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Bankruptcy

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BANKRUPTCY

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I. INTRODUCTION

Federal courts issued a number of interesting bankruptcy opinions during this Survey period. These opinions address challenging issues, such as the dischargeability of student loans and selecting the appropriate valuation date in Chapter 11 cram-downs. This Survey covers a handful of these cases, including three decisions by the U.S. Supreme Court. The authors have selected these decisions based on their importance to future insolvency practice, and we hope this Survey is useful to consumer and business bankruptcy practitioners alike.

II. 11 U.S.C. § 546(e)

A. No Safe Harbor? The Supreme Court Narrowly Interprets § 546(e) in *Merit Management Group, LP v. FTI Consulting, Inc.*

On February 27, 2018, the U.S. Supreme Court issued a unanimous opinion resolving the circuit split regarding the proper interpretation of the safe harbor provision found in 11 U.S.C. § 546(e). In *Merit Management Group, LP v. FTI Consulting, Inc.*,[1] the Supreme Court addressed whether a trustee could avoid a transfer where the funds passed through a disinterested third-party financial institution. In answering in the affirmative, the Supreme Court held that the relevant transfer protected by § 546(e) is the overarching transfer the trustee seeks to avoid.[2] Merely because a transfer passes through several component parts, including a financial institution, does not shield it from avoidance under the safe harbor provision.[3]

1. 138 S. Ct. 883, 888 (2018).
2. *Id.*
3. *See id.*

The dispute began when two companies, Valley View Downs, L.P. (Valley View) and Bedford Downs Management Corporation (Bedford Downs), competed for the "last harness-racing license in Pennsylvania."[4] Bedford Downs later decided it would withdraw as a competitor if Valley View purchased all of Bedford Downs's stock for $55 million.[5] Valley View agreed, and "arranged for the Cayman Islands branch of Credit Suisse" to finance the purchase.[6] Credit Suisse wired the cash to Citizens Bank of Pennsylvania, which was acting as the third-party escrow agent.[7] Bedford Downs's shareholders, which included Merit Management Group, L.P. (Merit), deposited their stock into escrow, and the transaction closed.[8] But Valley View encountered more problems and never opened its racetrack casino.[9] Valley View, along with its parent company, Centaur, L.L.C., later filed for Chapter 11 bankruptcy.[10]

During Valley View's Chapter 11, the bankruptcy court appointed FTI Consulting, Inc. (FTI) as trustee of the Centaur litigation trust.[11] FTI then filed suit against Merit seeking to avoid the $16.5 million transfer Merit received when it sold the Bedford Downs stock.[12] FTI alleged that the transfer "was constructively fraudulent under § 548(a)(1)(B) of the Code because Valley View was insolvent when it purchased Bedford Downs and 'significantly overpaid' for the . . . stock."[13] Merit countered that the transfer fell within the safe harbor provision.[14] Section 546(e) of the Bankruptcy Code provides "the trustee may not avoid a transfer that is a . . . settlement payment . . . made by or to (or for the benefit of) a . . . financial institution . . . or that is a transfer made by or to (or for the benefit of) a . . . financial institution . . . in connection with a securities contract."[15]

The U.S. District Court for the Northern District of Illinois sided with the majority of circuit courts and agreed with Merit.[16] But the U.S. Court of Appeals for the Seventh Circuit reversed, holding that "the § 546(e) safe harbor did not protect transfers in which financial institutions served as mere conduits."[17] The Supreme Court granted certiorari to resolve the conflicting interpretations among the circuit courts.[18]

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4. *Id.* at 890.
5. *Id.* at 891.
6. *Id.*
7. *Id.*
8. *Id.*
9. *Id.*
10. *Id.*
11. *Id.*
12. *Id.*
13. *Id.*
14. *Id.*
15. 11 U.S.C. § 546(e).
16. *Merit Mgmt. Grp.*, 138 S. Ct. at 892; *see also* FTI Consulting, Inc. v. Merit Mgmt. Grp., LP, 541 B.R. 850, 855–57 (N.D. Ill. 2015) (citing opinions from the Second, Third, Sixth, Eighth, and Tenth Circuits, all finding that a financial intermediary is protected under the safe harbor provision of § 546(e)).
17. *Merit Mgmt. Grp.*, 138 S. Ct. at 892.
18. *Id.*

In delving into the context, history, and text of § 546(e), the Supreme Court affirmed and remanded the Seventh Circuit's decision.[19] Contrary to the reasoning of the lower courts, the Supreme Court focused its inquiry on identifying the relevant transfer that was made before determining "whether a transfer was made by or to or for the benefit of a covered entity."[20] The Supreme Court specifically examined the very first clause of § 546(e),[21] which "indicates that § 546(e) operates as an exception to the avoiding powers afforded to the trustee under the substantive avoidance provision."[22] Moreover, § 546(e)'s "very last clause 'except under § 548(a)(1)(A) of this title' . . . reminds us that the focus of the inquiry is the transfer that the trustee seeks to avoid."[23] Overall, "[b]y referring back to a specific type of transfer that falls within the avoiding power, Congress signaled that the exception applies to the overarching transfer that the trustee seeks to avoid, not any component part of that transfer."[24]

Here, the overarching transfer FTI sought to avoid was Valley View's purchase of Bedford Downs's stock from Merit.[25] Credit Suisse and Citizens Bank were mere "component parts."[26] The Supreme Court therefore held that the transfer fell outside § 546(e)'s safe harbor.[27]

While *Merit* seems clear and straightforward, it arguably leaves room for much litigation. Since the "focus must remain on the transfer the trustee [seeks] to avoid," parties should be quick to argue that the overarching transfer in an avoidance action is not the transfer the trustee has identified.[28] But once the transfer is identified, the safe harbor inquiry ends.[29] This is because under *Merit* the "component parts are simply irrelevant."[30]

The Supreme Court's holding in *Merit* may be narrow, but it sends a broad message: parties may not insulate themselves from fraudulent transfer liability by routing transfers through a non-interested financial institution. For some parties, like Merit, this may mean turning over millions of dollars when another party to a transaction files for bankruptcy.

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19. *See id.* at 892–97.
20. *Id.* at 892.
21. The clause provides, "Notwithstanding sections 544, 545, 547, 548(a)(1)(B), and 548(b) of this title, ..." 11 U.S.C. § 546(e).
22. *Merit Mgmt. Grp.*, 138 S. Ct. at 893.
23. *Id.* (quoting 11 U.S.C. § 546(e)).
24. *Id.*
25. *Id.* at 897.
26. *Id.*
27. *Id.*
28. *Id.* at 895.
29. *Id.*
30. *Id.*

III. PROCEDURE

A. High Court Declines to Determine Legal Test for Non-Statutory Insiders, Instead Addressing the Proper Standard of Review

On March 5, 2018, the U.S. Supreme Court issued another narrow bankruptcy opinion. In *U.S. Bank National Association v. Village at Lakeridge, LLC*,[31] the Supreme Court held that clear error—not de novo—is the proper standard of review in deciding whether a transferee is a non-statutory insider under 11 U.S.C. § 101(31).[32] Surprisingly, the Supreme Court denied certiorari as to the correct legal test in determining whether one qualifies as a non-statutory insider under the Bankruptcy Code.[33] The Supreme Court only narrowly addressed the appropriate standard of review, leaving the real question unanswered.

The case arose out of a company's attempt to reorganize its debts under Chapter 11.[34] Village at Lakeridge, LLC (Lakeridge) filed for Chapter 11 bankruptcy because of two substantial debts it owed to two creditors: over $10 million to U.S. Bank and $2.76 million to MBP Equity Partners (MBP).[35] MBP was the single owner of Lakeridge.[36]

Lakeridge submitted a plan of reorganization that put U.S. Bank and MBP in two separate classes and impaired both of their interests.[37] U.S. Bank rejected the plan.[38] MBP, a statutory insider under § 101(31), could not vote to cramdown the plan under § 1129(a)(10).[39] Therefore, MBP looked to find a non-insider who could vote and agree to the plan.[40] Kathleen Bartlett, an MBP board member and an officer of Lakeridge, proposed a solution.[41] She offered to sell MBP's claim worth $2.76 million to Robert Rabkin, a retired surgeon and Bartlett's lover, for $5,000.[42] Rabkin accepted and later consented to Lakeridge's proposed plan.[43]

U.S. Bank subsequently commenced litigation against Lakeridge, arguing that Rabkin could not vote to accept the plan because he was a non-statutory insider.[44] Both Rabkin and Bartlett admitted they had a "romantic" relationship, and U.S. Bank argued Rabkin's purchase of MBP's claim "was not an arm's-length transaction."[45] The bankruptcy court dis-

31. 138 S. Ct. 960 (2018).
32. *Id.* at 963.
33. *See id.* at 965.
34. *Id.* at 964.
35. *Id.*
36. *Id.*
37. *Id.*
38. *Id.*
39. *Id.*
40. *Id.*
41. *Id.*
42. *Id.*
43. *Id.*
44. *Id.*
45. *Id.*

agreed, holding that Rabkin was not a non-statutory insider.[46] It found that Rabkin purchased the claim as a "speculative investment" upon due diligence.[47] The bankruptcy court also found that Rabkin and Bartlett lived separate lives in separate homes, and both managed their financial affairs independently.[48]

In a divided opinion, the U.S. Court of Appeals for the Ninth Circuit affirmed.[49] The majority reasoned that "a creditor qualifies as a non-statutory insider if two conditions are met: (1) the closeness of its relationship with the debtor is comparable to that of the enumerated insider classifications in [the Code], and (2) the relevant transaction is negotiated at less than arm's length."[50] The circuit court reviewed the bankruptcy court's finding that Bartlett and Rabkin's transaction was negotiated "at arm's length" under a clear error review.[51] The bankruptcy court's findings "could not be reversed under that deferential standard."[52]

On appeal, the Supreme Court held that the Ninth Circuit applied the appropriate standard in reviewing the bankruptcy court's decision.[53] Justice Kagan delivered the Supreme Court's opinion, and explained that a mixed question of law and fact "point[s] [the Supreme Court] to the same query: What is the nature of the mixed question here and which kind of court (bankruptcy or appellate) is better suited to resolve it?"[54] In this case, the mixed question was very fact-intensive[55]—the Ninth Circuit had to determine whether all the facts, taken together, showed that the transaction between Rabkin and Bartlett was not done at arm's length.[56] Justice Kagan noted, "A conclusion of that kind primarily rests with a bankruptcy court."[57] Therefore, the Supreme Court affirmed that the standard of review is only for clear error.[58]

It is unclear why the Supreme Court accepted this case when the only question it answered seemed to be an obvious one. Justice Sotomayor, joined by Justices Kennedy, Thomas, and Gorsuch, raised similar concerns in a concurring opinion.[59] Justice Sotomayor stated that "our holding eludes the more fundamental question of whether the Ninth Circuit's underlying test is correct."[60] Justice Kennedy went further.[61] In his own

46. *Id.*
47. *Id.*
48. *Id.* at 964–65.
49. *Id.* at 965.
50. *Id.* (citations omitted).
51. *Id.*
52. *Id.*
53. *Id.* at 969.
54. *Id.* at 966.
55. According to the Court, "the mixed question becomes . . . was Rabkin's purchase of MBP's claim conducted as if the two were strangers to each other?" *Id.* at 968.
56. *Id.* at 967.
57. *Id.* at 969.
58. *Id.*
59. *See id.* at 969–73 (Sotomayor, J., concurring).
60. *Id.* at 970.
61. *See id.* at 969 (Kennedy, J., concurring).

concurrence, Justice Kennedy remarked, "The Court's holding should not be read as indicating that the non-statutory insider test as formulated by the Court of Appeals is the proper or complete standard to use in determining insider status."[62] Consequently, *Lakeridge* leaves us wanting. If the Ninth Circuit's test for non-statutory insider status is not correct, then what is? Two things remain clear: (1) the Supreme Court is leaving it to the lower courts to articulate the proper test; and (2) parties are likely to win their insider argument in bankruptcy court, as reviewing courts must give its decision deference.

IV. DISCHARGE

A. Lessons Learned: The Supreme Court Resolves Circuit Split Regarding § 523 Nondischargeability Actions in *Appling*

The Bankruptcy Code is meant to give the honest debtor a fresh start by allowing him or her to discharge pre-existing debts.[63] As such, it contains exceptions to protect creditors in case of fraud.[64] A debtor that files for bankruptcy may not discharge a debt obtained by fraud "other than a statement respecting the debtor's . . . financial condition."[65] If the fraud in question respects the debtor's financial condition, it must be in writing and reasonably relied upon by the creditor to prevent discharge.[66] In *Lamar, Archer & Cofrin, LLP v. Appling*,[67] the U.S. Supreme Court considered whether a false statement about a single asset is a "statement respecting the debtor's . . . financial condition" such that the statement must be in writing and reasonably relied upon to prevent discharge of the resulting debt.

Prior to filing for bankruptcy, Scott Appling (Appling) hired Lamar, Archer & Cofrin, LLP (Lamar) to represent him in a business dispute. By March 2005, Appling owed Lamar over $60,000 in legal fees.[68] At that time, Appling falsely claimed that he was going to receive a $100,000 tax refund, which he would use to pay his debt.[69] Lamar reasonably relied on Appling's oral statement and continued to perform legal work for Appling.[70] In reality, Appling's tax refund was for much less than $100,000, and he used none of it to pay Lamar.[71] Five years later, Lamar obtained a state court judgment against Appling for $104,179.60.[72] Shortly thereafter, Appling filed for bankruptcy.[73]

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62. *Id.*
63. Lamar, Archer & Cofrin, LLP v. Appling, 138 S. Ct. 1752, 1758 (2018).
64. *See* 11 U.S.C. § 523(a)(2).
65. *Id.*
66. *Id.*
67. *Appling*, 138 S. Ct. at 1752.
68. *Id.* at 1757.
69. *Id.*
70. *See id.*
71. *Id.*
72. *Id.*
73. *Id.*

Lamar initiated an adversary proceeding against Appling during his bankruptcy.[74] The bankruptcy court ruled that because Appling made statements upon which Lamar reasonably relied, Appling's debt to Lamar was nondischargeable.[75] The U.S. District Court for the Middle District of Georgia affirmed.[76] In rejecting Appling's argument that his statement regarding a single asset "respected his financial condition," the district court held that "statements respecting the debtor's financial condition involve the debtor's net worth, overall financial health, or equation of assets and liabilities."[77] Upon further appeal, the U.S. Court of Appeals for the Eleventh Circuit reversed the lower courts' rulings.[78]

The Eleventh Circuit focused on the statutory language and held that a statement pertaining to a single asset *does* respect the debtor's financial condition.[79] The Eleventh Circuit reasoned that although "financial condition" likely refers to the entire state of one's financial affairs, a statement about a single asset can certainly still "respect" the financial condition of whomever said it.[80] According to the Eleventh Circuit, strictly ruling that *only* statements regarding the entirety of one's finances "respect [the speaker's] financial condition" would essentially read the word "respecting" out of the statute.[81] The Eleventh Circuit held that the Code's language is unambiguous on this issue and that the resulting policy of encouraging written records "promotes accuracy and predictability in bankruptcy disputes," consistent with the goals of the Code.[82]

In affirming the Eleventh Circuit, the Supreme Court relied on the statute's language, legislative history, and policy.[83] The Supreme Court tracked the long judicial tradition of reading "respecting" to have a broadening effect on statutes.[84] In analyzing the word's ordinary definition, the Supreme Court found that a statement about a single asset necessarily has a relation to the speaker's financial condition and therefore "respects" it.[85] Furthermore, the Supreme Court agreed with Appling that Lamar's preferred narrow construction would "read [ ] 'respecting' out of the statute."[86]

The Supreme Court then turned to the "incoherent results" that would stem from adopting Lamar's narrow interpretation.[87] It would result in heightened dischargeability requirements for a misrepresentation about a

74. *Id.*
75. *Id.* at 1758.
76. *Id.*
77. Appling v. Lamar, Archer & Cofrin, LLP (*In re* Appling), 848 F.3d 953, 956 (11th Cir. 2017).
78. *Id.* at 955.
79. *Id.* at 957–58.
80. *Id.* at 958.
81. *Id.*
82. *Id.* at 960.
83. Lamar, Archer & Cofrin, LLP v. Appling, 138 S. Ct. 1752, 1764 (2018).
84. *Id.* at 1760.
85. *Id.* at 1761.
86. *Id.*
87. *Id.*

single asset in a balance sheet, but not if the same misrepresentation were made alone.[88] The Supreme Court could not implement "such seemingly arbitrary distinctions" in lieu of congressional intent.[89] The Supreme Court concluded its opinion with a discussion about why its ruling is consistent with the legislative history of the Code before holding that "a statement about a single asset can be a 'statement respecting the debtor's financial condition' under § 523(a)(2) of the Bankruptcy Code."[90]

The ruling affirms a favorite principle of the law—get things in writing. Because an alleged fraudulent remark regarding a single asset can be a "statement respecting the debtor's financial condition," the Supreme Court's holding means such statements must be in writing to be nondischargeable under § 523(a)(2)(B). In this case, Appling's statement was not written and therefore dischargeable.[91] Although a lesson learned by Lamar, this ruling should be heeded by all future creditors. While *Appling* may be subject to certain exceptions, it highlights the importance of obtaining written documentation of any representation even remotely related to a debtor's financial condition. As they say, it is better to be safe than sorry.

B. Bankruptcy Court Urges Fifth Circuit to Reconsider *Gerhardt*'s Stringent Standards for Discharges of Student Loans

In *In re Thomas*,[92] the Bankruptcy Court for the Northern District of Texas held that a debtor did not satisfy her burden of showing undue hardship under 11 U.S.C. § 523(a)(8) to discharge her student loan debt. The debtor, like many others before her, failed to satisfy "the demanding standard adopted as controlling law in [the Fifth] Circuit."[93] The bankruptcy court highlighted the "incredibly high burden" the *Gerhardt*[94] test imposes on debtors seeking hardship discharges of student loans.[95] Notably, the bankruptcy court asked the U.S. Court of Appeals for the Fifth Circuit to clarify the application of certain *Gerhardt* factors and provide guidance on the prevailing standard.[96] The debtor sought to overturn the stringent *Gerhardt* standard altogether.[97]

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88. *Id.*
89. *Id.*
90. *Id.* at 1764.
91. *Id.* at 1758.
92. 581 B.R. 481 (Bankr. N.D. Tex. 2017).
93. *Id.* at 482.
94. 348 F.3d 89, 92 (5th Cir. 2003).
95. *In re Thomas*, 581 B.R. at 486.
96. *Id.*
97. *See id.* at 485 (the Debtor "urged the 'total incapacity' showing is far too stringent, asking the Court to utilize a 'realistic look' test in regards to the second prong of the *Brunner* test (as implemented by *In re Gerhardt*)."); *see also* Appellant's Opening Brief at 13–24, Vera Frances Thomas v. Dep't of Educ. (*In re* Thomas), 2018 WL 5784221 (5th Cir. 2018) (No. 18-11091).

Before filing for Chapter 7 bankruptcy in 2017, Ms. Vera Thomas (Debtor) attended Thomas Nelson Community College during the spring and fall of 2012.[98] At that time, the Debtor was fifty-seven years of age.[99] The Debtor financed a portion of her college education with two loans of $3,500 through the William D. Ford Federal Direct Loan Program with the Department of Education.[100] The total outstanding balance due as of March 12, 2017, was $7,806.45 with interest accruing at $0.66 per day.[101] In December 2013, the loans went into repayment status, and the Debtor failed to make payments as they became due.[102] The Debtor only ever made payments on the loans twice: once in April 2014 in the amount of $41.24, and once in May 2014 for $41.61.[103]

At the time the Debtor filed for bankruptcy relief, she was sixty-two years old and suffered from diabetic neuropathy—a severe, incurable medical condition.[104] Though the Debtor was previously employed, that employment was subsequently terminated.[105] The Debtor continued to seek employment but remained unemployed with no income throughout her bankruptcy.[106] Her situation was particularly difficult, as she faced an eviction notice, lost the support of her boyfriend, and did not qualify for Medicaid or Medicare.[107]

The Debtor moved to discharge her student loan debt pursuant to § 523(a)(8)(A)(i).[108] The Debtor had to "show that the debt, if excepted from discharge, would impose an 'undue hardship' on the debtor and the debtor's dependents."[109] Because the Bankruptcy Code does not define "undue hardship," the bankruptcy court relied on the three-prong *Brunner* test as construed by the Fifth Circuit in *In re Gerhardt*.[110] While the bankruptcy court found the Debtor satisfied the first prong of the *Brunner* test, the Debtor failed to meet the second prong.[111] The bankruptcy court emphasized that "[i]n this Circuit, the second prong of the *Brunner*

98. *In re Thomas*, 581 B.R. at 483–84.
99. *Id.* at 483.
100. *Id.*
101. *Id.*
102. *Id.*
103. *Id.*
104. *Id.*
105. *Id.* at 483–84.
106. *Id.* at 484.
107. *Id.*
108. *Id.*; *see* 11 U.S.C. § 523(a)(8)(A)(i).
109. *In re Thomas*, 581 B.R. at 484.
110. *Id.*; *see* United States Dep't of Educ. v. Gerhardt (*In re* Gerhardt), 348 F.3d 89, 91 (5th Cir. 2003) (citing Brunner v. N.Y. State Higher Educ. Serv. Corp., 831 F.2d 395, 396 (2d Cir. 1987)). The three-prong test requires the Debtor show that she:

> (1) cannot maintain, based on current income and expenses, a "minimal" standard of living for [herself] and [her] dependents if forced to repay the loans; (2) that additional circumstances exist indicating that this state of affairs is likely to persist for a significant portion of the repayment period of the student loans; and (3) that the debtor has made good faith efforts to repay the loans.

In re Thomas, 581 B.R. at 484 (quoting *In re Gerhardt*, 348 F.3d at 91).
111. *Id.* at 484–85.

test is especially difficult to meet."[112] Specifically, the Fifth Circuit "has indicated that a showing of dire financial conditions is not enough," but the debtor must have a "total incapacity" to pay debts both current and in the future.[113]

The bankruptcy court did not make a finding as to the third prong of *Brunner*.[114] The bankruptcy court did, however, note that "it is unclear in this Circuit what weight to give to the fact that a debtor like Ms. Thomas fails to participate in alternative repayment plans."[115] Most courts hold that this failure is not dispositive and is only a factor to consider in the analysis.[116] The bankruptcy court asked for guidance from the Fifth Circuit on this issue.[117]

While just over $7,000 worth of student loan debt may be small in comparison to the hundreds of thousands of dollars many consumers face, it was large enough in this case to seriously affect the Debtor's ability to obtain a fresh start. No matter the amount, the legal debate surrounding the dischargeability of student loan debt remains. All eyes are on the Fifth Circuit as the case is currently on appeal.[118]

V. FRAUD

A. You Better Be Specific! Fifth Circuit Weighs in on Pleading Fraud Under § 523(a)(2)

How detailed must one's fraud-based dischargeability complaint be to survive a motion to dismiss? In *In re Lindsey*,[119] the U.S. Court of Appeals for the Fifth Circuit shed light on the heightened pleading requirement in the context of a § 523(a)(2) non-dischargeability action, which excepts from discharge a debt "for money, property, services, or an extension . . . to the extent obtained by false pretenses, a false representation, or actual fraud."[120] The Fifth Circuit held that when pleading "actual fraud," a plaintiff must satisfy the heightened pleading requirements of Federal Rule of Civil Procedure 9(b) and Federal Rule of Bankruptcy Procedure 7009.[121] Specifically, this requires the plaintiff to allege, at minimum, "the nature of the fraud, some details, a brief sketch of how

112. *Id.* at 485.
113. *Id.* The Debtor conceded "that she is unable to show she is completely incapable of any employment now or in the future . . . ." *Id.* The Debtor "is able to work full-time" in a sedentary position but has not yet found new employment. *Id.* at 484.
114. *Id.* at 486. Courts consider the "debtor's efforts to obtain employment, maximize income, and minimize expenses." *Id.* at 485 (citation omitted).
115. *Id.* at 486.
116. *Id.* at 485–86 (citing Alderete v. Educ. Credit Mgmt. Corp. (*In re* Alderete), 412 F.3d 1200, 1206 (10th Cir. 2005); Tirch v. Pa. Higher Educ. Assistance Agency (*In re* Tirch), 409 F.3d 677, 682 (6th Cir. 2005); Educ. Credit Mgmt. Corp. v. Frushour (*In re* Frushour), 433 F.3d 393, 402–03 (4th Cir. 2005)).
117. *Id.* at 486.
118. *See* Appellant's Opening Brief, Vera Frances Thomas v. Dep't of Educ. (*In re* Thomas), 2018 WL 5784221 (5th Cir. 2018) (No. 18-11091).
119. 733 F. App'x 190, 191 (5th Cir. 2018).
120. *Id.*; *see also* 11 U.S.C. § 523(a)(2).
121. *In re Lindsey*, 733 F. App'x at 192.

the fraudulent scheme operated, when and where it occurred, and the participants."[122] The Fifth Circuit further held that simply asserting an intent to re-plead is not necessarily enough for purposes of a motion for leave to amend.[123] Both parts of the opinion are important to Texas bankruptcy lawyers.

The controversy in *In re Lindsey* arose from an unpaid balance on a contract between two parties, Chris Bennett (Bennett) and Kyle Lindsey (Lindsey).[124] In October 2014, KRL Custom Homes, LLC (KRL) entered into a contract with Bennett to build him a home.[125] Lindsey, in his capacity as sole owner of KRL, signed the contract on behalf of KRL.[126] In March 2015, Bennett and KRL executed an agreement in which KRL agreed to refund Bennett $42,300 in exchange for a release of any claims Bennett might have against KRL.[127] The refund was divided into three separate payments: (1) $15,000 in the form of three postdated $5,000 checks to replace the contract deposit and an earlier payment to KRL; (2) $7,300 to pay a plumbing company for plumbing work; and (3) $20,000 to pay another party for work performed on the home.[128] Despite this agreement, the three $5,000 checks did not clear.[129] Bennett was still owed the remaining $15,000.[130]

About a year later, Lindsey filed for Chapter 7 bankruptcy.[131] Lindsey's bankruptcy schedules listed his debts, including the $15,000 he owed to Bennett.[132] Bennett next filed an adversary proceeding against Lindsey, asserting that the $15,000 debt was non-dischargeable under § 523(a)(2)(A) "because Lindsey fraudulently induced the [agreement] by falsely promising that all subcontractors . . . were paid in full."[133] Lindsey filed a Rule 12(b)(6) motion to dismiss in response.[134]

At the hearing, the bankruptcy court expressed to Bennett's counsel that his complaint seemed conclusory.[135] Though counsel responded that he could re-plead, he never formally moved for leave to amend.[136] The fraud allegations in the complaint were sparse.[137] The complaint rested on the sole allegation that the "[d]ebtor knowingly, falsely swore in an affidavit relied upon by Bennett that each person had been paid in full for all labor and materials used in the residential construction . . . when in

122. *Id.* (citation omitted).
123. *Id.* at 193–94.
124. *See id.* at 191.
125. *Id.*
126. *Id.*
127. *Id.*
128. *Id.*
129. *Id.*
130. *Id.*
131. *Id.*
132. *Id.*
133. *Id.*
134. *Id.*
135. *Id.*
136. *Id.* at 191–92.
137. *See id.* at 192–93.

fact other persons were still owed for labor and materials."[138] Ultimately, the bankruptcy court granted Bennett's motion to dismiss.[139]

Lindsey appealed, and the U.S. District Court for the Western District of Texas affirmed.[140] Lindsey then appealed to the Fifth Circuit.[141] In affirming the lower courts, the Fifth Circuit reviewed two issues: (1) whether Bennett's complaint met the heightened pleading requirements for fraud; and (2) whether Bennett's motion for leave to amend was properly denied.[142]

As to the first issue, Bennett's complaint asserted that Lindsey lied under oath in his affidavit.[143] But the Fifth Circuit held that this bare assertion, absent any explanation for Bennett's belief that Lindsey's actions harmed him, was conclusory and did not satisfy the heightened pleading requirements of Federal Rule of Civil Procedure 9(b) and Federal Rule of Bankruptcy Procedure 7009.[144] Next, Bennett argued that the bankruptcy court should have allowed him to amend his complaint, and that Federal Rule of Civil Procedure 15(c) permits such amendment.[145] But Bennett only expressed his intent to re-plead if the bankruptcy court was to grant Lindsey's motion to dismiss.[146] Further, the bankruptcy court asked Bennett to describe the allegations he would include in his proposed amendments, and Bennett merely stated that he "would love to re-plead them so that they do."[147] Unfortunately, the Fifth Circuit also found this response conclusory.[148] Moreover, Bennett did not file a motion for leave to amend his complaint nor did he specifically convey how Lindsey harmed him.[149] The Fifth Circuit therefore held it was appropriate to deny Bennett's request for leave to amend his complaint.[150]

In summary, a complaint that does not plead plausible claims of fraud will be dismissed pursuant to Rule 12(b)(6). Likewise, merely asserting an intent to re-plead does not meet the federal requirements necessary for a court to grant relief under a motion for leave to amend. Accordingly, the Fifth Circuit agreed the bankruptcy court did not abuse its discretion in dismissing Bennett's § 532(a)(2) complaint and denying his

138. *Id.* at 193.
139. *Id.* at 192.
140. *Id.*
141. *Id.*
142. *See id.* at 192–94.
143. *Id.* at 193.
144. *Id.*
145. *Id.*; *see also* FED. R. CIV. P. 15(c). The Fifth Circuit has not explicitly held that a bankruptcy court must apply Rule 15(c) after the Federal Rule of Bankruptcy Procedure 4007(c) sixty-day deadline to bring a dischargeability action period has passed. *In re Lindsey*, 733 F. App'x at 193. Once the statutory period to file a complaint under Rule 4007 has expired, the bankruptcy court is not required to apply Rule 15(c) to amend complaints. *Id.*; *see also* FED. R. BANKR. P. 4007.
146. *In re Lindsey*, 733 F. App'x at 193–94.
147. *Id.* at 194.
148. *Id.*
149. *Id.*
150. *Id.*

motion for leave to amend.[151] This opinion sends a clear message to bankruptcy lawyers in the Fifth Circuit: plead fraud with particularity and preserve the right to file an amended complaint when faced with a motion to dismiss.

VI. THE EXEMPT CHARACTER OF PROCEEDS

A. *DeBerry* Brings it Home: Fifth Circuit Expands *In re Hawk* to Exempt Proceeds of Postpetition Sale of Homestead in Chapter 7

In *In re Deberry*,[152] the U.S. Court of Appeals for the Fifth Circuit held that proceeds of a Chapter 7 debtor's postpetition sale of a homestead remain unconditionally exempt under Texas law. In relying on its previous decision in *In re Hawk*,[153] the Fifth Circuit rejected the trustee's position that creditors were entitled to the homestead's sale proceeds because the funds were not reinvested in another homestead within six months. Perhaps most importantly, the opinion reaffirms *In re Hawk*'s discussion of how the Bankruptcy Code treats Chapter 7 and Chapter 13 transactions differently.[154] For these reasons, this case provides useful information for consumer bankruptcy practitioners.

Curtis DeBerry (Debtor) filed for Chapter 7 bankruptcy and listed his home as exempt homestead property.[155] No party objected.[156] Seven months later, he sold his home for $364,592.21.[157] Instead of reinvesting those proceeds into another home, the Debtor transferred the money to his wife and a law firm who had represented him in a separate criminal matter.[158]

The trustee filed an adversary proceeding against the Debtor, the Debtor's wife, and the law firm and partners who received the funds, claiming that the sale proceeds were no longer exempt.[159] The trustee alleged the creditors were entitled to the homestead proceeds because they had not been reinvested in another homestead within six months pursuant to the "proceeds rule" of the Texas Property Code.[160] In contrast, the Debtor argued the proceeds were exempt as of the time of filing the bankruptcy petition.[161] The U.S. Bankruptcy Court for the Western District of Texas agreed with the Debtor, holding that "when a Chapter 7 debtor sells his exempted Texas homestead postpetition, the proceeds of the sale are likewise exempted." The district court reversed, and an ap-

151. *Id.*
152. 884 F.3d 526 (5th Cir. 2018).
153. 871 F.3d 287, 296 (5th Cir. 2017).
154. *See In re DeBerry*, 884 F.3d at 530.
155. *Id.* at 527; *see also* Tex. Prop. Code Ann. § 41.001(a).
156. *In re DeBerry*, 884 F.3d at 527.
157. *Id.*
158. *Id.*
159. *Id.*
160. *Id.*; *see* Prop. Code § 41.001(c).
161. *In re DeBerry*, 884 F.3d at 527.

peal followed.[162]

The Fifth Circuit reversed the district court and reinstated the order of the bankruptcy court, finding no reason why its holding in *In re Hawk* would not apply in the context of Texas's homestead exemption.[163] In *In re Hawk*, the Fifth Circuit held that funds withdrawn from an exempt retirement account after the filing of a Chapter 7 petition do not lose their exempt status, even if those funds are not reinvested within sixty days in another retirement account.[164] In doing so, the Fifth Circuit relied on bankruptcy's "snapshot rule," in which a court looks "to the state law in effect at the time of filing [a bankruptcy petition]."[165] In the present case, the Fifth Circuit noted, "[W]e see no reason why *Hawk*'s analysis should not also apply to Texas's homestead exemption, which has much deeper roots than protections afforded retirement accounts."[166]

Yet, most importantly, the Fifth Circuit reaffirmed the distinctions between Chapter 7 and Chapter 13 of the Bankruptcy Code.[167] When a debtor files for relief under Chapter 7, "his assets, with specified exemptions, are immediately transferred to a bankruptcy estate."[168] The "Chapter 7 estate 'does not include the wages a debtor earns or the assets he acquires after the bankruptcy filing.'"[169] On the other hand, under Chapter 13, the Debtor's estate "includes both the debtor's property at the time of his bankruptcy petition, and any wages and property acquired after filing."[170] In this way, Chapter 13 operates differently than Chapter 7.[171]

In sum, the Fifth Circuit found that the Debtor's homestead and the proceeds from sale of that homestead belonged to the Debtor—not the estate's creditors.[172] Because the homestead was owned on the date of the filing of the Chapter 7 petition, those funds, per the reasoning in *In re Hawk*, remained unconditionally exempt.[173]

162. *Id.*
163. *Id.* at 530.
164. *In re Hawk*, 871 F.3d 287, 296 (5th Cir. 2017).
165. *Id.* at 291.
166. *In re DeBerry*, 884 F.3d at 529. In addition, in the present case, the trustee relied on two cases that were distinguished by the Fifth Circuit in *In re Hawk*. *See id.* (citing Viegelahn v. Frost (*In re* Frost), 744 F.3d 384, 389 (5th Cir. 2014); Zibman v. Tow (*In re* Zibman), 268 F.3d 298, 301 (5th Cir. 2001)). In *In re Zibman*, the distinguishing fact was that the debtor sold the homestead prepetition, and therefore the proceeds remained subject to the "proceeds rule" as Texas law requires. *See id.* In *In re Frost*, the homestead was sold postpetition, but the debtor filed for relief under Chapter 13 of the Bankruptcy Code, a key distinction. *Id.* at 530.
167. *See id.*; *see also In re Hawk*, 871 F.3d at 292.
168. *In re Hawk*, 871 F.3d at 292.
169. *Id.* (quoting Harris v. Viegel, U.S. 135 S. Ct. 189 (2015)).
170. *Id.*
171. *See id.*
172. *In re DeBerry*, 884 F.3d at 529–30.
173. *Id.*

VII. FEES

A. Fifth Circuit Holds Chapter 7 Trustees' Statutory Commissions are Presumptively Reasonable

Courts are split in determining the appropriate "commission" for Chapter 7 trustees under § 326(a) in light of Congress's amendments to provisions concerning Chapter 7 trustee payments in the Bankruptcy Abuse Prevention and Consumer Protection Act (BAPCPA) in 2005.[174] In *Lejeune v. JFK Capital Holdings, L.L.C.*,[175] the U.S. Court of Appeals for the Fifth Circuit interpreted "reasonable compensation" for Chapter 7 trustees under 11 U.S.C. §§ 326 and 330. The Fifth Circuit held that the percentage amounts provided in § 326(a) "are presumptively reasonable for Chapter 7 trustee awards."[176] In ruling on the matter as an issue of first impression, the Fifth Circuit joined what is now the majority view on Chapter 7 trustee compensation.[177]

The underlying bankruptcy case was filed in October 2014.[178] The Chapter 7 debtor, John F. Kelly (Kelly), had "allegedly operated an 80-plus entity single business enterprise to defraud his investors of millions of dollars."[179] One of the entities, JFK Capital Holdings, L.L.C. (JFK Capital), remained solvent and was awaiting an $876,000 settlement check related to a separate bankruptcy proceeding. Kelly's Chapter 7 bankruptcy trustee (Kelly Trustee) sought to preserve the incoming funds and negotiate with the attorneys responsible for the settlement who had not yet been paid.[180] The attorneys, who were owed over $300,000 in attorneys' fees, "eventually filed a state-court lawsuit to secure their claim against the settlement proceeds."[181] In response, the Kelly Trustee filed a Chapter 7 bankruptcy petition on behalf of JFK Capital to stay the state court litigation.[182] A Chapter 7 trustee (JFK Trustee) was appointed in JFK Capital's bankruptcy proceeding.[183]

Ultimately, the legal issues between the Kelly Trustee and JFK Trustee became contentious, and both trustees hired attorneys to resolve the disputes.[184] The bankruptcy court eventually reduced the JFK Trustee's fees upon finding some of the work done was "'absolutely ridiculous,'" and made a similar deduction on the Kelly Trustee's fee application.[185] On appeal, the U.S. District Court for the Eastern District of Louisiana "va-

174. *See* Lejeune v. JFK Capital Holdings, L.L.C. (*In re* JFK Capital Holdings, L.L.C.) 880 F.3d 747, 752–53 (5th Cir. 2018).
175. *Id.*
176. *Id.* at 753.
177. *See id.* at 753–54; 3 Collier on Bankruptcy ¶ 330.02 n.13 (Alan Resnick & Henry J. Sommer eds., 16th ed. rev. 2018) (citing numerous cases).
178. *In re JFK Capital Holdings, L.L.C.*, 880 F.3d at 750.
179. *Id.*
180. *Id.*
181. *Id.*
182. *Id.*
183. *Id.*
184. *Id.*
185. *Id.* at 750–51.

cated and remanded the bankruptcy court's order because the order contained no explanation for reducing the JFK Trustee's fees."[186] The Fifth Circuit granted certiorari on appeal.[187]

The Fifth Circuit began its analysis by addressing BAPCPA's amendments to § 330 of the Bankruptcy Code.[188] Although Chapter 7 and Chapter 11 trustees are subject to §§ 330(a)(7) and 326(a), "BAPCPA removed only Chapter 7 trustees from the list of professionals" in § 330(a)(3).[189] Therefore, courts "have since struggled to determine the appropriate method for determining 'reasonable compensation' for Chapter 7 trustees in light of the amendments."[190]

The Fifth Circuit next analyzed the two approaches courts have developed for determining the appropriate amount of compensation for Chapter 7 trustees.[191] Under the first approach, courts hold that the percentage amounts in § 326(a) are not only a maximum, but also a "presumptively reasonable fixed commission rate to be reduced only in rare instances."[192] The second approach, however, "declines to presume Section 326(a) percentages as reasonable because the 'bankruptcy court has discretion to award reasonable compensation *only* for actual and necessary services and may award an amount less than that requested by the trustee.'"[193] Although the district court adopted the second approach, the Fifth Circuit disagreed and adopted the first.[194]

In reaching its conclusion, the Fifth Circuit relied heavily on canons of statutory construction.[195] The Fifth Circuit focused on the added language of § 330(a)(7), which requires Chapter 7 trustees' commission to be "based on Section 326."[196] The language in § 326(a), in turn, provides that Chapter 7 trustees' fees are "not to exceed" the maximum percentages listed.[197] Contrary to the district court's analysis, the Fifth Circuit

186. *Id.* at 751.
187. *Id.*
188. *Id.* at 751–52.
189. *Id.* at 752; 11 U.S.C. §§ 326(a), 330(a).
190. *In re JFK Capital Holdings, L.L.C.*, 880 F.3d at 752–53 (citing *In re* Coyote Ranch Contractors, L.L.C., 400 B.R. 84, 92 (Bankr. N.D. Tex. 2009)).
191. *Id.* at 753.
192. *Id.* (citing Mohns, Inc. v. Lanser, 522 B.R. 594, 601 (E.D. Wis. 2015), *aff'd sub nom. In re* Wilson, 796 F.3d 818 (7th Cir. 2015)). The Seventh Circuit also distinguished several other opinions that ultimately align themselves with the first approach. *See id.* (citing *In re* Salgado-Nava, 473 B.R. 911, 921 (B.A.P. 9th Cir. 2012) (holding the presumptively reasonable approach is subject to adjustment in "extraordinary circumstances"); *In re* Scoggins, 517 B.R. 206, 214 (Bankr. E.D. Cal. 2014) (finding § 326(a)'s commission rates are reasonable, but the bankruptcy court may still engage in a more in-depth review of the trustee's services to ensure the presumption is justified)).
193. *In re JFK Capital Holdings, L.L.C.*, 880 F.3d at 753 (citing *In re Coyote Ranch Contractors, L.L.C.*, 400 B.R. at 94; *In re* King, 559 B.R. 158, 163 (Bankr. S.D. Tex. 2016)).
194. *Id.* at 754. The Fifth Circuit specifically found the bankruptcy court's decision in *Mohns* persuasive. *Id.* at 753 (citing *Mohns*, 522 B.R. at 601).
195. *Id.* at 754–55. "Because a different word is used in each provision, we assume that different meanings were intended." *Id.* at 755 (citing Sosa v. Alvarez-Machain, 542 U.S. 692, 711 n.9 (2004)).
196. *Id.*
197. *Id.*

honed in on the language of § 330(a)(1), which requires that awards be "subject to Section 326."[198] If the "based on" language of § 330(a)(7) only set a ceiling rate instead of indicating a standard commission rate, this would render the "subject to" language in § 330(a)(1) "superfluous."[199] The proper interpretation, the Fifth Circuit held, uses § 326 "not only as a maximum but as a baseline presumption for reasonableness in each case."[200] The Fifth Circuit left little room to deviate from this presumption, recognizing that although § 330 allows for a reduction or denial of compensation, "this should be a rare event" as "exceptional circumstances . . . is the key."[201]

Overall, *In re JFK Capital Holdings, L.L.C.* aligns the Fifth Circuit with the views of the Fourth and Seventh Circuits in holding that the percentages in § 326(a) are presumptively reasonable and that reducing or denying compensation under § 330 should be rare.[202] Congress's removal of Chapter 7 trustees from the language of § 330(a)(3) indicates a legislative intent for their compensation to be fixed, as opposed to being subject to a factor-driven, reasonableness assessment by the court. Moreover, the commission-based model disincentivizes Chapter 7 trustees from completing "duplicative or unnecessary services."[203] This opinion is a good one and should be useful for Chapter 7 trustees within the Fifth Circuit.

VIII. EXECUTORY CONTRACTS

A. No Notice Required: Fifth Circuit Declines to Create a Lack of Notice Exception to the § 365(d)(1) Sixty-Day Deadline in *RPD Holdings, L.L.C.*

In *RPD Holdings, L.L.C. v. Tech Pharmacy Services*,[204] the U.S. Court of Appeals for the Fifth Circuit held that a secured creditor did not acquire a patent license from the debtors' estates because the license agreement was a rejected executory contract under 11 U.S.C. § 365(d)(1).[205] Notably, the Fifth Circuit addressed whether courts may read an implicit exception into § 365(d)(1) where, as here, the debtors unintentionally failed to list the executory contract in its schedules.[206] The Fifth Circuit refused to read an actual or constructive notice requirement into the statute, and instead relied on Ninth Circuit case law to conclude that it is the affirmative duty of the Chapter 7 trustee to investigate for unscheduled

198. *Id.*
199. *Id.*
200. *Id.* at 755.
201. *Id.* at 756.
202. *See id.* at 753 (citing Mohns, Inc. v. Lanser, 522 B.R. 594, 601 (E.D. Wis. 2015), *aff'd sub nom. In re* Wilson, 796 F.3d 818 (7th Cir. 2015)); *see also* Gold v. Robbins (*In re* Rowe), 750 F.3d 392, 394 (4th Cir. 2014).
203. *In re JFK Capital Holdings, L.L.C.*, 880 F.3d at 756.
204. 907 F.3d 845, 851 (5th Cir. 2018).
205. *Id.* at 848.
206. *Id.* at 849.

executory contracts.[207]

In 2010, Tech Pharmacy Services (Tech) filed suit against several business entities involved in operating Onsite software (Onsite Parties), alleging that the Onsite Parties had infringed on Tech's patent on a system, software and related methods of remote pharmaceutical dispensing.[208] The parties later agreed to settle the dispute and entered into a license agreement (License Agreement) granting a "non-exclusive perpetual license" to all but one of the Onsite Parties.[209] The License Agreement provided that the Onsite Parties would provide quarterly reports and pay licensing fees for new machines and, in return, Tech would agree not to file patent infringement suits against the Onsite Parties.[210]

In 2012 and 2013, six of the Onsite Parties (Debtors) filed for Chapter 11 bankruptcy.[211] The case later converted to Chapter 7.[212] RPD Holdings, L.L.C. (RPD), a secured creditor, agreed to purchase its collateral from three of the Debtors in lieu of litigating its liens.[213] The terms of each sale were laid out in a separate asset purchase agreement (APA) approved by the Bankruptcy Court for the Northern District of Texas, though none of the APAs explicitly referenced the License Agreement.[214] RPD only later became aware of the License Agreement before the bankruptcy court approved the final APA.[215]

Almost a year later, Tech filed a state court lawsuit alleging that several defendants, including some of the Debtors acquired by RPD, had not complied with the terms of the License Agreement.[216] "RPD intervened and removed the proceeding to the bankruptcy court."[217] The bankruptcy court held that RPD had not purchased the License Agreement under any of the APAs because "the License Agreement was an executory contract that was rejected by operation of law" prior to the sales.[218] The U.S. District Court for the Northern District of Texas affirmed.[219]

On appeal, the Fifth Circuit addressed whether the License Agreement was an executory contract and, if it was, whether the Chapter 7 trustee's failure to assume that contract under § 365(d)(1)'s sixty-day deadline prevented RPD from acquiring the License Agreement when it was not

207. *Id.* at 857. The Fifth Circuit's holding seems limited to the facts of this case where there was "no intentional concealment" of the debtors' assets, and the license agreement "was a matter of public record." *Id.* at 857–58 ("[T]he statutory presumption of rejection after sixty days is conclusive where there is no suggestion that the debtor intentionally concealed a contract from the estate's trustee.").

208. *Id.* at 848–49.

209. *Id.* at 849.

210. *Id.*

211. *Id.*

212. *Id.*

213. *Id.*

214. *Id.*

215. *Id.*

216. *Id.* at 850.

217. *Id.*

218. *Id.*

219. *Id.*

listed on the Debtors' schedules.[220] The Fifth Circuit relied on the "Countryman" definition of an executory contract adopted by numerous circuit courts.[221] The Fifth Circuit found that the License Agreement was executory because both parties had ongoing material obligations under the agreement.[222]

The Fifth Circuit next analyzed whether the License Agreement survived the sixty-day "deemed rejection" window under § 365(d)(1) when the trustee had no knowledge of the contract, and the Debtors did not list it in its schedules.[223] The Fifth Circuit cited *In re Lovitt*, in which the U.S. Court of Appeals for the Ninth Circuit held that "under the Bankruptcy Act: 'a trustee has an affirmative duty to investigate for unscheduled executory contracts or unexpired leases,' and '[t]he statutory presumption of rejection by the trustee's nonaction within the sixty-day period following his qualification is a conclusive presumption.'"[224] The Fifth Circuit found § 704(a)(4) of the Bankruptcy Code firmly places an affirmative duty on the trustee to "investigate the financial affairs of the debtor."[225] No actual or constructive notice requirement as to the sixty-day deadline exists or is supported by the statutory text. Therefore, the Fifth Circuit refused to read such a requirement into the statute.[226]

The Fifth Circuit reaffirmed that under § 704(a)(4), the Chapter 7 trustee has the burden of investigating debtors' financial information. This opinion arguably protects Chapter 7 debtors who, absent bad faith, may fail to notify a trustee of relevant contracts or financial information. And an unscheduled contract may still be rejected. This decision highlights how important it is for purchasers of assets in bankruptcy sales to fully investigate all contracts and financial affairs of the debtor before the sale.

IX. VALUATION

A. You Get What You Get and You Don't Pitch a Fit—The Fifth Circuit Excludes Mobile Home Delivery and Setup Costs from Replacement Value Calculation

In *In re Glenn*,[227] the U.S. Court of Appeals for the Fifth Circuit affirmed the decisions of the U.S. District Court for the Northern District

220. *See id.*
221. *Id.* at 851 n.16. "[A] contract is executory if 'performance remains due to some extent on both sides' and if 'at the time of the bankruptcy filing, the failure of either party to complete performance would constitute a material breach of the contract, thereby excusing the performance of the other party.'" *Id.* (quoting Phoenix Expl. v. Yaquinto (*In re* Murexco Petroleum), 15 F.3d 60, 62–63 (5th Cir. 1994)).
222. *Id.* at 856.
223. *Id.* at 857. Importantly, there was no evidence the Debtors intentionally omitted the contract from its schedules. *Id.*
224. *Id.* at 857 (citing Cheadle v. Appleatchee Riders Ass'n (*In re* Lovitt), 757 F.2d 1035, 1040-42 (9th Cir. 1985) (discussing 11 U.S.C. § 110(b) (1970)).
225. *Id.* (citing 11 U.S.C. § 704(a)(4)).
226. *Id.*
227. 900 F.3d 187, 193 (5th Cir. 2018).

of Mississippi and the U.S. Bankruptcy Court for the Northern District of Mississippi that delivery and setup costs should not be included in the valuation of a retained mobile home under § 506(a) of the Bankruptcy Code.[228] While courts have uniformly excepted such service charges from valuation pursuant to § 506(a), the Fifth Circuit had yet to opine on this issue.[229] This decision, therefore, should prove helpful to both lawyers and judges alike.[230]

When Kayla Glenn was interested in buying a used mobile home, 21st Mortgage Corporation (21st Mortgage) financed the purchase at a fixed price that included the cost of delivery as well as the blocking, leveling, and anchoring required to situate the home.[231] Glenn subsequently filed for bankruptcy under Chapter 13 and was permitted to keep the home so long as she paid 21st Mortgage the home's secured value over the course of the plan.[232] 21st Mortgage argued that the cost of the mobile home's delivery and setup services should be included in its valuation, but both the bankruptcy and district courts disagreed.[233]

The dispute centered around the interpretation of § 506(a) of the Bankruptcy Code, which provides a property's "replacement value" is "the price a retail merchant would charge for property of that kind considering the age and condition of the property at the time value is determined."[234] In addition, § 506(a)(2) states the replacement value should be calculated "without deduction for costs of sale or marketing."[235] As a result, 21st Mortgage argued that delivery and setup costs fall under the category of costs of sale or marketing and therefore should be included in the replacement value of the mobile home.[236]

The Fifth Circuit, on the other hand, relied on U.S. Supreme Court precedent in *Associates Commercial Corp. v. Rash*,[237] which interpreted § 506(a) to exclude from replacement value "the value of items the debtor does not receive when he retains his vehicle, items such as warranties, inventory storage, and reconditioning."[238] Instead, replacement value should be calculated just from "the price a retail merchant would charge for property of that kind" for the "proposed disposition or use" of the property.[239] As such, the assessment should be based upon the value of items Glenn actually received upon retaining her mobile home. Delivery and setup costs, therefore, are rightfully excluded from the calcula-

228. *Id.*
229. *See id.*
230. *Id.*
231. *See id.* at 188.
232. *Id.*
233. *See id.* at 188–89.
234. 11 U.S.C. § 506(a)(2).
235. *Id.*
236. *In re Glenn*, 900 F.3d at 189.
237. 520 U.S. 953 (1997).
238. *Id.* at 965 n.6.
239. *See In re Glenn*, 900 F.3d at 190–92.

tion of value.[240] Additionally, the Fifth Circuit agreed with the trustee that costs of delivery and setup are to be considered "completed service charges," not costs of sales or marketing and therefore held that delivery and setup charges can—and should—be deducted from the replacement value calculation.[241]

In the authors' view, the court of appeals got it right. The amount at issue in this case was $4,000.[242] While this may not be a lot of money to most, it could be significant to a Chapter 13 debtor. Importantly, this case provides bankruptcy practitioners with a helpful framework to clarify which items are included in replacement value calculations under § 506(a).

B. Courts Have Flexibility in Selecting Valuation Date in Chapter 11 Cram-Downs, but Must Account for Postpetition Use of Collateral

Is the petition date or the effective plan date the appropriate date for a bankruptcy court to value collateral in Chapter 11 cram-downs? In an important ruling, *In re Houston Regional Sports Network, L.P.*,[243] the U.S. Court of Appeals for the Fifth Circuit held that under 11 U.S.C. § 506, bankruptcy courts have flexibility to select a valuation date so long as they consider the purpose of the valuation and postpetition use of the collateral at issue. In this case, the Fifth Circuit remanded for a re-valuation because the U.S. Bankruptcy Court for the Southern District of Texas did not consider the collateral's value in light of the plan of reorganization.[244]

Houston Regional Sports Network, L.P. (Network or Debtor) is a television network that was formed by the Houston Astros baseball team and Houston Rockets basketball team (the Teams) to televise the Teams' games.[245] The Network was given the sole right to broadcast games in exchange for fees, and also entered into an Affiliation Agreement (Agreement) with Comcast Cable Communications, LLC, under which the Network would be carried on Comcast's systems through 2032 for a monthly fee.[246] In 2010, one of Comcast's affiliates executed "a $100 million loan to the Network, secured by a lien on substantially all of the Network's tangible and intangible assets."[247] These assets did not include the Teams' media rights but did include the Agreement.[248]

In mid-2013, the Network failed to pay the fees to the Astros.[249] Later,

240. *See id.* at 191–92.
241. *See id.* at 192.
242. *Id.* at 188.
243. 886 F.3d 523, 532 (5th Cir. 2018).
244. *Id.* at 534.
245. *Id.*
246. *Id.*
247. *Id.*
248. *Id.*
249. *Id.*

in September, numerous Comcast entities forced the Network into involuntary Chapter 11 bankruptcy.[250] The Teams subsequently entered into a sale agreement with AT&T and DirecTV included in the Chapter 11 plan, under which AT&T and DirecTV would receive all equity in the Network and the right to broadcast certain content.[251] Further, the Teams agreed to waive their $107 million in media-rights fees the Network owed and accrued postpetition.[252]

Before Chapter 11 plan confirmation, Comcast made an 11 U.S.C. § 1111(b) election.[253] This election applied to the Network's intangible collateral, and the bankruptcy court valued this collateral as of the petition date.[254] Notably, the bankruptcy court's valuation considered agreements that did not exist but that could have been entered into postpetition.[255] Moreover, the bankruptcy court valued the Agreement as of the plan effective date but discounted the $107 million in waived media-rights fees.[256] Thus, the resulting value of the Network's intangible assets was zero, and Comcast could not make a valid § 1111(b) election.[257] The U.S. District Court for the Southern District of Texas affirmed, holding that the Agreement was properly valued as of the petition date.[258]

On appeal to the Fifth Circuit, Comcast argued the appropriate valuation date is the plan effective date.[259] This would result in a higher valuation of the Agreement and in turn make Comcast eligible for its § 1111(b) election.[260] The Fifth Circuit began its analysis by highlighting that the "Bankruptcy Code itself does not dictate the appropriate valuation date for Chapter 11 bankruptcies."[261] Citing § 506(a)(1), the Fifth Circuit noted the value of a secured claim is to be determined "in light of the 'purpose of the valuation and proposed disposition or use of such property.'"[262] Section 506(a) is often used in conjunction with § 1129(b), which "requires valuation of collateral in the context of plan confirmation when the debtor retains possession of the collateral."[263] Section 506(a),

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250. *Id.*
251. *Id.*
252. *Id.*
253. *Id.*; *see also* 11 U.S.C. § 1111(b). This "permits an undersecured creditor . . . to elect to have its claim treated as fully, rather than partially, secured." *In re Hous. Reg'l Sports Network, L.P.*, 886 F.3d at 526.
254. *In re Hous. Reg'l Sports Network, L.P.*, 886 F.3d at 527.
255. *Id.*
256. *Id.*
257. *Id.* A creditor cannot make a § 1111(b) election if the collateral is of "inconsequential value." *See* § 1111(b)(1)(B)(i).
258. *In re Hous. Reg'l Sports Network, L.P.*, 886 F.3d at 527.
259. *Id.* at 528. The Fifth Circuit noted the bankruptcy court valued Comcast's collateral as of the petition date because it believed *In re Stembridge* controlled. *Id.* In *In re Stembridge*, the Fifth Circuit held the petition date is the appropriate valuation date in the cram-down of a Chapter 13 plan. *See In re* Stembridge, 394 F.3d 383, 388 (5th Cir. 2004).
260. *In re Hous. Reg'l Sports Network, L.P.*, 886 F.3d at 528.
261. *Id.*
262. *Id.* (quoting 11 U.S.C. § 506(a)(1)).
263. *Id.* (citing 11 U.S.C. § 1129(b)).

however, instructs courts on how to make the initial valuation.[264] Section 1129 is then used to calculate the collateral's present value.[265]

The Fifth Circuit relied on statutory text and case law to hold that bankruptcy courts have flexibility in determining whether the petition date or effective plan date is the appropriate date to value collateral in Chapter 11 cram-down scenarios.[266] The Bankruptcy Code's 2005 amendments to § 506 provide that Chapter 7 and 13 bankruptcy valuations are calculated as of the petition date, but no similar provision is provided for Chapter 11 corporate bankruptcies.[267] Moreover, case law dictates that courts to review the debtor's use of collateral when determining valuation.[268] While it was not in error for the bankruptcy court in this case to select the petition date as the valuation date, it was erroneous for the court to deduct the Teams' unpaid, waived media fees from the value of Comcast's collateral.[269] This is because "[u]nder the Plan, the Network will now be able to use the Agreement to generate revenue free and clear of the previously outstanding media-rights fees, as the Teams have agreed to waive them."[270] In sum, the fees will never be paid and thus the Agreement was not valued in light of its "proposed use."[271]

In re Houston Regional Sports Network is notable for several reasons. First, the Fifth Circuit declined to follow Third and Eighth Circuit precedent, which holds that the effective or plan confirmation date is the proper valuation date in the Chapter 11 plan cram-down context.[272] The Fifth Circuit reasoned that the fact that § 506(a) valuations can be made at different times under different circumstances, "does not lessen the force of the Third and Eighth Circuit holdings."[273] Second, the Fifth Circuit declined to extend its holding in *In re Stembridge*, which held that the petition date is the appropriate valuation date in Chapter 13 cram-downs.[274] This is because Congress, the Fifth Circuit reasoned, did not include Chapter 11 in its § 506(a) revisions.[275] And third, the Fifth Circuit gave bankruptcy courts the flexibility to determine a valuation date for collateral in Chapter 11 cram-downs, which is necessary in light of the complex nature of such cases.[276]

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264. *Id.*
265. *Id.*
266. *See id.* at 529.
267. *Id.*
268. *Id.* (citing Assoc.'s Commercial Corp. v. Rash, 520 U.S. 953 (1997)).
269. *Id.* at 532.
270. *Id.* at 533.
271. *Id.* at 534.
272. *Id.* at 529 (citing *In re* Heritage Highgate, Inc., 679 F.3d 132, 143 (3d Cir. 2012); *In re* Ahlers, 794 F.2d 388, 400 n.14 (8th Cir. 1986), *rev'd on other grounds sub nom.* Norwest Bank Worthington v. Ahlers, 485 U.S. 197 (1988)).
273. *In re Hous. Reg'l Sports Network, L.P.*, 886 F.3d at 531.
274. *Id.* (citing *In re* Stembridge, 394 F.3d 383 (5th Cir. 2004)).
275. *Id.*
276. *Id.* at 532.

C. On Remand, Bankruptcy Court Reopens Evidentiary Record in *In re Houston Regional Sports Network*

On remand of the Fifth Circuit's decision in *In re Houston Regional Sports Network*,[277] the bankruptcy court faced a new issue—whether the court "may, must, or may not" reopen the evidentiary record in order to properly re-valuate the Agreement in light of the plan of reorganization.[278] Ultimately, the bankruptcy court determined that it had discretion to reopen the evidentiary record because there was nothing in the Fifth Circuit's mandate precluding it from doing so.[279] The bankruptcy court held that it would reopen the record; it reserved the scope of the reopening for a later date.[280]

The dispute stemmed from the parties' different interpretations of the Fifth Circuit's mandate on remand—that the bankruptcy court perform a "re-valuation of the collateral in light of the Plan."[281] Comcast argued that reopening the record would amount to legal error because the bankruptcy court's only task was to compute a new mathematical value.[282] To do so, Comcast argued, the bankruptcy court needed only to rely on already-introduced evidence.[283] In contrast, the Debtor argued the record needed to be reopened in order to properly revaluate the collateral at issue.[284]

The bankruptcy court relied on case law and the mandate rule[285] to find that it had discretion to reopen the evidentiary record to effectuate the Fifth Circuit's ruling on remand.[286] Notably, the bankruptcy court reasoned that much of Comcast's counter-arguments went to the scope of the reopened record and not whether the court had the discretion to do so.[287] "To be clear," the bankruptcy court concluded, "Comcast will be free to argue whether evidence, when offered, is relevant to the valuation issue."[288] The bankruptcy court accordingly held it would open the record in order to revalue the Agreement in light of the Plan.[289]

277. *Id.* at 534.
278. *In re* Hous. Reg'l Sports Network, L.P., 593 B.R. 461, 462 (Bankr. S.D. Tex. 2018).
279. *Id.* at 466.
280. *Id.* at 469.
281. *Id.* at 466 (quoting *In re Hous. Reg'l Sports Network, L.P.*, 886 F.3d at 534).
282. *Id.*
283. *Id.*
284. *Id.*
285. "'The mandate rule requires a district court on remand to effect' the mandate of a superior court 'and to do nothing else.'" *Id.* at 468 (quoting Gen. Universal Sys., Inc. v. HAL, Inc., 500 F.3d 444, 454 (5th Cir. 2007)).
286. *Id.* at 466 (citing Jones & Laughlin Steel Corp. v. Pfeifer, 462 U.S. 523, 551 (1983); State Indus., Inc. v. Mor-Flo Indus., Inc., 948 F.2d 1573, 1577 (Fed. Cir. 1991)).
287. *Id.* at 468.
288. *Id.* at 469.
289. *Id.*

X. CONCLUSION

During this Survey period, the U.S. Supreme Court handed down three notable bankruptcy opinions. While two of the Supreme Court's decisions addressed rather narrow statutory issues, it is likely their holdings will have broad implications for future insolvency litigation.[290] The Supreme Court's decision in *Lakeridge*, however, left many consumer and business bankruptcy attorneys confused.[291] What is the appropriate legal test to determine whether one qualifies as a non-statutory insider under the Bankruptcy Code? Post-*Lakeridge*, the answer to that question is now expected to rest with the lower courts.[292]

In addition, the Fifth Circuit tackled several difficult bankruptcy topics this term, ranging from the exempt nature of Chapter 7 homestead proceeds in *In re Deberry*[293] to more complex corporate valuation matters.[294] Consumer practitioners should keep a watchful eye on the Fifth Circuit next year because the Fifth Circuit is expected to release its opinion on the dischargeability of student loan debt.[295] Until then, we hope this Survey provided some useful guidance and practical information to our readers, as 2018 was a solid year for bankruptcy law.

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290. *See* Lamar, Archer & Cofrin, LLP v. Appling, 138 S. Ct. 1752, 1758 (2018); *see also* Merit Mgmt. Grp., LP v. FTI Consulting, Inc., 138 S. Ct. 883, 883 (2018).

291. *See supra* Part III, Section A.

292. *See generally* U.S. Bank Nat'l Ass'n v. Vill. at Lakeridge, LLC, 138 S. Ct. 960, 963 (2018).

293. 884 F.3d 526, 530 (5th Cir. 2018).

294. *See* Hous. Sportsnet Fin., L.L.C. v. Hous. Astros, L.L.C. (*In re* Hous. Reg'l Sports Network, L.P.), 886 F.3d 523, 532 (5th Cir. 2018); *see also* RPD Holdings, L.L.C. v. Tech Pharm. Servs. (*In re* Provider Meds, L.L.C.), 907 F.3d 845, 851 (5th Cir. 2018).

295. *See* Thomas v. United States Dep't of Educ. (*In re* Thomas), 581 B.R. 481, 482 (Bankr. N.D. Tex. 2017).