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## Bankruptcy

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# BANKRUPTCY

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## I. INTRODUCTION

This year’s bankruptcy survey is shorter, in part because bankruptcy filings surprisingly remain low, even in an uncertain economy. The authors have selected several cases of interest to most insolvency professionals. For the business practitioners, this Article touches on several standing cases and highlights a very important executory contract decision. Included in this survey for consumer lawyers is our typical discussion of a recent homestead case as well as the most recent dischargeability decision from the U.S. Supreme Court.

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## II. BANKRUPTCY SALES

### A. STATUTORY MOOTNESS IS FATAL TO APPEAL OF BANKRUPTCY SALE ORDER

In the opinion *In re Walker County Hospital District*, the U.S. Court of Appeals for the Fifth Circuit held that § 363(m) of the United States Code barred a creditor’s appeal regarding the terms of a bankruptcy sale when the creditor “failed to seek the required stay of the Sale Order.”<sup>1</sup> The Fifth Circuit followed precedent set out in *In re Sneed Shipbuilding, Inc.*<sup>2</sup> and *American Grain Association v. Lee-Vac, Ltd.*<sup>3</sup> by preventing the modification of an authorized sale unless the authorization and sale were stayed pending appeal.<sup>4</sup> The decision reflects the Fifth Circuit’s conviction to stay within the purpose of the statute, to “promote the finality of bankruptcy sales[,] thereby maximizing the purchase price of estate assets.”<sup>5</sup>

“Walker County Hospital Corporation ([hereinafter] the ‘Hospital’ or the ‘Debtor’) operated a not-for-profit community hospital in Huntsville, Texas.”<sup>6</sup> The healthcare provider was the largest in the county and serviced many residents within the rural area.<sup>7</sup> In 2019, the Hospital was on the brink of financial ruin when it filed for Chapter 11 bankruptcy and attempted “to auction off its assets and operations.”<sup>8</sup> The Debtor received only one bid, “a ‘stalking horse bid’ from Huntsville Community Hospital, a joint venture between Walker County Hospital District . . . and Community Hospital Corporation ([hereinafter] the ‘Buyers’).”<sup>9</sup> A group of the Debtor’s unsecured creditors concurrently appointed an official committee (the Committee) to represent its interests.<sup>10</sup>

The three parties, “[t]he Debtor, the Buyers, and the Committee, reached [an agreement] that . . . govern[ed] the sale of . . . the Hospital’s assets and operations to the Buyers.”<sup>11</sup> In exchange for favorable terms of the sale, the Committee agreed to waive potential sale objections.<sup>12</sup> In other words, the agreement allowed the Committee to secure “more

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Contributing law students and externs to the U.S. Bankruptcy Court for the Northern District of Texas include Caleb Lewis from Louisiana State University Law School; Braxton Markle from UNT School of Law; Nicole Davies from Emory University School of Law; and Adnan Bajramovic and Morgan Craft from SMU Dedman School of Law.

2. *In re Walker Cnty. Hosp. Corp.*, 3 F.4th 229, 236 (5th Cir. 2021).

3. 916 F.3d 405, 409–10 (5th Cir. 2019).

4. 630 F.2d 245, 248 (5th Cir. 1980).

5. *In re Walker Cnty. Hosp. Corp.*, 3 F.4th at 235–36.

6. *Id.* at 234 (alteration in original) (quoting WILLIAM L. NORTON, 2 NORTON BANKR. L. & PRAC. § 44:37 (3d ed. 2021)).

7. *Id.* at 231.

8. *Id.*

9. *Id.*

10. *Id.*

11. *Id.*

12. *Id.*

funds . . . to pay off unsecured creditors.”<sup>13</sup> The agreement also provided two valuable rights to the Buyers.<sup>14</sup> “First, the Buyers’ bid was conditioned on raising financing from a third-party lender ([hereinafter] the ‘Lender’) . . . .”<sup>15</sup> Second, the transaction was scheduled to close before the Hospital received a large incoming Medicaid payment.<sup>16</sup> This meant that the Buyers “would be entitled to receive” the Medicaid payment as part of the sale.<sup>17</sup> In contrast, “if the sale closed after the Hospital received” the Medicaid payment, the payment would be divided amongst “the Buyers’ and the Debtor’s estate” through an “Accounts Receivable Sharing Waterfall” formula.<sup>18</sup> The latter scenario would result in less pay-out for the Buyers.<sup>19</sup> “[T]he bankruptcy court . . . subsequently entered a Sale Order pursuant to 11 U.S.C. § 363(b).”<sup>20</sup>

Following the Sale Order, the Lender reviewed the Hospital’s records to determine if it would finance the Buyers’ purchase.<sup>21</sup> The due diligence process was arduous and extended beyond the Medicaid payment date.<sup>22</sup> “The Buyer[s] informed the Debtor that losing the Medicaid payment would sink [their] ability to receive financing [and] to close the transaction.”<sup>23</sup> In response, “the Debtor filed an emergency motion in bankruptcy court seeking to amend the Sale Order.”<sup>24</sup> “The Debtor asked the court to [lower] the purchase price . . . and . . . grant the Buyers an administrative expense claim” that would further “decrease the sale price . . . .”<sup>25</sup> The Debtor explained that the delayed closing forced the Debtor and the Buyers to create side agreements that would “keep the hospital running.”<sup>26</sup> It further elaborated that, without this agreement, “the hospital would have to cease operations[,]” thereby killing the transaction.<sup>27</sup> In essence, the Debtor argued that the amended Sale Order was in the best interest of all parties. The Debtor also requested that “the court . . . waive the standard fourteen-day stay usually required by Federal Rule of Bankruptcy Procedure 6004(h).”<sup>28</sup>

The Committee received notice of the motion “shortly after.”<sup>29</sup> It allegedly called the bankruptcy court to object to the motion and request a meet and confer with the Debtor and the Buyers.<sup>30</sup> However, the record

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13. *Id.* at 232.

14. *Id.*

15. *Id.*

16. *Id.*

17. *Id.*

18. *Id.*

19. *Id.*

20. *Id.*

21. *Id.* at 231.

22. *Id.* at 232.

23. *Id.*

24. *Id.*

25. *Id.*

26. *Id.*

27. *Id.*

28. *Id.*

29. *Id.* at 233.

30. *Id.*

did not reflect that communication.<sup>31</sup> The record did show that “one of the Buyers filed a joinder to the Debtor’s motion” supporting the proposition that the requested relief was necessary to close the transaction.<sup>32</sup> “[T]he bankruptcy court entered an order amending the Sale Order” (the Amendment Order) the next day.<sup>33</sup>

The Amendment Order was immediately effective, allowing the Debtor and the Buyers to close the sale for the Hospital’s assets less than twenty-four hours later.<sup>34</sup> This was problematic for the Committee because the Amendment Order contained language that required an objecting party to pursue a stay before the closing date.<sup>35</sup> More specifically, the Amendment Order stated “that ‘[a]ny party objecting to this order must exercise due diligence in filing an appeal and pursuing a stay within the time prescribed by law and prior to the Closing Date, [sic] or risk its appeal will be foreclosed as moot.’”<sup>36</sup> While “[t]he Committee did not seek a stay . . . , it did appeal the bankruptcy court’s Amendment Order to the [U.S. District Court for the Southern District of Texas]” about two weeks after the closing.<sup>37</sup>

In its appeal to the district court, the Committee argued that the bankruptcy court violated its procedural due process rights.<sup>38</sup> The Buyers sought dismissal of the Committee’s appeal on the basis that “it was mooted by 11 U.S.C. § 363(m) . . . .”<sup>39</sup> This provision “provides that the ‘modification on appeal’ of certain authorized bankruptcy sales ‘does not affect the validity of’ such a sale ‘to an entity that purchased . . . such property in good faith . . . unless’ that sale was ‘stayed pending appeal.’”<sup>40</sup> Given that “the Committee did not . . . seek a stay, the Buyers argued that” § 363(m) foreclosed modification.<sup>41</sup> The district court “did not address the Committee’s due process argument” and dismissed the case on the basis “that the Committee’s appeal was statutorily moot.”<sup>42</sup>

The Fifth Circuit took up the Committee’s appeal. “[T]he Committee argue[d] that the lower court erred in applying § 363(m)” because (1) the Committee “only appealed the Amendment Order, not the Sale Order[;]” and (2) “the Amendment Order did not mention” §§ 363(b) or 363(c), the “subsections that authorize sales to which § 363(m) applies.”<sup>43</sup> The Fifth Circuit did not find these arguments persuasive. It responded by pointing out that the Amendment Order did not “authorize a new or

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31. *Id.*

32. *Id.*

33. *Id.*

34. *Id.*

35. *Id.*

36. *Id.*

37. *Id.* (alterations in original).

38. *Id.*

39. *Id.*

40. *Id.*

41. *Id.* (alterations in original) (quoting 11 U.S.C. § 363(m)).

42. *Id.*

43. *Id.*

different sale[.]”<sup>44</sup> Rather, it merely “amended the Sale Order based ‘upon all of the proceedings[.]’”<sup>45</sup> In other words, the Amendment Order could not be separated from the Sale Order.<sup>46</sup> The Fifth Circuit, relying on a litany of precedent, held that “[a] failure to obtain a stay is *fatal* to a challenge of a bankruptcy court’s authorization of the sale of property.”<sup>47</sup> The lower court’s ruling was affirmed.

### III. DISCHARGEABILITY

#### A. CONFIRMED PLAN CAN LIMIT CLAIMS AGAINST NON-DEBTOR GUARANTOR

In *New Falls Corp. v. LaHaye*, the U.S. Court of Appeals for the Fifth Circuit held that the terms of a prior bankruptcy which bound a creditor to a fixed-value credit may not be relitigated in a subsequent bankruptcy of a different entity.<sup>48</sup> As part of a Chapter 11 plan for a grocer’s bankruptcy, a court awarded the grocery store and its underlying real property to a creditor as a fixed-value credit.<sup>49</sup> The owners of the grocery store, the LaHayes (who owned LaHaye Enterprises LLC (the LLC)), had personally guaranteed the original loan and therefore remained liable for the remaining balance.<sup>50</sup> Under the terms of the LLC’s bankruptcy, the owners “would make monthly payments against the [remaining] debt and would be entitled to a partial release of liability for the rest” upon confirmation of the plan.<sup>51</sup>

Shortly after the LLC’s bankruptcy plan was confirmed, the owners filed for personal bankruptcy.<sup>52</sup> This stalled the sale of the grocery store such that the storefront sat vacant and declined in value. The creditor argued that the LLC’s bankruptcy plan was binding with respect to debtors, not the guarantors, thus the LaHayes remained liable for the full balance of the original debt plus interest.<sup>53</sup> The LaHayes objected, claiming *New Falls* was bound by the LLC’s bankruptcy plan.<sup>54</sup> The bankruptcy court sustained the objection and confirmed the personal bankruptcy plan. The U.S. District Court for the Western District of Louisiana affirmed, finding that the “LaHayes’ personal liability was ‘specifically addressed’ by the first bankruptcy plan,” and therefore *res judicata*

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44. *Id.* at 235.

45. *Id.*

46. *Id.*

47. *See id.*

48. *Id.* at 234–35 (first quoting *In re Ginther Trusts*, 238 F.3d 686, 689 (5th Cir. 2001) (per curiam); then quoting *Am. Grain Ass’n v. Lee-Vac, Ltd.*, 630 F.2d 245, 247–48 (5th Cir. 1980); subsequently quoting *Fabrique, Inc. v. Corman*, 813 F.2d 725, 725 (5th Cir. 1987); then quoting *In re Gilchrist*, 891 F.2d 559, 560–61 (5th Cir. 1990); finally quoting *In re Sneed Shipbuilding, Inc.*, 916 F.3d 405, 407 (5th Cir. 2019)).

49. *In re LaHaye*, 17 F.4th 513, 520 (5th Cir. 2021).

50. *Id.* at 515.

51. *Id.*

52. *Id.*

53. *Id.*

54. *Id.* at 516.

foreclosed New Falls from raising the issue in the subsequent bankruptcy.<sup>55</sup>

The Fifth Circuit affirmed the district court's ruling, holding that the bankruptcy court properly confirmed the personal bankruptcy plan.<sup>56</sup> Although the grocery store property had not been transferred to New Falls, the LLC's plan allowed for a release of liability for the LaHayes upon confirmation of the plan.<sup>57</sup> The plan did not indicate "that the LaHayes b[ore] the burden of ensuring that New Falls receive[d] the surrendered property."<sup>58</sup> The term within the LLC's bankruptcy plan was binding beyond the LLC's bankruptcy because the plan did not discharge the guaranty, but instead reduced the guarantor's liability by ordering the debtor to surrender assets in satisfaction of the debt.<sup>59</sup> Because Section 1141 bars relitigation of provisions of confirmed plans, New Falls was unable to claim that the LaHayes were liable for the full debt.<sup>60</sup> The Fifth Circuit also denied New Falls' attack on the valuation of the grocery store, which sat empty and declined in value during the litigation proceedings, stating that the valuation binds all parties despite any post-confirmation price fluctuations.<sup>61</sup> "Under [S]ection 1141, New Falls was bound by the provision of the LLC's confirmed bankruptcy plan, which require[d] it to accept the [store] in exchange for a fixed-value credit . . . ."<sup>62</sup> As such, New Falls was unable to relitigate the aforementioned issue through the LaHayes' personal bankruptcy.<sup>63</sup>

B. SUPREME COURT ESTABLISHES THAT A STATEMENT ABOUT A  
SINGLE ASSET CAN BE A "STATEMENT RESPECTING THE  
DEBTOR'S FINANCIAL CONDITION" WITHIN THE  
FRAUD EXCEPTION TO DISCHARGE

In *Lamar, Archer & Cofrin, LLP v. Appling*,<sup>64</sup> the U.S. Supreme Court addressed what constitutes a "statement respecting the debtor's financial condition" under Section 523(a)(2) of the Bankruptcy Code.<sup>65</sup> "The Bankruptcy Code prohibits debtors from discharging debts for money, property, services, or credit obtained by 'false pretenses, a false representation, or actual fraud,'"<sup>66</sup> "other than a statement respecting the debtor's . . . financial condition."<sup>67</sup> However, if the materially false statement concerns the debtor's financial condition and is made in writing,

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55. *Id.*

56. *Id.*

57. *Id.* at 516, 520.

58. *Id.* at 516–17.

59. *Id.* at 517.

60. *Id.* at 519.

61. *Id.*

62. *Id.* at 520.

63. *Id.*

64. *Id.*

65. 138 S. Ct. 1752 (2018).

66. *Id.* at 1757.

67. *Id.* (quoting 11 U.S.C. § 523(a)(2)(A)).

then that debt is also nondischargeable.<sup>68</sup> More specifically, the Supreme Court unanimously held that a bankruptcy debtor's statements concerning a single asset could qualify as nondischargeable pursuant to 11 U.S.C. §523(a)(2)(B) if in writing.<sup>69</sup> The Supreme Court started its analysis with the plain meaning of a "statement respecting the debtor's financial condition."<sup>70</sup> Subsequently, the Supreme Court assessed the practical results of the petitioner's interpretation of the phrase.<sup>71</sup> Thereafter, the Supreme Court found that the statutory history of the phrase corroborated its interpretation.<sup>72</sup> Finally, the Supreme Court opined that its translation of the phrase did not undermine the purpose of 11 U.S.C. §523(a)(2).<sup>73</sup>

The controversy in *Appling* concerned a debtor, R. Scott Appling (Appling), who made false representations regarding his tax refund and his intent to use it to compensate his legal counsel in a business litigation matter.<sup>74</sup> Appling's representation, Lamar, Archer & Cofrin, LLP (Lamar), relied on Appling's false statements and continued to act as his counsel "without initiating collection of the overdue amount."<sup>75</sup> After Appling received a significantly smaller tax refund than he articulated to Lamar, he spent the refund on his business rather than settling his debts with Lamar as he promised.<sup>76</sup> Following the Georgia state court's judgment in favor of Lamar, "Appling . . . filed for Chapter 7 bankruptcy[.]" and "Lamar initiated an adversary proceeding against Appling in the Bankruptcy Court for the Middle District of Georgia."<sup>77</sup> Upon completion of trial, the bankruptcy court found that Appling's fraudulent statements about his tax refund did not constitute a "statement respecting the debtor's financial condition," and thus "Appling's debt to Lamar was nondischargeable under 11 U.S.C. §523(a)(2)(A)."<sup>78</sup>

While the U.S. District Court for the Middle District of Georgia affirmed the bankruptcy court's decision, the U.S. Court of Appeals for the Eleventh Circuit reversed, and the Supreme Court agreed, holding that statements about a single asset, including a tax refund, constitute a "statement respecting the debtor's financial condition."<sup>79</sup> Since "Appling's statements about his expected tax refund were not in writing, the Court of Appeals held that § 523(a)(2)(B) did not bar Appling from discharging his debt to Lamar."<sup>80</sup> "The [Supreme] Court [then] granted certiorari . . . to resolve a conflict among the [c]ourts of [a]ppeals as to whether a statement about a single asset could be a 'statement respecting the

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68. 11 U.S.C. § 523(a)(2)(A).

69. *Id.* § 523(a)(2)(B).

70. *Appling*, 138 S. Ct. at 1757, 1764.

71. *Id.* at 1759.

72. *Id.* at 1761.

73. *Id.* at 1762.

74. *Id.* at 1762–64.

75. *Id.* at 1757.

76. *Id.*

77. *Id.*

78. *Id.*

79. *Id.* at 1758.

80. *Id.*



debtor's financial condition.'"<sup>81</sup>

The Supreme Court began its analysis by focusing on the ordinary meaning of “respecting” and defined it as “concerning,” “about,” “regarding,” and “relating to.”<sup>82</sup> While Lamar argued that “respecting” is commonly understood to have a more limited scope such that the statement must be about the “debtor's overall financial state or well-being,”<sup>83</sup> the Supreme Court agreed with Appling's interpretation that “‘respecting’ in a legal context generally has a broadening effect” which encompasses both the subject of the phrase and “matters relating to that subject.”<sup>84</sup> As such, the Supreme Court determined “that a statement is ‘respecting’ a debtor's financial condition if it has a direct relation to or impact on the debtor's overall financial status” and that “[a] single asset has a direct relation to and an impact on the aggregate financial condition[.]”<sup>85</sup> Therefore, “a statement about a single asset can be a ‘statement respecting the debtor's financial condition.’”<sup>86</sup>

Next, the Supreme Court anticipated the “inexplicably bizarre” results associated with Lamar's view.<sup>87</sup> For instance, “a highly general statement like, ‘I am above water,’ would need to be in writing to foreclose discharge, while a highly specific statement like, ‘I have \$200,000 of equity in my house,’ would not.”<sup>88</sup> The Supreme Court then found that the statutory history corroborated its reading of the phrase.<sup>89</sup> Not only have the courts of appeals consistently construed the phrase to include statements about a single asset, but Congress has also preserved the language of the phrase on multiple occasions—including when the provision was added to the modern Bankruptcy Code.<sup>90</sup>

Lastly, the Supreme Court demonstrated why its interpretation did not undermine the purpose of Section 523(a)(2) as Lamar claimed.<sup>91</sup> Even though the reach of Section 523(a)(2)(B) is broadened by accepting that a statement about a single asset is a “statement respecting the debtor's financial condition,” “[d]ecisions from this Court and several lower courts . . . [have] demonstrate[d] that [Section 523(a)(2)(A)] still retains a significant function[.]”<sup>92</sup> While Lamar focused on the “defenseless creditors swindled by lying debtors careful to make their financial representations orally,”<sup>93</sup> the Supreme Court acknowledged “Congress'[s] effort to balance the potential misuse of such statements by both debtors and cred-

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81. *Id.*

82. *Id.*

83. *Id.*

84. *Id.*

85. *Id.* at 1760.

86. *Id.* at 1761.

87. *Id.*

88. *Id.*

89. *Id.*

90. *Id.* at 1762.

91. *Id.*

92. *Id.* at 1763–64.

93. *Id.* at 1763.

itors.”<sup>94</sup> Overall, this case solidifies the purpose of Section 523(a)(2)(B)’s heightened requirement for rendering nondischargeable statements respecting the debtor’s financial condition.<sup>95</sup>

#### IV. STANDING

##### A. DEBTOR CANNOT OBJECT TO LITIGATION FUNDING AGREEMENT ENTERED INTO BY TRUSTEE AND CREDITOR

In *In re Dean*, the U.S. Court of Appeals for the Fifth Circuit dismissed a debtor’s appeal from an order affirming a litigation funding agreement for lack of standing.<sup>96</sup> This ruling reaffirms that bankruptcy standing is very narrow under the “person aggrieved” test.<sup>97</sup>

The debtor, William Berry Dean, “filed a Chapter 7 voluntary petition in 2019.”<sup>98</sup> Following the filing of the petition, “Scott M. Seidel [(the Trustee)] was appointed trustee for the estate.”<sup>99</sup> The Trustee lacked “sufficient unencumbered funds to retain counsel to pursue claims for the estate” and he therefore entered into an agreement with one of the creditors, Reticulum, to fund litigation “in exchange for a share of . . . [l]itigation [p]roceeds” in addition to its pro rata share as one of Dean’s creditors.<sup>100</sup> “[T]he bankruptcy court held a hearing [and] granted [the] motion to approve the [litigation funding] [a]greement.”<sup>101</sup> The U.S. District Court for the Northern District of Texas approved the ruling, “holding that [the bankruptcy court] had not committed clear error.”<sup>102</sup> Dean appealed this ruling, arguing “that [the] agreement undermine[d] the statutory ranking system for distribution of the estate’s property by allowing Reticulum to jump ahead of other creditors in order of payment.”<sup>103</sup>

The Fifth Circuit found that Dean lacked standing to appeal the bankruptcy order under the person aggrieved test.<sup>104</sup> Under this test, “[t]he appellant must show that he is ‘directly, adversely, and financially impacted’” by the specific order of the bankruptcy court, not by the bankruptcy proceedings generally.<sup>105</sup> Because the trustee represents the estate, not the debtor “the debtor-out-of-possession . . . has no concrete interest in how the . . . court divides up the estate.”<sup>106</sup>

Although the debtor could have been affected by a related pending action, the litigation funding agreement itself did not directly affect

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94. *Id.* at 1764

95. *Id.* at 1763.

96. *Id.* at 1764.

97. *In re Dean*, 18 F.4th 842, 843, 845 (5th Cir. 2021).

98. *Id.* at 844–45.

99. *Id.* at 843.

100. *Id.*

101. *Id.*

102. *Id.*

103. *Id.*

104. *Id.*

105. *Id.* at 844–45.

106. *Id.* at 844 (quoting *In re Technicool Sys., Inc.*, 896 F.3d 382, 384 (5th Cir. 2018)).

whether Dean's debts would be discharged or affect the other related pending case.<sup>107</sup> As the Fifth Circuit noted, the "[a]ppellants cannot demonstrate bankruptcy standing when the court order to which they are objecting does not directly affect their wallets."<sup>108</sup> The Fifth Circuit cited two cases in support of this proposition, first stating that the Fifth Circuit has "held that the owner of a debtor company in Chapter 7 bankruptcy could not object to an order approving the hiring of special counsel because such order would not affect the debtor company's discharge."<sup>109</sup> In addition, the Fifth Circuit also cited their previous ruling where "a creditor did not have bankruptcy standing to object to an order approving the sale of assets because the creditor would be in the same position financially, whether or not the bankruptcy court approved the sale."<sup>110</sup>

The Fifth Circuit concluded by contrasting their ruling in *In re Mandel*,<sup>111</sup> in which a "debtor retained . . . standing because his claim had not yet been discharged."<sup>112</sup> The Fifth Circuit noted that "*Mandel* does not stand for the . . . proposition that the . . . existence of a pending debt creates bankruptcy standing for the debtor."<sup>113</sup> In sum, the Fifth Circuit held that Dean "d[id] not have bankruptcy standing because he c[ould not] show how the order approving the litigation funding agreement would [have] directly, adversely, and financially impact[ed] him."<sup>114</sup> This ruling continues the Fifth Circuit's narrow interpretation of the person aggrieved test and the difficulty associated with obtaining bankruptcy standing.

B. FIFTH CIRCUIT ADOPTS BOTH APPELLATE STANDING FOR  
TRUSTEES AND A PROSPECTIVE ASSESSMENT FOR  
COMPENSABLE SERVICES IN *IN RE* COMMUNITY  
HOME FINANCIAL SERVICES

In *In re Community Home Financial Services*,<sup>115</sup> the U.S. Court of Appeals for the Fifth Circuit addressed three issues on appeal.<sup>116</sup> First, the Fifth Circuit held that the appeal was not moot despite a settlement between debtor's counsel and the creditors regarding fees.<sup>117</sup> Second, the Fifth Circuit found that the Trustee had standing to appeal from a district court order vacating a fee award to debtor's counsel.<sup>118</sup> Third, the Fifth Circuit determined that a bankruptcy court award should be evaluated

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107. *Id.*

108. *Id.* at 844–45.

109. *Id.* at 844.

110. *Id.* (citing *Technicool Sys., Inc.*, 896 F.3d at 384).

111. *Id.* (citing *Fortune Nat. Res. Corp. v. U.S. Dep't of Interior*, 806 F.3d 363, 367 (5th Cir. 2015)).

112. 641 F. App'x 400, 405 (5th Cir. 2016) (per curiam) (unpublished).

113. *Dean*, 18 F.4th at 845

114. *Id.*

115. *Id.*

116. 990 F.3d 422, 422 (5th Cir. 2021).

117. *Id.* at 426–28.

118. *Id.* at 426–27.

based on the reasonableness and likely benefit to the estate from the time the services were rendered.<sup>119</sup> Ultimately, the Fifth Circuit reversed the judgment of the U.S. District Court for the Southern District of Mississippi and remanded “for the district court to reinstate the bankruptcy court’s fee award.”<sup>120</sup>

This appeal to the Fifth Circuit arose out of the district court’s order to vacate the bankruptcy court’s fee award to debtor’s counsel. After entering Chapter 11 bankruptcy, Community Home Financial Services, Inc. (CHFS) “remained the debtor in possession” and, with the bankruptcy court’s approval, appointed Derek Henderson (Henderson) and Wells Marble & Hurst, PLLC (Wells Marble) (collectively, Debtor’s Counsel) as its representation.<sup>121</sup> Debtor’s Counsel initiated a series of adversary proceedings against CHFS’s two largest creditors—Edwards Family Partnership, Inc. (Edwards Family) and Beher Holdings Trust (Beher) (collectively, the Creditors).<sup>122</sup>

After the bankruptcy court appointed Kristina Johnson (Johnson) as Trustee, Debtor’s Counsel sought bankruptcy court fees “in connection with the adversary proceedings” prior to Johnson’s appointment.<sup>123</sup> “The bankruptcy court awarded fees to” Debtor’s Counsel, and the Creditors “timely appealed” to the district court.<sup>124</sup> Following the district court’s judgment to remand “for further findings of fact regarding the fees[,]” “the bankruptcy court once again awarded fees to [Debtor’s Counsel].”<sup>125</sup> Upon receiving another notice of appeal from the Creditors, “the district court vacated the fee award[,]” holding that the decision of Debtor’s Counsel “to pursue adversary proceedings ‘was not a good gamble.’”<sup>126</sup>

In their appeal, Debtor’s Counsel and the Trustee “argu[ed] that the district court improperly evaluated the benefit[s] of [counsel’s services] retrospectively” rather than from the time the services were rendered.<sup>127</sup> In response, the Creditors “moved to dismiss the Trustee[’s] [appeal] for lack of standing.”<sup>128</sup> Subsequently, Debtor’s Counsel settled their fee dispute with the Creditors, and the latter, claiming such settlement mooted the appeal, moved to dismiss the Trustee’s appeal.<sup>129</sup> In opposition, the Trustee asserted the case remained live notwithstanding the settlement.<sup>130</sup>

The Fifth Circuit first analyzed Article III’s “case or controversy” re-

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119. *Id.* at 427.

120. *Id.* at 428.

121. *Id.*

122. *Id.* at 424.

123. *Id.*

124. *Id.* at 425.

125. *Id.*

126. *Id.*

127. *Id.*

128. *Id.*

129. *Id.*

130. *Id.*

quirement regarding the Trustee's appeal.<sup>131</sup> The Creditors contended that their settlement with Debtor's Counsel mooted the appeal because the fee dispute was "fully resolved by compromise between the only parties with a legally cognizable interest" in the case.<sup>132</sup> In fact, the Creditors maintained that the Trustee did not have a legal interest at any time in the case and, thus, lacked standing to appeal.<sup>133</sup> On the other hand, the Trustee averred that she did have standing because of "an ongoing duty . . . to represent the interests of the bankruptcy estate in the award of fees."<sup>134</sup>

Recognizing that the Creditors "effectively collapse[d] the [issue of] mootness . . . with . . . standing[.]"<sup>135</sup> the Fifth Circuit rejected the Creditors' test for trustee standing—that "a bankruptcy appellant must . . . show that he was 'directly and adversely affected pecuniarily by the order of the bankruptcy court.'<sup>136</sup> Indeed, the Fifth Circuit acknowledged the unique position of a trustee compared to that of all other bankruptcy parties and agreed with the determinations of the First, Fourth, Sixth, and Ninth Circuits that the pecuniary interest test for trustee standing is inadequate.<sup>137</sup> Further, the Fifth Circuit relied on its own cases which "have implicitly recognized that trustee standing does not depend on a pecuniary interest" but rather derives from a "trustee's duties to administer the bankruptcy estate[.]"<sup>138</sup> In finding that the Trustee had a sufficient legal interest in the fee dispute and that "the payment of fees to [Debtor's Counsel] directly affect[ed] the administration of the bankruptcy estate[.]" the Fifth Circuit held that "the Trustee in this case ha[d] standing [to appeal] and [that] this case [was] not moot[.]"<sup>139</sup>

Furthermore, the Fifth Circuit addressed the relevant test for compensable services in a bankruptcy case. The Fifth Circuit determined that the district court's decision to vacate the bankruptcy court award was improperly based upon a "retrospective assessment" of Debtor's Counsel's decision to pursue adversary proceedings.<sup>140</sup> While the district court found "that the decision to pursue adversary proceedings 'was an expensive course of action'" and "was not a good gamble[.]" the Fifth Circuit highlighted the appropriate test for awarding bankruptcy fees from clear Fifth Circuit law—namely, to "look[ ] at the reasonableness of pursuing

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131. *Id.*

132. *Id.* at 426.

133. *Id.*

134. *Id.*

135. *Id.* at 425.

136. *Id.* at 426.

137. *Id.* (quoting *In re Technicool Sys., Inc.*, 896 F.3d 382, 385 (5th Cir. 2018) (quoting *Fortune Nat. Res. Corp. v. U.S. Dep't of Interior*, 806 F.3d 363, 366 (5th Cir. 2015))).

138. *Id.* at 426–27 (first citing *In re Clark*, 927 F.2d 793, 795 (4th Cir. 1991); then citing *In re Richman*, 104 F.3d 654, 657 (4th Cir. 1997); then citing *In re Plaza de Diego Shopping Ctr., Inc.*, 911 F.2d 820, 824 (1st Cir. 1990) (citing *In re Revco*, 898 F.2d 498, 499 (6th Cir. 1990)); then citing *In re Eisen*, 31 F.3d 1447, 1451 n.2 (9th Cir. 1994)).

139. *Id.* at 427 (citing *U.S. ex rel. Spicer v. Westbrook*, 751 F.3d 354, 362 (5th Cir. 2014)).

140. *Id.*

the adversary proceedings from the time [Debtor’s Counsel] provided their services.”<sup>141</sup> After settling on the proper perception measure, the Fifth Circuit ruled that compensation is necessary when, “[v]iewed prospectively, [the] pursuit of the adversary proceedings was ‘necessary to the administration of the case’ to resolve otherwise unsettled disputes about the priority of claims.”<sup>142</sup>

In conclusion, *In re Community Home Financial Services* provides significant clarification as to a trustee’s standing and to compensation for services rendered in a bankruptcy case. Notably, the Fifth Circuit joined other circuits in holding that a trustee has standing because of their persistent task to ensure that “only proper payments are made from the bankruptcy estate.”<sup>143</sup> The Fifth Circuit also confirmed that the reasonableness of the choice to pursue a course of action should be viewed prospectively, rather than retrospectively, as it concerns evaluating compensable services.<sup>144</sup> Overall, this case will provide guidance to both trustees seeking legal action as well as attorneys seeking compensation from pursuing a cause of action.

## V. HOMESTEAD EXEMPTIONS

### A. FIFTH CIRCUIT ENFORCES HOMESTEAD EXEMPTIONS

In *In re Morgan*, the U.S. Court of Appeals for the Fifth Circuit affirmed the lower courts’ rulings that a debtor was not entitled to homestead protection on a property that he never lived in.<sup>145</sup> At the time the debtor filed for bankruptcy, he owned two residential real properties. The debtor had been leasing and living in the first property, located on Warner Road (the Warner Road Property) for more than three years leading up to his bankruptcy petition.<sup>146</sup> In 2016, the debtor purchased a property located on Logans Lane (the Logans Lane Property). Shortly after closing on the Logans Lane Property, the debtor closed on the Warner Road Property. Subsequently, the debtor separated from his wife, who resided at the Logans Lane Property while the debtor continued to inhabit the Warner Road Property.<sup>147</sup>

In his bankruptcy petition, the debtor claimed a homestead exemption to the Logans Lane Property, despite his tenuous connection to it.<sup>148</sup> The debtor had moved a few items of furniture and clothing into the Logans Lane Property, but never established continual habitation of this property.<sup>149</sup> For the three years leading up to bankruptcy, the debtor had “claimed Warner Road [Property] as his homestead for property tax pur-

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141. *Id.* at 428.

142. *Id.* at 427–28.

143. *Id.* at 428.

144. *See id.* at 427.

145. *See id.*

146. *In re Morgan*, 848 F. App’x. 629, 630 (5th Cir. 2021) (per curiam) (unpublished).

147. *Id.* at 630–31.

148. *Id.* at 631.

149. *Id.* at 630–31.

poses.”<sup>150</sup> “Regions Bank[ ] filed an objection to [the debtor’s] designation of Logans Lane [Property] as his . . . homestead.”<sup>151</sup> “The bankruptcy court sustained [this] objection[,]” concluding that “Logans Lane was not the debtor’s primary residence, and” therefore the debtor “could not claim [it] as his homestead.”<sup>152</sup> The U.S. District Court for the Southern District of Texas affirmed.

The Fifth Circuit applied the clearly erroneous standard and affirmed the lower court’s ruling that the debtor had not taken the requisite acts or shown intention to claim the property as a homestead.<sup>153</sup> “Under Texas law, [the] individual [seeking] homestead protection [bears] the . . . burden [of showing] the homestead character of [the] property” by proving “(1) overt acts of homestead usage and (2) the intention to claim the property as a homestead.”<sup>154</sup> The Fifth Circuit determined that the debtor’s time at the property was sporadic and infrequent, such that even though the debtor “kept some belongings at [the] Logans Lane [Property], visited on weekends, and conducted some business there,” the aforementioned actions were “insufficient to convert [the property] into a homestead.”<sup>155</sup> Further, the debtor’s “announced intentions of reconciling with [his estranged wife]” and cohabitating with her lent itself to a finding of homestead conversion insufficiency.<sup>156</sup> The Fifth Circuit refused to overturn the lower courts’ factual findings that the debtor “failed to show any intent, supported by overt acts,” to make the property his homestead.<sup>157</sup>

## VI. EXECUTORY CONTRACTS

### A. HIGHLAND

The Bankruptcy Code allows a trustee to reject a debtor’s existing executory contracts upon reorganization, thereby breaching the contract.<sup>158</sup> Injured parties may recover damages from the debtor but may not insist on specific performance of the contract.<sup>159</sup> In *In re Highland Capital Management*, the U.S. Bankruptcy Court for the Northern District of Texas, Dallas Division considered whether a bankruptcy court could require a reorganized debtor to submit to mandatory arbitration when the trustee rejected the limited partnership agreement containing the arbitration clause.<sup>160</sup>

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150. *Id.* at 631–32.

151. *Id.* at 632.

152. *Id.* at 631.

153. *Id.*

154. *Id.* at 631–32.

155. *Id.* at 631 (quoting *Zorrilla v. Aypco Constr. II, LLC*, 469 S.W.3d 143, 159 (Tex. 2015)).

156. *Id.* at 632.

157. *Id.*

158. *Id.*

159. 11 U.S.C. § 365(a).

160. *See id.* § 365.

After reorganization under Chapter 11 in February 2021, Highland Capital Management L.P. (Highland) brought a series of suits to recover amounts owed on outstanding notes.<sup>161</sup> All the note obligors were “closely related to Highland’s former president, James Dondero[.]”<sup>162</sup> As a defense to payment of the notes, Dondero alleged that Highland orally agreed, through its largest limited partner, to forgive the notes as compensation.<sup>163</sup> However, the partner who allegedly made the agreement, Dugaboy Investment Trust (Dugaboy), happened to be Mr. Dondero’s family trust, headed by his sister, Nancy Dondero.<sup>164</sup> Highland brought new claims against Dugaboy, Mr. Dondero, and Ms. Dondero.<sup>165</sup> The Dondero/Dugaboy defendants moved to stay litigation on the note proceedings and compel arbitration on some of the new claims, in accordance with Highland’s original limited partnership agreement.<sup>166</sup> Highland argued that “the rejection of the [limited partnership agreement] excuse[d] Highland from . . . submit[ting] to mandatory arbitration.”<sup>167</sup>

The bankruptcy court determined that arbitration agreements are executory contracts because neither side had substantially performed the agreement when enforcement was sought.<sup>168</sup> Because the trustee properly rejected the limited partnership agreement, it also rejected the arbitration clause within it.<sup>169</sup> Courts cannot require specific performance by the trustee, therefore Highland could not be forced to participate in mandatory arbitration under the rejected limited partnership agreement.<sup>170</sup> Furthermore, compelling arbitration “would frustrate a central purpose” of bankruptcy proceedings: “centraliz[ing] disputes over debtors’ assets and obligations in one forum.”<sup>171</sup> In the present case, “requiring arbitration . . . would [have] impose[d] undue . . . burdens and expenses on the parties to the detriment of Highland’s creditors.”<sup>172</sup> The bankruptcy court determined that even if it erred in finding that the arbitration clause was properly rejected and no longer bound Highland, the Dondero/Dugaboy defendants waived their rights to arbitrate when they did not insist on arbitration in their original answers to the suit on the notes and engaged in discovery in excess of that provided for in the lim-

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161. *In re Highland Cap. Mgmt., L.P.*, No. 19-34054-SGJ11, 2021 WL 5769320, at \*2 (Bankr. N.D. Tex. Dec. 3, 2021) (mem. op.).

162. *Id.* at \*1.

163. *Id.*

164. *Id.*

165. *Id.*

166. *Id.*

167. *Id.* at \*2.

168. *Id.* at \*3.

169. *Id.* at \*7 (citing Jay Lawrence Westbrook, *The Coming Encounter: International Arbitration and Bankruptcy*, 67 MINN. L. REV. 595, 623 (1983)).

170. *Id.*

171. *Id.* at \*6.

172. *See id.* at \*4–7 (finding a prior case persuasive that mandating arbitration could frustrate central purposes of bankruptcy code).



ited partnership agreement's arbitration clause.<sup>173</sup>

## VII. CONCLUSION

The survey period for bankruptcy has been relatively quiet, largely because of the dearth in cases being filed. The authors hope that the cases selected provide some guidance to insolvency lawyers and advisors.

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173. *Id.* at \*7.