in the Bankruptcy Administrator program. In order to maintain uniformity between U.S. Trustee districts and Bankruptcy Administrator districts, 28 U.S.C. § 1930(a)(7) provides that the Judicial Conference of the United States may require chapter 11 debtors in Bankruptcy Administrator districts to pay fees equal to those imposed in U.S. Trustee districts. After the 2017 amendment, the U.S. Trustee began imposing the increased fees even on debtors with cases pending prior to the enactment of the amendment. In contrast, the Judicial Conference elected to apply the increased fees only to cases "filed on or after October 1, 2018," after the date of enactment. As such, the enactment of the 2017 amendment resulted in certain chapter 11 debtors in U.S. Trustee

districts paying significantly higher fees than identically situated debtors in Bankruptcy Administrator districts. This, according to Judge Holcomb, rendered § 1930(a)(6) as amended unconstitutionally non-uniform in violation of the Bankruptcy Clause.

Judge Holcomb then turned to the Due Process Clause of the Fifth Amendment and the Equal Protection Clause of the Fourteenth Amendment. Applying rational-basis review, Judge Holcomb noted that Congress enacted the 2017 amendment to address a shortfall in the U.S. Trustee fund. As such, the amendment was not arbitrary or irrational and thus did not violate due process or equal protection.

Gabriel Inv. Grp., Inc. v. Tex. Alcoholic Beverage Comm’n (In re Gabriel Inv. Grp., Inc.), 630 B.R. 216 (W.D. Tex. 2021).

Summary: The district court affirmed a bankruptcy-court holding that the Texas Alcoholic Beverage Code, which prohibits public corporations from holding “package store” permits, does not allow a public corporation to take advantage of a “grandfather” exemption by purchasing the stock of a corporation that holds a permit by way of that exemption.

The Texas Alcoholic Beverage Code governs which entities may and may not operate retail liquor stores, also known as “package stores,” in the state of Texas. In general, the Alcoholic Beverage Code prohibits public corporations from holding permits to own or operate package stores, known as “package store permits” or “P Permits.” Debtor Gabriel Investment Group, Inc., or GIG, is a public corporation that holds a P Permit through a grandfather exemption to this prohibition. GIG confirmed a plan of reorganization involving a “divisive merger” whereby GIG would separate into two distinct entities. The first, the reorganized debtor, would be an operating entity that would continue to operate package stores as a privately held corporation. The second, a public corporation known as Legacy GIG, would retain one of its grandfathered P Permits and then be sold in order to pay the debts owed to various creditors. Legacy GIG’s value depended in large part on its ability to continue operating package stores via its grandfathered P Permit. In order to ensure this, GIG filed an adversary proceeding against the Texas Alcoholic Beverage Commission for a declaratory judgment that: (1) GIG is and will remain exempt from the Alcoholic Beverage Code’s public-corporation ban regardless of whether any future owner is a public corporation; and (2) the rights and privileges associated with GIG’s grandfather exemption will continue unimpaired following any acquisition of GIG’s stock.

The bankruptcy court framed the case as one revolving entirely around statutory interpretation. Section 22.16(a) of the Alcoholic Beverage Code states that “[a] package store permit may not be owned or held by a public corporation, or by any entity that is directly or indirectly owned or controlled, in whole or in part, by a public corporation, or by any entity which would hold the package store permit for the benefit of a public corporation.” Tex. Alco. Bev. Code § 22.16(a). Section 22.16(f) provides a grandfather clause, which states that section 22.16 “shall not apply to a corporation” that meets three specific criteria. *Id.* § 22.16(f). GIG argued that subsection (f) essentially negates the application of section 22.16 entirely for grandfathered corporations such as GIG. Thus, even if GIG’s stock were to be purchased by an otherwise prohibited public corporation, GIG’s P Permit will remain valid. TABC, on the other hand, argued that subsection (a) focuses broadly on the term “permit” whereas subsection (f) focuses narrowly on the term

“corporation,” and therefore, when read together, the two subsections prohibit corporations from obtaining an interest in a P Permit regardless of whether the interest is held via a separate, exempt corporation.

The bankruptcy court did not quite agree with either party’s interpretation and instead posited a third interpretation. According to the bankruptcy court, subsection (a) applies to three distinct types of entity: (1) public corporations, (2) entities owned or controlled by public corporations, and (3) entities holding P Permits for the benefit of public corporations. Subsection (f), on the other hand, only applies to corporations. This implies that the use of the word “corporation” in both subsections is linked and that, when read together, the two subsections focus on the corporation that ultimately benefits from the P Permit. The bankruptcy court illustrated its interpretation by looking to the case of GIG itself. GIG currently exists as only one of the three prohibited types of entities listed in subsection (a), i.e., a public corporation that holds a P Permit. GIG is exempted by subsection (f), however, and so subsection (a) does not apply to it in this capacity. Were GIG to sell its stock to a separate public corporation, though, it would become the other two prohibited types of entities as well, i.e., an entity owned or controlled by a public corporation and an entity holding a P Permit for the benefit of a public corporation. Because subsection (a) and (f), read together, focus on the term “corporation,” the corporation at issue in this instance is the corporation that would own or control GIG or for whose benefit GIG holds the P Permit. If that corporation were not also exempt under subsection (f), then the Alcoholic Beverage Code would no longer allow GIG to hold a P Permit.

The bankruptcy court then examined the legislative history of the Alcoholic Beverage Code’s public-corporation ban. Testimony of the bill’s drafter and the bill’s sponsor revealed an intent to ensure that package-store owners were live human beings who were easily identifiable and could be held accountable in their communities. This history bolstered the bankruptcy court’s interpretation of the text and the legislature’s intent to prohibit non-exempt corporations to benefit from P Permits.

On appeal, the district court affirmed the bankruptcy court’s decision and agreed that the subsection (f) exemption does not extend to public corporations that directly or indirectly own or control an entity that holds a P Permit or that would benefit from the P Permit, even if the permit holder is exempt. Accordingly, the district court held that the grandfather exemption in subsection (f) does not apply to any non-exempt public corporation that acquires an ownership interest in GIG.

The case is currently pending appeal in the Fifth Circuit.

UNITED STATES BANKRUPTCY COURT

KrisJenn Ranch, LLC v. DMA Properties, Inc. (In re KrisJenn Ranch, LLC), 629 B.R. 589 (Bankr. W.D. Tex. 2021) (King, C.J.).

Summary: A pipeline right-of-way was an interest in real property, but a 20% interest in the net profits of a company that owned the right-of-way was an interest in personal property, which does not meet the requirements under Texas law for a covenant running with the land.

The subject of this dispute was a pipeline right-of-way in east Texas owned by KrisJenn Ranch, LLC (the “ROW”), which was valued around \$10 million. KrisJenn Ranch, LLC, together with its two series-entities (together, “KrisJenn”) filed for chapter 11 bankruptcy and initiated this adversary proceeding against DMA Properties, Inc. and Longbranch Energy, LP (“DMA” and “Longbranch”) to determine whether the promise to pay a net-profits interest met the requirements of a covenant running with the land under Texas law.

In 2015, Larry Wright, the owner of KrisJenn, entered into a business relationship with Frank Daniel Moore, the principal of DMA. Together, Wright and Moore began to buy and sell saltwater disposal wells. Under the arrangement, Moore procured investment opportunities and Wright provided the funding. The duo engaged in the business of “flipping” saltwater disposal wells with another investor named Darin Borders, the principal of Longbranch. After successfully flipping two wells, Wright and Moore created Black Duck Properties, LLC (“Black Duck”). Black Duck was owned 50/50 by Wright through KrisJenn and Moore through his entity SCMED Oilfield Consulting, as members.

In 2016, Borders and Moore discovered the ROW, then-owned by Express Pipeline Connection, LLC (“Express Pipeline”), and entered into a purchase agreement with Express Pipeline through Longbranch. The “Longbranch Purchase Agreement” gave Longbranch the contractual right to purchase the ROW for \$5 million, including a \$25,000 earnest money payment. The Longbranch Purchase Agreement defined the ROW as “[O]wnership interest in certain pipe and related facilities . . . shown on the plat attached hereto as Exhibit ‘A’, and described on Exhibit ‘B’ attached hereto, and the rights-of-way, easements, contracts, permits and leases described on Exhibit ‘C’ attached hereto”

Moore and Borders believed that Wright possessed the capital to pay the \$5 million purchase price, so they agreed to bring Wright into the ROW deal as the “money guy.” They planned for Wright to purchase the ROW through Black Duck. Longbranch assigned the Longbranch Purchase Agreement to Black Duck in a short, two-page contract (the “Longbranch Assignment”). As consideration, Black Duck agreed to pay Longbranch “twenty percent . . . of the Net Profits from [Black Duck] or its successors or assigns.” “Net Profits” meant “gross revenues actually received by [Black Duck], or its successors or assigns directly from the operation, use, maintenance, or sale (including partial sales or conveyances) of the [ROW].” Black Duck’s obligation to pay the net-profits interest was to “attach and run with the [ROW] and [Black Duck] binds its successors and assigns to the payment of the Net Profits Share.” The Longbranch Assignment did not include a legal description of the ROW.

After Wright funded various additional earnest money payments to extend the closing date, Black Duck finally closed on the ROW in August 2017. After closing on the ROW, Moore relinquished his 50% interest in Black Duck and resigned from his position as manager. Under the “DMA Agreement,” in exchange from withdrawing from Black Duck, Moore (through DMA) would receive “[n]o less than 20% Carried Interest” in the ROW “[u]nder the exact same terms and conditions as the [Longbranch Assignment].” The DMA Agreement included language identical to the Longbranch Assignment and no legal description of the ROW was attached. Shortly after this business divorce, Wright caused Black Duck to execute a letter of intent to sell the ROW to

TCRG East Texas Pipeline 1, LLC for \$2.5 million with a 16% profits interest retained by Black Duck.

After discovering this proposed sale, Borders and Moore each informed TCRG of their respective 20% net-profits interests. Wright did not disclose the net-profits interests to TCRG because he believed that Moore and Borders only held a net-profits interest in the profits received by Black Duck through its 16% retained interest in the ROW. Borders and Moore, conversely, believed that their interests ran with the land. The TCRG sale closed, but Wright was forced to rescind and repurchase the ROW due to threats of litigation from Moore and Borders.

Three lawsuits were filed in Texas state courts in 2019 to interpret the terms of the Longbranch Assignment and the DMA Agreement (the “Assignment Agreements”). KrisJenn filed chapter 11 and initiated this adversary proceeding for declaratory judgment and tortious interference with the TCRG sale against DMA and Longbranch. KrisJenn sought a declaration that the net-profits interests in the Assignment Agreements are personal covenants, and not real covenants that attach and run with the ROW. DMA and Longbranch answered and filed a multitude of counterclaims and cross actions. DMA and Longbranch argued that the net-profits interests attach and run with the ROW and are enforceable against the subsequent owners, TCRG and KrisJenn.

The primary issue before the bankruptcy court was whether the net-profits interests in the Assignment Agreements constituted real covenants running with the land under Texas law. In Texas, the elements of a covenant running with the land include: (1) the obligation touches and concerns the land, (2) the obligation relates to a thing in existence or specifically binds the parties and their assigns, (3) the obligation is intended by the original parties to run with the land, (4) the successor to the burden has notice of the obligation, and (5) there must be privity of estate between the parties when the covenant is made. *In re Energytec, Inc.*, 739 F.3d 215, 221 (5th Cir. 2013). Arguments at trial focused primarily on the elements of intent, touch and concern, and privity. The court addressed each element and found that multiple elements were lacking.

First, the court addressed whether the net-profits interests were intended by the original parties to run with the land. A covenant running with the land is not created simply because a contract uses classic language like “shall attach and run with the land” and “binding upon . . . successors and assigns.” The court focused on language in the Assignment Agreements that Black Duck’s obligation to pay the net-profits interests “shall run with the [ROW] and [Black Duck] binds *its successors and assigns*.” The parties disagreed over whether this language meant that the net-profits interests flowed from revenue generated from the ROW itself, or from Black Duck’s revenue from the use or sale of the ROW. The court found that “its successors and assigns” was unambiguous because it was used three times in each Assignment Agreement, and every time it was used to refer to the successors and assigns of the parties, not the ROW. The court found that the intent element was lacking.

Next, the court addressed the touch and concern element. While the ROW itself is clearly an interest in real property, the parties disputed whether the net-profits interest is an interest in real property or a mere personal covenant. A covenant touches and concerns land when the underlying obligations affect the “nature, quality or value of the thing demised, independently of collateral circumstances, or if it affect[s] the mode of enjoying it.” *In re El Paso Refinery, LP*, 302 F.3d

343, 356 (5th Cir. 2002). To prove this element, DMA and Longbranch needed to show that the obligation to pay net-profits burdens the owner of the ROW's real property interests. Because the Assignment Agreements created a net-profits interest "in the cash flow or sales proceeds received by Black Duck from the ROW," the net-profits interests were an interest in personal property. *In re KrisJenn, LLC*, 629 B.R. at 601.

The court drew comparisons to two other cases regarding the touch and concern element. First, the Fifth Circuit in *In re Energytec* considered an obligation to pay a transportation fee as part of the sale of a gas pipeline pursuant to a letter agreement and bill of sale. The Fifth Circuit held that the fee touched and concerned land because the fee was a "clear restriction on the owner's use and enjoyment of the pipeline." *Id.* (citing *In re Energytec*, 739 F.3d at 215). Second, the bankruptcy court in *In re Chesapeake* considered whether a natural gas purchase agreement between a debtor and a pipeline company contained covenants running with the land for purposes of rejection under bankruptcy law. *In re Chesapeake Energy Corp.*, 622 B.R. 274 (Bankr. S.D. Tex. 2020). The agreement included a "dedication covenant" which required the debtor to sell all gas it produced from its leases to ETC Texas Pipeline Ltd. The court in *Chesapeake* held that the covenant did not touch and concern land because the agreement did not assign an interest in any oil and gas lease but only assigned an interest in the gas produced and severed from the mineral estate, and "produced gas" is personal property. Here, the court found that the net-profits interest was more similar to the dedication covenant in *Chesapeake* than it was to the transportation fee in *Energytec*. Like "produced gas," Black Duck's net profits from the ROW are personal property that do not touch and concern the ROW.

Next, the court briefly addressed privity of estate and notice. There are two traditional components to privity of estate, vertical privity and horizontal privity. Vertical privity requires "a successor-in-interest relationship as to each owner of the burdened property." *In re KrisJenn, LLC*, 629 B.R. at 602. Here, vertical privity clearly existed because Black Duck purchased the ROW and sold it to TCRG, which then sold it to KrisJenn. The court noted that "it is unclear whether horizontal privity is still required," because the Fifth Circuit has criticized the doctrine. *Id.* at 603. Horizontal privity requires that a covenant "must be contained in a grant of land or in a grant of some property interest in the land." *Id.* Horizontal privity was missing here because the Assignment Agreements did not grant any "simultaneous interest" in real property between the parties. *Id.* Last, the court held that notice was lacking because the recorded Assignment Agreements did not include a sufficient legal description of the ROW. Because the Assignment Agreements did not contain enforceable covenants running with the land, the net-profits interests were personal covenants of Black Duck. The court entered declaratory judgment in favor of KrisJenn.

In re Chesapeake Energy Corp., 622 B.R. 274 (Bankr. S.D. Tex. 2020) (Jones, J).

Summary: A natural gas purchase agreement between chapter 11 debtors and a pipeline company did not contain covenants running with the land under Texas law for purposes of rejection under 11 U.S.C. § 365.

Chapter 11 debtors sought to reject a gas purchase agreement with ETC Texas Pipeline, Ltd. ("ETC") as an executory contract under 11 U.S.C. § 365. ETC objected and argued that the agreement was not executory because it contained a covenant running with the land. The debtors

countered that no privity of estate existed, and the agreement did not touch and concern the land. The bankruptcy court held a hearing on August 31, 2020 and took the matter under advisement.

Debtors Chesapeake Exploration L.L.C. and Chesapeake Energy Marketing, LLC (“Chesapeake”) entered into a gas purchase agreement with ETC effective February 23, 2016. Under the agreement, Chesapeake agreed to sell ETC certain quantities of gas. The parties executed a transaction confirmation, and Chesapeake agreed to the following dedication covenant: “[Chesapeake] dedicates for sale and delivery hereunder all of the Gas owned or controlled by [Chesapeake] or an Affiliate of [Chesapeake] that is produced from the oil and gas leases described in Exhibit ‘C’” and “[Chesapeake’s] dedication hereunder is a covenant running with the land”

Under Texas law, a covenant runs with the land and is enforceable if: (1) the obligation touches and concerns the land, (2) the obligation relates to a thing in existence, or specifically binds the parties and their assigns, (3) the original parties intended for the obligation to run with the land, and (4) the successor to the burden has notice of the obligation. *In re El Paso Refinery, LP*, 302 F.3d 343, 355 (5th Cir. 2002). Some courts also require privity of estate. *In re Energytec, Inc.*, 739 F.3d 215, 221 (5th Cir. 2013). Under § 365(a), debtors “may assume or reject any executory contract” The court first rejected ETC’s argument that a contract is not executory if it contains a covenant that runs with the land. The court was unable “to locate any authority for such a proposition.”

The court analyzed the gas purchase agreement in detail. There was no dispute that the contract related to a thing in existence and contained language that specifically binds the parties and their assigns. Notice was not an issue. The court determined that an intent that the obligation run with the land was missing despite express language that the obligation would run with the land. Because the parties agreed to a “formulaic monetary payment” as the exclusive remedy for breach, and “such a remedy is inherently personal in nature,” this provision expressed the “parties’ true intent under and the personal nature of their agreement.” *In re Chesapeake*, 622 B.R. at 282.

The court then focused on the remaining elements of “touch and concern” and privity. A covenant touches and concerns land when the covenant affects the nature, quality or value of the thing demised, or if it affects the mode of enjoying it. The court held that the dedication covenant did not touch and concern land because “produced gas,” under the agreement, meant “gas severed from the mineral estate” and produced gas is personal property under Texas law. *Id.* at 283 (citing *Phillips Petroleum Co. v. Adams*, 513 F.2d 355, 363 (5th Cir. 1975)). It was only after gas was produced did an obligation arise, therefore, ETC had no right to affect Chesapeake’s use or enjoyment of real property rights. The touch and concern element was lacking.

Last, privity of estate between the parties to an agreement is required for a covenant to run with the land. *Westland Oil Dev. Corp. v. Gulf Oil Corp.*, 637 S.W.2d 903, 910 (Tex. 1982). Vertical privity is the requirement that “there must be a mutual or successive relationship to the same rights of property.” *Id.* at 910–11. Here, vertical privity did not exist because gas purchase agreement only contained a specific dedication of gas. In other words, the gas purchase agreement was an agreement for “the ongoing purchase and sale of personal property—not the burdening of a real property interest.” *In re Chesapeake*, 622 B.R. at 284. The court noted that it is unclear whether

horizontal privity is a requirement after the Fifth Circuit expressed skepticism in *In re Energytec*, however, horizontal privity did not exist here because there was “no simultaneous interest” at the time of the gas purchase agreement. *In re Energytec*, 739 F.3d at 222. The court held that the gas purchase agreement did not contain a covenant running with the land and the agreement was an executory contract subject to rejection under § 365.

In re Nat’l Rifle Ass’n of Am., 628 B.R. 262 (Bankr. N.D. Tex. 2021) (Hale, J.).

Summary: The NRA’s chapter 11 bankruptcy case was dismissed as a bad-faith filing because the true purpose for filing was to avoid dissolution by the New York attorney general, which is not a “valid bankruptcy purpose.”

On August 6, 2020, the New York attorney general filed a complaint in New York state court against the NRA seeking dissolution of the NRA, among other relief. The complaint also named the NRA’s executive vice president, general counsel, former treasurer and chief financial officer, and former chief of staff as defendants. The allegations in the extensive complaint accused the NRA and its officers of a grocery list of exploitation and self-dealing conduct in violation of New York law. In addition to dissolution, the complaint sought restitution of funds paid to certain officers, a ban on certain officers from serving as fiduciaries of any New York charity, and voiding of certain transactions.

In response, the NRA’s board of directors formed a Special Litigation Committee and approved an employment agreement for Mr. Wayne LaPierre, NRA executive vice president. The employment agreement permitted Mr. LaPierre to “exercise corporate authority in furtherance of the mission and interests of the NRA, including without limitation to reorganize or restructure the affairs of the Association.” *Id.* at 268. The board was unaware that the NRA was considering bankruptcy and was not advised that the language in the employment agreement authorized Mr. LaPierre to file bankruptcy unilaterally. Mr. LaPierre caused the NRA and Sea Girt, LLC to file for chapter 11 relief on January 15, 2021. Early in the bankruptcy case, “many parties involved . . . began to take positions on the motions filed and the various relief requested,” including a motion to appoint an examiner under 11 U.S.C. § 1104(c) and a motion to dismiss the case or, in the alternative, appoint a chapter 11 trustee. *Id.* at 269. The court held a twelve-day trial to consider the three forms of relief: dismissal, appointment of a chapter 11 trustee, or appointment of an examiner.

The court first considered whether cause existed to dismiss the case as a bad faith filing. Section 1112(b) of the Bankruptcy Code permits courts to dismiss a chapter 11 case for cause. The movant bears the initial burden to prove cause by showing a lack of good faith in filing, then the burden shifts to the debtor to show good faith. *Id.* at 270. A chapter 11 petition is filed in good faith if it “serves a valid bankruptcy purpose.” *Id.* at 271. The NRA provided several reasons for filing bankruptcy, including (1) the need to streamline litigation, (2) the need for a breathing spell, (3) the NRA’s desire to become a Texas nonprofit organization, and (4) to reduce operating costs. Other parties argued that the true purpose was to “escape civil prosecution and avoid regulatory oversight from the NYAG, [and] also to stall litigation.” *Id.* at 272. Based on the evidence and testimony of witnesses including Mr. LaPierre, the NRA’s CFO, and the NRA’s general counsel, the court was persuaded that there was no financial reason for the bankruptcy. Instead, the primary

purpose of filing was “to avoid potential dissolution in the NYAG Enforcement Action.” *Id.* at 279.

The court considered a “conglomerate of factors” and applied a totality of the circumstances test to determine good faith. See *In re 15375 Mem’l Corp.*, 589 F.3d 605, 618 n.7 (3d Cir. 2009); *In re Little Creek Dev. Co.*, 779 F.2d 1068, 1072 (5th Cir. 1986). Here, the court found that the purpose was to “deprive the NYAG of the remedy of dissolution, which is a distinct litigation advantage” and not a valid bankruptcy purpose. *Id.* at 281. The court considered the secrecy around the decision to file for bankruptcy, the lack of disclosure to the board of directors, the NRA’s healthy financial position, and the “existential threat” of the New York regulatory action. The NRA’s bankruptcy purpose to obtain an unfair litigation advantage over the New York attorney general and to avoid the New York regulatory scheme was bad faith and grounds for dismissal.

In re Expo Constr. Grp. LLC, No. 20-34099, 2021 WL 2470984 (Bankr. S.D. Tex. June 16, 2021) (Rodriguez, J.).

Summary: A creditor’s adversary complaint against a chapter 11 debtor, which was filed before the bar date, served as a timely informal proof of claim.

A chapter 11 debtor, Expo Construction Group, LLC, objected to a formal proof of claim for \$11.1 million filed by creditor Flash Funding, LLC because it was filed after the bar date. Prior to the bar date, however, Flash Funding filed an adversary proceeding seeking nondischargeability pursuant to 11 U.S.C. § 523(a)(4) against Expo. Still before the bar date, Flash Funding amended its complaint to seek (1) declaratory judgment, (2) identification and recovery of trust funds pursuant to 11 U.S.C. § 541, (3) an accounting of diverted trust funds, and (4) for attorney’s fees and monetary damages in an amount equal to not less than \$1.1 million. The bar date for non-governmental proofs of claim was December 21, 2020. On February 4, 2021, Flash Funding filed its unsecured proof of claim for \$1.1 million.

Expo argued that Flash Funding was listed as “disputed” on Expo’s schedules, so Flash Funding was required to file a timely proof of claim pursuant to FED. R. BANKR. P. 3003(c)(2). Flash Funding did not dispute that its formal proof of claim was filed forty-five days after the bar date but argued that its adversary proceeding constituted an informal proof of claim. The bankruptcy court explained that a “creditor’s pre-bar date filing of an adversary proceeding may be treated as an informal proof of claim that can be amended after the bar date to conform with, inter alia, the requirements of Federal Rule of Bankruptcy Procedure 3001(a).” *Id.* at 293 (citing *Garza v. JD Foods Inc. (In re Garza)*, 222 F. App’x 350, 352–53 (5th Cir. 2007)). The court applied the Fifth Circuit’s five-part test from *Nikoloutsos* to determine what qualifies as an informal proof of claim. *In re Nikoloutsos*, 199 F.3d 233 (5th Cir. 2000). To be an informal claim, (1) the claim must be in writing, (2) the writing must contain a demand by the creditor on the debtor’s estate, (3) the writing must evidence an intent to hold the debtor liable for such debt, (4) the writing must be filed with the bankruptcy court, and (5) allowance of the claim must be equitable under the circumstances. *Id.*

The bankruptcy court found that Flash Funding’s complaint in the adversary proceeding clearly satisfied the first four prongs. Regarding the fifth prong, Expo argued that the complaint should

not be allowed as an informal claim because “[w]hen Debtor’s counsel saw the complaint, she immediately knew that the complaint was erroneously [sic], and knew the Debtor could and should ignore it” because “[§] 523(a)(4) actions are only allowed against individual debtors and not against corporate debtors.” *Id.* Even though the initial complaint was erroneous, the complaint was amended before the bar date. The court found that it was not inequitable to allow the informal proof of claim. Expo’s objection to the claim was overruled.

In re Gates (Gates v. RAC Acceptance Tex., LLC), 621 B.R. 129 (Bankr. W.D. Tex. 2020) (King, C.J.).

Summary: A creditor willfully violated the automatic stay by repeatedly contacting a chapter 7 debtor when the creditor knew of the bankruptcy. Actual damages of \$110 were awarded but no emotional distress damages, punitive damages, or contempt sanctions were warranted.

Cheryl Lynn Gates, a chapter 7 debtor, initiated an adversary proceeding against creditor RAC Acceptance Texas, LLC seeking actual damages, punitive damages, a finding of contempt, costs, and fees under 11 U.S.C. § 362(k) based on alleged violations of the automatic stay. The court held a two-day trial. Evidence and testimony revealed that RAC employees made repeated postpetition contacts with Gates to collect money due on a prepetition furniture financing transaction.

Prior to bankruptcy, Gates entered into a Rental-Purchase Agreement for a mattress and sofa in which Gates promised to make biweekly rental payments of \$72.46. Gates made a few payments to RAC for the first month, January 2020, then stopped making payments. Fourteen days after signing the Agreement, Gates filed for bankruptcy and listed RAC improperly as an unsecured creditor. RAC was mailed formal notice of the bankruptcy using the address of RAC’s financing office in Live Oak, Texas, which is located in the back of an Ashley Furniture HomeStore retail location.

In the following weeks, RAC staff contacted Gates regarding her overdue balance at least twenty-nine times, including fourteen voicemail messages, four text messages, nine unanswered telephone calls with no message, and two emails. Gates answered one phone call from an RAC employee and advised him of her bankruptcy and directed him to contact her attorney and to not call her anymore. The employee proceeded to call her three more times in the following days. One text from the RAC District Manager attempted to broker a deal to cure her past due payments, which would “[s]top Rent A Center from visiting home this week and calls [sic] by calling in payment today.” *Id.* at 133. Gates responded by text to advise RAC again of her pending bankruptcy. Finally, Gates’s counsel sent a “cease and desist” letter to RAC. At trial, Gates claimed that she suffered severe emotional distress because of the stay violations, and that the collection activity aggravated her preexisting health conditions. Gates also attributed the loss of her job as a tenant liaison with a commercial real estate firm to the stress and anxiety caused by RAC’s collection activity. Gates testified that she “couldn’t sleep at night” and was “scared to death” based on her belief that RAC was threatening to come to her home and take possession of the couch and mattress. *Id.* at 135.

The bankruptcy court determined that RAC’s postpetition contacts with Gates constituted a willful

violation of the automatic stay under 11 U.S.C. § 362(k). Section 362(k) provides debtors with a private right of action for damages for any willful violation of the automatic stay. To establish a willful violation of the stay, debtors must show that (1) the creditor knew of the existence of the stay, (2) the creditor's actions were willful, and (3) the creditor's actions violated the stay. No specific intent is required for a "willful" stay violation, instead, the creditor must merely intend to take the actions that violate the stay. *Id.* at 136 (citing ***Campbell v. Countrywide Home Loans, Inc.***, 545 F.3d 348, 354–55 (5th Cir. 2008)). Here, all three elements were clearly met, and the conduct fell within the parameters of § 362(a)(6) as an act to collect a prepetition debt.

Moving to damages, the court recognized that § 362(k)(1) provides that the debtor "shall recover" actual damages, costs, and attorney's fees. The debtor still bears the burden, however, of providing sufficient factual foundation for actual damages. A mere "fleeting, inconsequential, and medically insignificant annoyance, aggravation, or indignation," does not justify actual damages. *Id.* at 137. The court found that actual damages of \$110.00 were appropriate to recoup out-of-pocket medical expenses and for the willful stay violations. Emotional distress damages, which require a showing of "specific discernable injury to [her] emotional state," were not appropriate because Gates did not produce credible evidence of harassment or coercion by RAC, and her claims were exaggerated. *Id.* at 138.

Next, the court turned to Gates's request for punitive damages, contempt, and attorney's fees. Bankruptcy courts may award punitive damages for willful stay violations "in appropriate circumstances." 11 U.S.C. § 362(k)(1). The existence of "appropriate circumstances" requires a finding of "egregious conduct" by the party that violates the stay. *Id.* at 139 (citing ***Monge v. Rojas (In re Monge)***, 826 F.3d 250, 256 (5th Cir. 2016)). Punitive damages can be appropriate even if a willful violation of the stay causes minimal actual damages where the creditor acts recklessly or with a high degree of reprehensibility in disregard for the automatic stay. *Id.* at 139–40. Here, the failure of RAC employees to follow company policy and cease contact with the Gates was not sufficiently egregious to warrant punitive damages. Next, violations of the automatic stay are punishable by contempt of court, and bankruptcy courts are afforded broad discretion in the use of the contempt power under § 105(a). Here, the court found no basis to use its contempt power against RAC. Last, debtors may recover reasonable fees and expenses incurred in prosecuting a successful § 362(k) action. The court awarded Gates reasonable fees and costs.

In re Sparks, No. 20-50079-rlj11V, 2021 WL 2638602 (Bankr. N.D. Tex. 2021) (Jones, J.).

Summary: A debtor could use the proceeds of the sale of his homestead to purchase a new homestead from his chapter 11 estate, but he had to pay full price for the property. The debtor could not use proceeds from the homestead sale to purchase personal property, however, because such proceeds become non-exempt under Texas law.

An individual chapter 11 debtor, Robert Sparks, sold his homestead in Lubbock, Texas and realized approximately \$347,000.00 in cash proceeds after paying off the mortgage holder. In bankruptcy, the debtor sought approval to purchase real estate and certain items of personal property in cash from the bankruptcy estate using his proceeds. The real estate, called the "Home Place," was a 160-acre tract with a home in Parmer County, Texas. The proposed purchase price was \$170,000.00. The personal property included "Ivy Investments" of \$24,436.80, "money on

deposit” of \$15,656.81, and two vehicles valued at \$22,000.00. Although the appraisal value of the Home Place was \$180,000.00, the debtor, as the owner of the property, proposed to give himself a \$10,000.00 discount.

City Bank, an unsecured creditor owed over \$400,000.00, opposed the proposal to purchase estate property. City Bank argued that the \$347,000.00 in proceeds were “conditionally exempt because under the ‘Texas Proceeds Rule,’ proceeds from the sale of a homestead lose their exempt status if not reinvested into another homestead within six months of the sale.” *Id.* at *1. Here, the extra proceeds not reinvested into the new homestead should lose their exempt status and be used to pay unsecured creditors. City Bank argued that the debtor should not be allowed to purchase nonexempt personal property with homestead proceeds and that the debtor should not benefit from a discount on the new homestead because he was on both sides of the deal.

The bankruptcy court addressed whether the debtor’s two purchases of the Home Place and the personal property should be allowed. The court agreed with City Bank’s explanation of the law governing Texas homesteads *Id.* (citing *In re Frost*, 744 F.3d 384 (5th Cir. 2014)). The court held that the debtor could not use the nonexempt proceeds to purchase the personal property, instead, it must go to the benefit of unsecured creditors. Next, the court allowed the debtor to purchase the Home Place despite the fact that he was on both sides of the transaction. The court ordered, however, that the debtor must act selflessly and increase the sales price to \$180,000.00.

In re Steen, No. 20-50042-rlj13, 2021 WL 2877515 (Bankr. N.D. Tex. July 8, 2021) (Jones, J.).

Summary: Attorney’s fees incurred defending a chapter 13 debtor in a nondischargeability proceeding were reasonable and necessary under 11 U.S.C. § 330(a)(4)(B) and allowed as fees benefiting only the debtor and not the estate. Section 330(a)(4)(B) is an exception to the American Rule and the general rule that administrative expenses must benefit the estate.

Debtors Shayne Steen and Tracie Cole filed a chapter 13 petition including a disclosure of compensation of their attorney, Sam Gregory. Later, Steen’s ex-wife initiated an adversary proceeding claiming that debt owed to her by Steen was nondischargeable under 11 U.S.C. § 523(a)(4). The bankruptcy court granted Steen’s motion to dismiss, and Gregory applied for compensation in the amount of \$6,260.00 for his services as counsel to Steen in the adversary. The chapter 13 trustee objected and argued that the bankruptcy estate should not have to pay Gregory’s fees.

The trustee argued that unsecured creditors should not “have to bear the burden of the work done on Shayne’s behalf” and noted that the ex-wife was never charged for the fees. *Id.* at *1. The American Rule, which states that parties involved in litigation are responsible for paying their own attorney’s fees absent a fee-shifting statute, prevents the fees from coming out of the chapter 13 estate. In response, Gregory asserted that the language of § 330(a)(4)(B) permits attorney’s fees when the services rendered provide a benefit and are necessary “to the debtor.” *Id.* at *2. Nowhere in § 330(a)(4)(B) does it require the services to also benefit the estate.

The court analyzed § 330 of the Bankruptcy Code, which provides for compensation of professionals like Gregory. Section 330(a)(4)(A) provides that compensation is not permitted for

services that were not reasonably likely to benefit the estate or were not necessary to the administration of the case. Section 330(a)(4)(B) provides an exception: “[T]he court may allow reasonable compensation to the debtor’s attorney for representing the interests of the debtor in connection with the bankruptcy case based on a consideration of the benefit and necessity of such services to the debtor . . .” 11 U.S.C. § 330(a)(4)(B). The court must consider if the services benefitted the debtor or the estate, whether the services were necessary, and whether the compensation requested is reasonable.

There was no dispute that the time spent was reasonable for the services performed. The parties disputed whether Gregory’s services were beneficial and necessary to either the debtors or to the debtors’ estate. Regardless of whether the services benefitted the estate, the court explained that “Congress plainly intended that counsel for a chapter 13 debtor could be compensated . . . for services that provided a benefit to the debtor [but] . . . no direct benefit upon the bankruptcy estate.” *Id.* at *3 (quoting *In re Riley*, 923 F. 3d 433, 443 (5th Cir. 2019)). Here, Gregory’s services were clearly compensable under § 330(a)(4)(B). Next, the court held that the fees were reasonable based on the *First Colonial* factors. *Baddock v. Am. Benefit Life Ins. Co. (In re First Colonial Corp. of Am.)*, 544 F.2d 1291, 1298–99 (5th Cir. 1977).

Finally, the court held that § 503 of the Bankruptcy Code creates an exception to the American Rule by permitting attorney’s fees to be paid as an administrative expense from the assets of the bankruptcy estate. The American Rule does not apply “when there is an explicit statutory provision providing for attorney fees.” *Id.* at *5. Section 330(a)(4)(B), incorporated through § 503(b)(2), “is an explicit statutory provision that provides for attorney fees to be paid by the bankruptcy estate.” *Id.* The court allowed Gregory’s fees.

Trejo v. Navient (In re Trejo), Case No. 17-42439-MXM-7, 2020 WL 1884444 (Bankr. N.D. Tex. Apr. 15, 2020) (Mullin, J.).

Summary: A debtor with limited education and job skills that cared for her two dependent children with worsening medical and psychological conditions could discharge her student loans, as failure to do so would impose an undue hardship on her and her daughters.

Debtor Jessica Garcia Trejo is a single mother in her late forties with three daughters, including two teenage dependent daughters and one nondependent daughter in her mid-twenties. The two dependent daughters have been diagnosed with serious Type II diabetes, high blood pressure, psoriasis, eating disorders, severe depression, suicidal tendencies, and ADHD. They require constant care from Trejo. Between the years 2008 and 2013, Trejo took out more than \$54,000 in student loans to pursue a degree in bilingual education, a degree which she never received. Additionally, Trejo signed a \$13,522.00 Parent PLUS loan on behalf of her eldest daughter to help her complete her last semester of college and earn her degree. Trejo filed for chapter 7 bankruptcy on June 8, 2017. That same day, she initiated an adversary proceeding against Navient Solutions, LLC and Sallie Mae seeking to discharge her federal student loans under 11 U.S.C. § 523(a)(8) on the basis that excepting them from discharge would impose an undue hardship on her and her dependents. Trejo subsequently dismissed Sallie Mae and filed an amended complaint adding the U.S. Department of Education as a defendant. Navient then filed a motion to dismiss, which was granted. Trejo’s adversary proceeding against the DOE continued to trial, at which point Trejo

owed \$83,442.65 in principal and \$7,156.15 in interest on her student loans for a total debt of \$90,598.80.

In determining undue hardship for purposes of § 523(a)(8), the Fifth Circuit follows the *Brunner* test set out by the Second Circuit in *Brunner v. N.Y. State Higher Educ. Servs. Corp.*, 831 F.2d 395 (2d Cir. 1987). Under the three-part *Brunner* test, the debtor must show that: (1) the debtor cannot maintain a minimal standard of living if forced to repay the loans; (2) additional circumstances exist indicating that this state of affairs is likely to persist for a significant portion of the repayment period; and (3) the debtor has made good-faith efforts to repay the loans. Judge Mullin held that Trejo satisfied all three prongs.

First, Judge Mullin found that the deterioration of her two dependent daughters' medical and psychological conditions did not permit Trejo to seek or hold even part-time employment, as she had to constantly care for and supervise her daughters. Furthermore, Trejo's total monthly income to support herself and her daughters came only in the form of her daughters' Supplemental Security Income benefits from the Social Security Administration in the amount of \$1,470.00, food stamps worth \$210.00, and occasional assistance with utility bills and food from local churches. As a result, Judge Mullin found that Trejo struggled each month to pay her "meager" monthly expenses of \$1,750.00 for her family of three and that "no realistic 'belt tightening'" would create sufficient discretionary income to pay her loans. *Id.* at *6.

Second, Judge Mullin found that Trejo's age, severely limited education, lack of job skills and experience, and the additional physical, medical, and psychological health challenges presented by her dependent daughters established "compelling circumstances that saddle Ms. Trejo with a total incapacity to pay her student loan debts." *Id.* at *8. Accordingly, there existed "no realistic, foreseeable avenue through which Ms. Trejo could improve her condition and reach some untapped earning potential that would allow her to pay down her student loan debt without jeopardizing herself or her dependents." *Id.*

Finally, Judge Mullin found that, while Trejo had never been able to make any payments on her student loan debt, she did make good-faith efforts to seek payment deferrals and forbearances on her loans through her "constant telephone contact with Sallie Mae, Navient, and [the DOE] seeking to explore more long-term, income-based repayment options for her student loans." *Id.* at *10. Based on the foregoing, Judge Mullin found that Trejo satisfied her burden of establishing undue hardship under "the demanding standard adopted by the Fifth Circuit when considering the third prong of the *Brunner* test." *Id.*