STATE BAR OF TEXAS
BANKRUPTCY LAW SECTION
NEWSLETTER

February 2008 Volume 7 — No. 3

INSIDE THIS ISSUE:

A MESSAGE FROM THE CHAIR

By Debbie Langehennig, State Bar of Texas Bankruptcy Section Chair

Happy New Year! I hope you enjoyed a wonderful holiday season with family and friends. If you are looking for a worthwhile venture for your time and talent in 2008, consider some of these projects.

Pro Bono Services

The SDTX bankruptcy judges entered a Standing Order No. 2007-3 on September 11, finding that counsel representing a pro bono debtor in the district are not debt relief agencies under sections 526 through 528 merely because of the pro bono representation. **In Re "Pro Bono Services"** – may be found on the SDTX court website, or at http://txbankruptcylawsection.com/.

Section 101, in paragraph 12A provides that a debt relief agency means any person who provides any bankruptcy assistance to an assisted person in return for the payment of money or *other valuable consideration*. The court clarifies that "goodwill or other non-pecuniary benefits of civic service do not constitute other valuable consideration."

So many law firms have been hesitant to accept pro bono assignments for fear of being labeled a "debt relief agency" and becoming subject to the requirements of sections 526, 527 and 528 of BAPCPA. We are hopeful that this will put pro bono projects back on track in Houston and hopefully work its way across the state of Texas.

The Bankruptcy Section has made a financial contribution to the Houston Volunteer Legal Project to help jump start pro bono services in Houston bankruptcy cases. If you are interested in pro bono work in your area, please contact a member of the Section council.

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ARTICLE: *I NEVER PROMISED YOU A ROSE GARDEN (OR A SUCCESSFUL CASE)*

Rakhee V. Patel and Gerrit M. Pronske[1]

A regular submission from the Young Lawyers Committee of the Bankruptcy Law Section.

The recovery of attorneys' fees in the Fifth Circuit by attorneys employed by the bankruptcy estate has, in recent years, become more and more problematic. In *In re Pro-Snax Distributors*,[2] the primary issue for the Fifth Circuit was the resolution of a circuit court split on the issue of whether Chapter 11 debtor's counsel could be compensated by the estate for services rendered after the appointment of a trustee. The court found, based on a strict reading of section 330(a), that debtor's counsel could not be compensated for post-appointment services because the section did not include debtor's counsel as a category of individuals that were permitted to be compensated.[3] The Fifth Circuit then addressed "the other task to which this appeal commends us." The Court, citing to a case involving the award of

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ARTICLE: LIFE IN THE FIFTH CIRCUIT SINCE MARRAMA

By: Jason Kathman, Extern to Judge Harlin D. Hale, Texas Wesleyan University School of Law (2009) and Rob Colwell, Law Clerk to Judge Harlin D. Hale, U.S. Bankruptcy Court for the Northern District of Texas

Section 706(a) of the Bankruptcy Code states that a debtor "may convert a case under [chapter 7] to a case under chapter 11, 12, or 13 of [the Code] at any time, if the case has not been converted under section 1112, 1208, or 1307 of [the Code]. Any waiver of the right to convert a case under this subsection is unenforceable."[1] In *Marrama v. Citizens Bank of Massachusetts*, __ U.S. __, 127 S.Ct. 1105, 166 L.Ed.2d 956 (2007), the Supreme Court granted certiorari to resolve a split in the circuits as to whether a debtor's right to convert under section 706(a) is absolute, or whether this right could be limited in circumstances of bad faith on the part of the debtor.[2]

Circuit Split Resolved

In Marrama, the Supreme Court found that the debtor's right to convert under section 706(a) was not absolute when read in conjunction with section 706(d) of the Bankruptcy Code, which provides that "[n]otwithstanding any other provision of this section, a case may not be converted to a case under another chapter of this title unless the debtor may be a debtor under such a chapter."[3] The Court rejected Marrama's argument that the House and Committee reports advocated an "an unqualified right of conversion," instead holding that the reference to an "absolute right" of conversion was more equivocal than Marrama contended.[4] The Court found that the limitation found in subsection (d) expressly conditioned Marrama's right to convert on his ability to qualify as a 'debtor' under Chapter 13."[5]

The Court held that Marrama was disqualified to be a debtor for at least two reasons. First, section 109(e) of the Code places a limit on the amount of indebtedness that an individual may have in order to qualify for relief under Chapter 13. Marrama had initiated a new Chapter 13 case the day before certiorari was granted and a Massachusetts Bankruptcy Court held that he was disqualified under section 109(e).[6] More importantly, the Court focused on section 1307(c) of the Code which provides that a Chapter 13 proceeding may be either dismissed or converted to a Chapter 7 proceeding "for cause."[7] The Court found that while prepetition bad-faith conduct is not included in the list of causes laid out in section 1307(c), bankruptcy courts "routinely treat dismissal for prepetition bad-faith conduct as

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NACTT
NATIONAL ASSOCIATION OF CHAPTER 13 TRUSTEES

NACTT Announces New Academy For Consumer Bankruptcy Education

The National Association of Chapter 13 Trustees recently announced the creation of a new entity, the NACTT Academy for Consumer Bankruptcy Education, Inc., which is intended to enhance the NACTT's historic commitment to bankruptcy education by utilizing opportunities available in the current electronic environment.

Andrea Celli, President of the Academy Board of Directors, which includes Henry Hildebrand of Nashville, TN, Carl Bekofske of Flint, MI, Jan Johnson of Sacramento, CA and Kathleen Leavitt of Las Vegas, NV, all Chapter 13 Trustees, who are former presidents of the NACTT, stated, "We intend for the Academy to develop innovative educational programs which will be of direct assistance to all participants in the consumer bankruptcy system."

The Academy's efforts will be directed by Tom Waldron, a former bankruptcy judge, who enjoys a national reputation for the creation and presentation of consumer bankruptcy education programs and Derrick Bolen, who has previously developed technology for the NACTT and is an expert in electronic information services and delivery systems.

Robin Weiner, President of the NACTT, commented: "The Academy is fortunate to be able to retain the services of these dedicated professionals to initiate efforts that will bring teaching and learning together in new and exciting ways, which will be unveiled at the NACTT Annual Seminar in San Francisco, July 9th -12th. Please save these dates and plan to join us in San Francisco."

NCBJ | National Conference of Bankruptcy Judges

FANTASTIC SPONSORSHIP OPPORTUNITY REGARDING THE NCBJ PLANNING RECEPTION: *March 3, 2008 at Hilton Americas, Houston, Texas*

We are extremely fortunate this year that the National Conference of Bankruptcy Judges' mid-year planning meeting is taking place on March 3 and 4, 2008, in Houston, Texas. The Bankruptcy Law Section of the State Bar of Texas is organizing a "southwestern" style reception to welcome the Judges to Texas. It will take place on March 3 from 5:30 to 7:00 p.m. at the Hilton Americas hotel in downtown Houston.

Due to the fact that space is limited to a total of 125 persons, the Bankruptcy Section is offering the following opportunity on a "***FIRST COME, FIRST SERVED***" basis:

In return for a $250.00 sponsorship fee of the reception, your firm is entitled to 2 guests. We expect this event to be fully subscribed so don't miss this tremendous opportunity!

Please act now to reserve your firm's sponsorship and attendance at the reception by forwarding your sponsorship checks (made out to the Bankruptcy Law Section of the State Bar of Texas) by no later than February 25 to Tom Howley, Bankruptcy Law Section Treasurer, Haynes and Boone, LLP, 1221 McKinney St., Suite 2100, Houston, Texas, 77010. When you send your check, please identify who will be attending the reception from your firm.

If you have any questions, please contact any member of the Planning Committee:

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Mary A. Daffin (mad@bbwcdf.com)
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CHAPTER 11 PRACTICE: *USE IT OR LOSE IT: PRESERVING YOUR LIEN IN THE CONFIRMATION PROCESS*

By Sarah Mardock, Second Year Law Student, SMU Dedman School of Law (Extern to Judge Harlin Dewayne Hale, United States Bankruptcy Judge) (smardock@smu.edu)

On November 6, 2007, the Fifth Circuit upheld a bankruptcy court's decision to extinguish pre-existing liens not expressly addressed in a Chapter 11 reorganization plan.[1] The Fifth Circuit held that under 11 U.S.C. § 1141(c), confirmation of a Chapter 11 plan voids liens not specifically preserved by the plan, as long as the property attached is dealt with by the plan and the lien holder participates in the reorganization.[2]

In May 1996, Elixer Industries, Inc. recorded a judgment lien of $40,961.53 in the mortgage records of Natchitoches Parish, Louisiana on property owned by Ahern Enterprises. Included in the property was a manufacturing facility already subject to a prior recorded mortgage held by City Bank that exceeded the value of the property. Soon after, Ahern filed for Chapter 11 protection. In November 1996, Elixer filed proof of an unsecured priority claim. Because there was no unencumbered property to which the lien could attach and Elixer's lien was junior to City Bank, the bankruptcy judge found Elixer only had a general unsecured claim. A Chapter 11 plan was subsequently confirmed on May 30, 1997. In October 1997, Ahern voluntarily converted its Chapter 11 to Chapter 7. In April 2005, after discovering the manufacturing facility still remained subject to Elixer's lien in addition to three others, City Bank filed a complaint for declaratory relief in bankruptcy court, claiming that the liens were void. Elixer counter-claimed, requesting declaration that the lien was still valid. The bankruptcy court found in favor of City Bank, holding Elixer's lien had been extinguished, and the district court affirmed.[3]

On appeal, the Fifth Circuit affirmed the bankruptcy and district courts, holding that under 11 U.S.C. § 1141(c) the "confirmation of a Chapter 11 plan voids liens not preserved by the plan, provided that the plan dealt with the property to which they attach and the lien holder participates in the reorganization."[4] More specifically, the court held that a lien is extinguished if four requirements are met: (1) the Chapter 11 plan must be confirmed, (2) the property subject to the lien must be dealt with by the plan, (3) the lien holder must participate in the

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CALL FOR ARTICLES AND ANNOUNCEMENTS

The **State Bar of Texas Bankruptcy Law Section** is dedicated to providing Texas practitioners, judges, and academics with comprehensive, reliable, and practical coverage of the evolving field of bankruptcy law. We are constantly reviewing articles for upcoming publications. We welcome your submissions for potential publication. In addition, please send us any information regarding upcoming bankruptcy-related meetings and/or CLE events for inclusion in the newsletter calendar, as well as any items for our "Troop Movements" section (changes in practices).

If you are interested in submitting an article to be considered for publication or to calendar an event, please either e-mail your submission to chufft@velaw.com or eborrego@whc.net or mail it to a member of the Editorial Staff (addresses below).

Please format your submission in Microsoft Word. Citations should conform to the most recent version of the Bluebook, the Texas Rules of Form, and the Manual on Usage, Style & Editing.

Should you have any questions, please visit our website at http://txbankruptcylawsection.com.

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SAVE THE DATE!

DON'T MISS THE UPCOMING BENCH/BAR CONFERENCES

Northern District

Northern District of Texas Bench/Bar Conference
June 13, 2008
Infomart - Dallas
(for more information visit www.txnb.uscourts.gov)

Western District

Western District of Texas Bench/Bar Conference
June 4 – 6, 2008
Marriott Horseshoe Bay, Austin
(for more information, visit www.txwb.uscourts.gov)

UPCOMING EVENTS

February 23, 2008	Elliott Cup Competition (Bankruptcy Moot Court), Dallas
March 4-11, 2008	Distance Seminar in Barcelona, Spain
April 3-6, 2008	ABI Spring Meeting, Washington, DC
May 1-2, 2008	State Bar Advanced Business Bankruptcy Course, Four Seasons Hotel, Austin
June 4-6, 2008	Western District of Texas Bench/Bar Conference, Marriott Horseshoe Bay, Austin (for more information, visit www.txwb.uscourts.gov)
June 13, 2008	Northern District of Texas Bench/Bar Conference, Infomart - Dallas (for more information visit www.txnb.uscourts.gov)
June 19-20, 2008	UT Consumer Bankruptcy Practice Course, Moody Gardens, Galveston, Texas (a reception sponsored by the Young Lawyers Committee of the State Bar Bankruptcy Section will be held on Thursday, June 19, 2008 following the program)

LOCAL EVENTS

Dallas

The Dallas Bar Association Bankruptcy and Commercial Law Section normally meets the first Wednesday of each month at the Belo Mansion. Social begins at 5 p.m. with program beginning at 5:30 p.m.

The South Texas College of Law Bankruptcy Law Conference. "Adjusting to the Changing Bankruptcy Landscape: Judges' and Trustees' Perspectives", March 28, 2008 (live in Dallas at the Belo Mansion—simulcast in Houston)

Fort Worth - Tarrant County

Bankruptcy Section - monthly CLE luncheon meetings on the third Monday of each month to its members. Contact - Marilyn Garner at (817) 462-4075 or marilyndgarner@flashwave.com. Meetings are normally held at the Ft. Worth Petroleum Club.

San Antonio

The San Antonio Bankruptcy Bar Association meets on the 4th Tuesday of every month at the San Antonio Country Club. Social begins at 5 p.m. with program beginning at 5:30 p.m. Participants receive 1 hour CLE credit.

A Brown Bag lunch with Judge Clark, Judge King, the Bankruptcy Clerk, and members of the Bankruptcy Bar is held quarterly at the Adrian Spears Judicial Training Center.

THE STATE BAR OF TEXAS BANKRUPTCY LAW SECTION

announces the

26th Annual Advanced Business Bankruptcy Seminar

May 1-2, 2008

Four Seasons Hotel — Austin

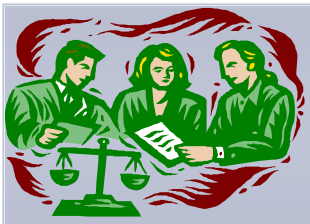
98 San Jacinto Blvd., Austin, TX 78701

Early Bird Registration: $495.00

(Regular Course Fee: $545.00)

Note: Early Bird Registration ends Thursday, April 17, 2008

www.TexasBarCLE.com



The Dallas Volunteer Attorney Program Needs Bankruptcy Help!

The **Dallas Volunteer Attorney Program (DVAP)** desperately needs volunteer attorneys to accept pro bono Ch. 7 cases for representation! We need attorneys in the Dallas metroplex area that are licensed to represent clients in the Northern District Federal Court for simple Chapter 7 pro bono matters.

DVAP has a financial and asset criteria that all applicants must meet before we can accept their application. In order for someone to be eligible for legal services here, their gross income must fall below the 200% federal poverty level.

In the case of bankruptcy applicants they must also fulfill the following criteria:

- They must be in at least $10,000 of unsecured debt.
- If they own real property, they must be current on their mortgage payments and they must intend to continue to maintain their mortgage payments.
- They also must not have filed for bankruptcy within the last 8 years.

The majority of our bankruptcy applicants are elderly and have often recently lost a spouse. We also get many applicants both young and old with terminal and/or chronic health problems, who find themselves in dire financial straits due to a combination of their medical debts and credit card debt, which have often accumulated due to everyday living expenses. Often the applicants have adopted an "ostrich" approach to their finances, by burying their heads in the sand and have no idea what their current financial situation is. They are hounded by creditor phone calls and letters and do not know where to turn.

Since the bankruptcy reform 2 years ago, we have adopted a very detailed, time consuming system of gathering documents from the applicants, in-house at DVAP, BEFORE a case is placed with a volunteer attorney. We ask the applicants to obtain numerous documents, trying to gather as much information and documents from the applicant as possible, so that the volunteer attorney has everything they need to start drafting the petition as soon as they get the file! With this done ahead of time, the volunteer attorney does not have to waste their valuable time gathering information. Our bankruptcy paralegal here asks the applicants to obtain, amongst other documents, their credit reports, tax returns, bank statements, copies of house deeds, etc.

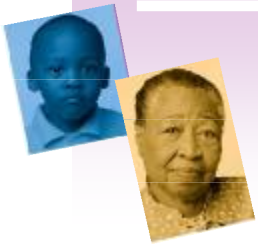
We also use a credit counseling company that we refer clients to, when they are ready to do the pre-filing credit counseling certificate. Our DVAP bankruptcy paralegal assists the applicants in obtaining the pre-filing credit counseling certificate, so when a file is sent to the volunteer attorney, the applicant has already obtained this certificate. Once they have filed their bankruptcy petition, through their assigned volunteer attorney, they must also file a pre-discharge counseling certificate, with the court, which can also be obtained from this same credit counseling company. This company will again charge the applicants a fee, but an application to waive the fee can be submitted to the company, and our bankruptcy paralegal assists with that as well!

DVAP also has a "Client Information Worksheet," which we ask the applicants to complete. The Worksheet refers to the schedules required to be filed when submitting a bankruptcy petition. So this information will also assist the volunteer attorney with drafting the petition and schedules.

DVAP informs our applicants that their pro bono attorney will try to file an Affidavit of Inability to Pay Costs (AIP) when they file their Ch. 7, however, should that AIP be turned down by the court, the applicants know they must pay that filing fee themselves.

So, as you can see, we try to do as much document gathering and legwork as we can on these Ch. 7 cases, before a pro bono attorney accepts them, to make it more simple for the volunteer attorney!!

If anyone is interested in getting more information about DVAP or taking a pro bono Ch. 7 case from us, please contact DVAP recruiter Chris Reed-Brown at reed-brownc@lanwt.org or call her at 214-748-1234, x2243.



Somehow you can help,
You can give the time you have available in service to our clients.
Or you can assist those efforts with a generous gift to the program.
It's like billable hours for your soul.

Article: Supreme Court Grants Writ on Section 1146 Issues

By Kathleen Donovan, Third-year law student, University of Notre Dame Law School
(Extern to Judge Martin DeWayne Hale, United States Bankruptcy Judge)

On December 7, 2007, the Supreme Court of the United States granted a petition for a writ of certiorari to hear the case of *Florida Dept. of Revenue v. Piccadilly Cafeterias, Inc.* This case is before the Supreme Court because of inconsistent rulings among the circuit courts of appeals on the issue of whether section 1146(a) of the Bankruptcy Code applies to pre-confirmation asset transfers. Section 1146(a), formerly section 1146(c), mandates that "the issuance, transfer, or exchange of a security or the making or delivery of an instrument of transfer under a plan confirmed under section 1129 of this title, may not be taxed under any law imposing a stamp tax or similar tax." 11 U.S.C.A. 1146(a) (West 1998 & Supp. 2007).

The Third and Fourth Circuits have read section 1146(a) to exclude pre-confirmation transfers from tax exemption. These courts held that Congress only intended to make the tax exemptions available to asset transfers that occur temporally after the confirmation of a confirmed plan. The Fourth Circuit based its holding on the plain language of the statute. *In re NVR, LP*, 189 F.3d 442 (4th Cir. 1999). The Third Circuit majority in *In re Hechinger Investment Co. of Delaware, Inc.,* 335 F.3d 243 (3d Cir. 2003), ruled that such an interpretation of "under a plan confirmed" is appropriate because such an interpretation is identical to the phrase's meaning in section 365(g) of the Bankruptcy Code. *Id.* at 252.

In *Florida Dept. of Revenue v. Piccadilly Cafeterias, Inc.*, 484 F.3d 1299 (11th Cir. 2007), the Eleventh Circuit Court of Appeals addressed this specific issue for the first time. Piccadilly and Piccadilly Acquisition Corporation ("PAC") entered into an asset purchase agreement under which PAC would purchase almost all of Piccadilly's assets. Piccadilly filed for bankruptcy on the following day and filed a motion seeking the court's authorization to sell its assets outside of the ordinary course of business. The bankruptcy court approved the sale, and Piccadilly agreed to sell its assets to the highest bidder, Piccadilly Investments, LLC, despite its agreement with PAC. Piccadilly subsequently signed a global settlement agreement with its creditors, and the bankruptcy court approved the global settlement agreement and the sale of Piccadilly's assets. The bankruptcy court also agreed that the sale was exempt from stamp taxes because it was a transfer under its confirmed plan. The district court affirmed the bankruptcy court's ruling.

The Eleventh Circuit read the phrase "under a plan confirmed" to refer to whether the transfer is necessary for the confirmed plan. Under the Eleventh Circuit's view, the timing of the transfer is irrelevant. In Piccadilly, the court concluded that the inclusion of express temporal restrictions in several Code provisions, including sections 1104(a) and (c), 1114(e)(2) and 1127(b), implies that Congress did not intend a temporal restriction in section 1146(a). 11 U.S.C.A. §§ 1104(a), 1104(c), 1114(e)(2), 1127(b) (West 1998 & Supp. 2007). Consequently, the Eleventh Circuit ruled that pre-confirmation asset transfers may be eligible for tax exemption under section 1146(a).

Because of the clear division of the circuit courts, the Supreme Court must now decide whether to apply the strict textual interpretation of the Third and Fourth Circuits or the expansive Eleventh Circuit interpretation that will authorize more tax exemptions. Because the sale of assets prior to a plan occurs with great frequency in the Bankruptcy Courts, the ruling by the High Court is one to watch.

Life in the Fifth Circuit Since Marrama

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implicitly authorized by the words 'for cause.'"[8] The Court further found that "a ruling that an individual's Chapter 13 case should be dismissed or converted to Chapter 7 because of prepetition bad-faith conduct, including fraudulent acts committed in an earlier Chapter 7 proceeding, is tantamount to a ruling that the individual does not qualify as a debtor under Chapter 13. That individual, in other words, is not a member of the class of " 'honest but unfortunate debtor[s]' " that the bankruptcy laws were enacted to protect."[9]

Expansion of the Court's Power to Prevent Abuse

In drafting the decision for the Court, Justice Stevens emphasized that Congress gave the "honest but unfortunate debtor" a "fresh start" and the chance to repay his debts, should he acquire the means to do so.[10] Section 706(a) functions as a consumer protection provision which protects a debtor from being forced to waive that right; however, a statutory provision protecting a borrower from waiver is not a shield against forfeiture.[11] As a result, the Court held that "the broad authority granted to bankruptcy judges to take any action that is necessary or appropriate 'to prevent an abuse of process' described in § 105(a) of the Code, is surely adequate to authorize an immediate denial of a motion to convert under § 706[.]"[12]

This statement from the Supreme Court seems to be in contrast with its previous decision in *Norwest Bank Worthington v. Ahlers*,[13] which has been interpreted to limit a court's ability to do equity under section 105(a), likening it to an "All

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A Message from the Chair

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Debtors Beware! Fractional Interest Conveyance Scheme

Judge Stacey Jernigan makes a plea to the consumer debtor bankruptcy bar in *In re Michael and Brenda White*, in a case where the court uncovers a fraudulent scheme by a bankruptcy servicer. The bankruptcy servicer in this case, and other cases, offered to stall a foreclosure for a steep fee by conveying a fractional interest in the debtors' home to another party. Judge Jernigan asks that attorneys who represent consumer debtors warn clients of the hazards of dealing with some of the non-attorney Bankruptcy Servicers offering illusory relief. The court's opinion may be found on the NDTX court website, or at www.texasbar.com/bankruptcy/newsletter.asp.

MoneyWise – Financial Education for High School Students

The Section continues to expand its MoneyWise program across Texas. Judge Parker and EDTX attorneys are recruiting volunteers and signing up high schools in the Eastern District. A group of San Antonio attorneys are working to implement the education program in San Antonio school districts. Watch for the upcoming article featuring MoneyWise in the San Antonio Business Journal.

NACTT Academy

The National Association of Chapter Thirteen Trustees announces the creation of a new entity, the NACTT Academy for Consumer Bankruptcy Education, Inc., to develop innovative educational programs which will be of direct assistance to all participants in the consumer bankruptcy system.

The Academy's efforts will be directed by Tom Waldron, a former bankruptcy judge, who enjoys a national reputation for the creation and presentation of consumer bankruptcy education programs and Derrick Bolen, who has previously developed technology for the NACTT and is an expert in electronic information services and delivery systems.

Look for the press release from the NACTT in this newsletter.

The Section offers these and other volunteer opportunities. We also welcome your suggestions for other efforts to promote our profession and our community. Let us hear from you!

— Debbie

I Never Promised you a Rose Garden

(Continued from page 1)

debtor's counsel fees after the appointment of a trustee, stated that in connection with the award of reasonable fees[4] for debtor's counsel validly employed pursuant to section 327 and 330(a) in that case, the legal services rendered by counsel must represent "an identifiable, tangible and material benefit to the estate."[5] The Fifth Circuit reiterated the district court's instruction to the bankruptcy court, on remand, to "consider strongly the debtor's lack of success in obtaining confirmation" of a plan because the standards set forth in section 330 require "that – at the time the services are performed – the chance of success must outweigh the costs of pursuing the action."[6] The Fifth Circuit concluded, on the facts of the case, that because the majority of interest holders in the case stated as their only goal that the case be administered under chapter 7, the debtor, and its counsel, should have "known at the outset that … prosecution of a … plan would fail."[7] Accordingly, the Fifth Circuit found that debtor's counsel should not be compensated for its services in connection with the chapter 11, given that "its services were futile."[8]

Courts within other jurisdictions have outright rejected the *Pro-Snax* material benefit analysis.[9] Courts in this jurisdiction have, in applying the *Pro-Snax* opinion, found that the material benefit analysis is to be applied in hindsight.[10] Thus, in the wake of *Pro-Snax* and its progeny, law was developing in various courts in this jurisdiction setting debtor's counsel with the task of being the guarantor of the ultimate success of a case.

Recently, the applicability and the practical application of the *Pro-Snax* decision rose to the forefront again. In *In re Gadzooks*,[11] attorneys for the official equity security holders committee in a chapter 11 bankruptcy case provided services during the chapter 11 case in connection with a plan of reorganization that contained a rights offering to recapitalize the debtor. After the debtor's reorganization prospects spiraled downward, the equity security holders committee was disbanded and the bankruptcy court ultimately confirmed a liquidating chapter 11 plan.[12] The attorneys for the official equity security holders committee, professionals validly employed pursuant to section 327, filed a fee application. In an objection filed to the fee application, the liquidating trustee neither objected to any of the individual time entries nor to the rates charged by the law firm, but rather questioned whether the law firm should receive any compensation, relying on *Pro-Snax*, arguing that counsel had not provided an "identifiable, tangible, and material benefit"

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Use It or Lose It

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reorganization, and (4) the plan must not preserve the lien.[5] The court determined that Elixer's lien was extinguished by the plan.[6]

First, under Bankruptcy Code § 1141(c), the plan must be confirmed. The Fifth Circuit held that the plan was confirmed without an objection by Elixer. Additionally, the Fifth Circuit held that the plan satisfied the second requirement because the plan provided that "City Bank and Trust Company …holds a mortgage and security interest in the Debtor's land, building, inventory, and fixtures."[7] While some courts have required the lien be specifically dealt with in the plan, the Fifth Circuit held that all that is necessary is a showing that the property subject to the lien is dealt with in the plan. Because the manufacturing facility was included in the "Debtor's land [and] building," this requirement was satisfied. Further, the court found that because the reorganization plan provided for a pro-rata payment to unsecured creditors, and that unsecured creditors specifically included all judgment lien holders, Elixer's interest was dealt with in the plan.

Moreover, the court held that it is not required for the lien to be specifically addressed in the reorganization, so long as the lien holder satisfies the third requirement, that is, by participating in the reorganization. The court went on to say the participation requirement may be satisfied merely by receiving notice of the plan and an opportunity to object.[8] In this case, the court held that Elixer sufficiently participated in the plan process by filing its proof of claim.

Finally, the court held that the plan satisfied the fourth requirement because it did not expressly preserve the lien. Under Bankruptcy Code § 1141(c), property is "free and clear" of liens that are not expressly preserved in the plan. While the plan specifically stated that City Bank retained its liens and encumbrances on Ahern's property, it made 0no mention of Elixer. Elixer argued that the Chapter 11 plan "otherwise provided" and did not extinguish the lien because the plan had not been consummated before the conversion.[9] Normally, a plan provides otherwise by "expressly stating that the lien as asserted remains on the property to which it is attached." Elixer argued that because consummation did not occur prior to conversion, the lien was not extinguished and thus remained in effect. The court held that confirmation of the plan discharges the debtor from any extraneous debt, not the event of substantial or complete consummation. So, even if the plan did not take effect until its consummation date, the lien was already extinguished at confirmation.[10]

From this case, a secured creditor who participates in a Chapter 11 reorganization may lose its lien after confirmation of the plan if the property is dealt with in the plan and the lien is not specifically preserved, and not withstanding the fact that the case is subsequently converted to Chapter 7.

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[1] *In re Ahern Enterprises, Inc.*, 507 F.3d 817 (5th Cir. 2007).

[2] *Id.* at 820.

[3] *Elixir Industries, Inc. v. City Bank and Trust Co., No.* Civ.A. 05-1959, 2006 WL 2505558 (W.D. La. Aug. 24, 2006). (Or *Ahern Enterprises, Inc.*, 507 F.3d at 819)

[4] *Ahern Enterprises,* Inc., 507 F.3d at 820.

[5] *Id* at 822.

[6] *Id.* at 818.

[7] *Id.* at 823.

[8] *Id.* (at 823)

[9] *Id.* (at 823)

[10] Bankruptcy Code § 1141(c) states "*except as otherwise provided* in the plan or in the order confirming the plan, after confirmation of a plan, the property dealt with by the plan is free and clear of all claims and interests of creditors, equity security holders, and of general partners in the debtor."

TROOP MOVEMENT

David G. McLane (formerly of Gardere Wynne Sewell LLP) and **J. Scott Carlos** have become Of Counsel and **Lyndel Anne Mason, Anne Elizabeth Burns** and **George Yu-Fu King** have become associates at **Cavazos, Hendricks, Poirot & Smitham, P.C.** (formerly known as Cavazos, Hendricks & Poirot, P.C.), 900 Jackson Street, Suite 570, Dallas, Texas 75202.

Rebecca Lynn Heiss (formerly of Kirkpatrick & Lockhart Preston Gates Ellis LLP, Los Angeles, California), has become an associate of **Vinson & Elkins**, 2001 Ross Avenue, Suite 3700, Dallas, Texas 75201.

Holly J. Warrington has relocated to the Beijing office of Vinson & Elkins LLP., 20/F, Beijing Silver Tower, No. 2, Dong San Huan Bei Lu, Chaoyang District, Beijing 100027, China.

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Writs Act."[14] Similarly, the Fifth Circuit has stated that "a court's powers under § 105(a) are not unlimited as that section only 'authorizes bankruptcy courts to fashion such orders as are necessary to further the substantive provisions of the Code,' and does not permit those courts to 'act as roving commission[s] to do equity.'"'[15]

Since the decision in Marrama was handed down about a year ago, several courts in the Fifth Circuit have zeroed in on this expansive language with regard to a bankruptcy court's ability to "take any action that is necessary or appropriate 'to prevent an abuse of process'" and have cited Marrama for one of two propositions: (1) some have used the reasoning in Marrama to justify their decision to sanction the debtor for his bad faith acts;[16] while (2) others have used the reasoning in Marrama to justify a decision that fashions a remedy the code requires but is contrary to another section's provision.[17]

Sanctions for Bad Faith Debtors.

When a debtor seeks an order confirming the dismissal of his case under Bankruptcy Code section 521(i)(2)[18] because of his own default, a court may inquire into the debtor's motivation; and, if the debtor was acting in bad faith may condition the dismissal so that the debtor is "not rewarded for his own malfeasance."[19] In Hall, the court noted that the case was a "poster child for a bad faith debtor."[20] The debtor first filed for protection under Chapter 13 but had his case dismissed for failure to file all the required schedules pursuant to section 521(a)(1). After an appeal and several motions to have the case reinstated, the debtor filed a second case under Chapter 13. In his second case, the debtor filed all the required schedules but simply put "TBA" or "To Be Amended" on each of the schedules.[21] Additionally, he filed several groundless adversary proceedings against his secured creditors and transferred title to real estate, without notice to creditors, out of his Chapter 13 estate to a corporate entity he controlled.[22]

At a show cause hearing for why the case should not be dismissed, the Chapter 7 Trustee and the United States Trustee both asked the court not to dismiss the case but to sanction the debtor.[23] In response, the debtor filed a motion seeking the court to order that the second bankruptcy case was automatically dismissed because of his failure to comply with § 521(a).[24] The issues before the court were (1) whether the case was dismissed pursuant to § 521(i)(1) because of the debtor's failure to comply, and (2) whether an order reflecting such a summary dismissal be with prejudice because of the debtor's abuse of the bankruptcy system.

The court found that a motion filed pursuant to 521(i)(2) could only be denied in limited circumstances.[25] Thus, the court found that the case was automatically dismissed on the forty-sixth day pursuant to § 521(i)(1). The court then turned to the second issue. Relying on Marrama, the court found that it was "legitimate for the [c]ourt to inquire into the motivation and/or good faith (or lack thereof) of the debtor" in seeking an order under § 521(i)(2).[26] Because the debtor had obviously acted in bad faith throughout both cases, the court conditioned the "automatic dismissal" of the case by prohibiting the debtor from filing any petition under Title 11 for a period of two years.[27]

Broad Application of Section 105(a)

In two separate cases out of the Southern District of Texas the court applied the holding in Marrama for the principle that section 105(a) allows a bankruptcy judge to fashion a remedy to achieve a result the Code requires, despite another Code section's inconsistent approach.[28]

In Perez, the district court upheld a local rule of the bankruptcy court that payments owed to a mortgage lender under Chapter 13 should be made through the trustee.[29] The Southern District of Texas had previously instituted a local rule that home mortgage payments would be made through the Chapter 13 trustee, rather than directly by the debtor.[30] Debtors, Mario and Maria Perez, moved for leave to pay the mortgage lender directly instead of through the trustee. After a hearing on the issue, the court declined to exercise its discretion to waive the conduit payments.[31]

On appeal, the debtors challenged the local rule on several ground including whether the local rule violated the Code by allowing preconfirmation payments by the trustee. The bankruptcy court had concluded that the local rule did not violate the Code because the preconfirmation mortgage payments were not "plan payments" but were "adequate protection payments."[32] The district court agreed with the bankruptcy court's reasoning and expanded on one of the footnotes. The footnote stated that section 105(a) would allow the court to achieve the Code's presumption in favor of payments through the trustee without using the "nidubitable equivalent" form of adequate protection under section 363 (3).[33] Relying on Marrama, the court asserted that where an express statute requires a specific result, section 105 can be used to ensure that result.[34] In other words, under section 105(a), a bankruptcy judge may fashion pragmatic approaches to achieve results the Code clearly requires, even though the inconsistent approach of another Code section is unclear or ambiguous. Following this reasoning, the district court held that section 105 "properly applies to allow the trustee to disburse one or two monthly payment that are due postpetition but preconfirmation."[35]

Similarly, in *In re Padilla*,[36] the bankruptcy court relied on Marrama to conclude that section 105 gives the court the power to order disgorgement of fees and expenses charged by a mortgage lender who failed to file a Rule 2016(a)

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application for its reimbursable expenses. In two separate cases mortgage lenders had charged the debtor's accounts for legal fees, inspection costs and other expenses. While these fees are recoverable under section 506(b), a mortgage lender can not collect post-petition reimbursable expenses without restraint.[37]

In Jacobson, the Bankruptcy Court for the Eastern District of Texas found that the debtor failed to disclose several pieces of real property acquired after marriage but held only in his wife's name, in his bankruptcy schedules, thereby hampering the ability of the Chapter 13 Trustee to investigate the debtor's schedules and administer the bankruptcy estate.[38] The Chapter 13 Trustee moved to dismiss the case pursuant to Bankruptcy Code section 1307(c), and the debtor responded by filing a 1307(b) motion to dismiss.[39] In finding that a debtor's right to dismiss was not "absolute," as the debtor contended, the court found that "the statutory language of § 1307(c), on its face, supports a conclusion that a debtor's ability to dismiss a case under subsection (b) does not preclude a conversion of the case under subsection (c)."[40] The Court further found that its discretion to fashion orders under section 105(a), and the equities in the case supported its interpretation of section 1307.[41] Finding the debtor to be "far from honest and forthright," the court denied his motion to dismiss.[42]

Conclusion

Based on the opinions that have been published by the courts in the Fifth Circuit since Marrama, the Supreme Court's decision has had the effect of going beyond answering the question of whether or not a debtor's right to convert his chapter 7 case is absolute, and instead has broadened a court's ability, consistent with the Bankruptcy Code, to fashion remedies to curtail abuse. In doing so, it has emphasized the bankruptcy court's duty that existed well before the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, to limit bankruptcy protection to the "honest but unfortunate debtor." As these recent decisions show, judges are more than happy to police the system when given the discretion to do so.

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[1] 11 U.S.C. § 706(a).
[2] Compare *Martin v. Martin* (*In re Martin*), 880 F.2d 857, 859 (5th Cir. 1989) (holding that a debtor's right to convert under §706(a) is absolute); *In re Miller,* 303 B.R. 471 (10th Cir. B.A.P. 2003) (same); *In re Croston* , 313 B.R. 447 (9th Cir. B.A.P. 2004) (same); *In re Finney*, 992 F.2d 43 (4th Cir. 1993) (same); *In re Schaitz*, 913 F.2d 452 (7th Cir. 1990) (same); with *In re Cooper*, 426 F.3d 810 (6th Cir. 2005) (debtor's right to convert could be denied in absence of good faith); *In re Kuntz*, 233 B.R. 580 (1st Cir. B.A.P. 1999) (same).
[3] 11 U.S.C. § 706(d).
[4] *Marrama*, 127 S. Ct. at 1110.
[5] *Id.*
[6] *Id.* n. 7.
[7] *Id.*; See 11 U.S.C. § 1307(c) (including a nonexclusive list of 10 causes that justify relief).
[8] *Id.* at 1111.
[9] *Id.* (citing *Grogan v. Garner*, 498 U. S. 279, 287, 111 S.Ct. 654, 659 (1991)).
[10] *Id.* at 1107 (citing *Grogan v. Garner*, 498 U. S. 279, 287, 111 S.Ct. 654, 659 (1991)).
[11] *Id.* at 1111.
[12] *Id.* at 1111-1112.
[13] 485 U.S. 197, 206-207, 108 S.Ct. 963, 969 (1988) (that "whatever equitable powers remain in the bankruptcy courts must and can only be exercised within the confines of the Bankruptcy Code.").
[14] See *In re Combustion Engineering, Inc.,* 391 F.3d 190, 225 (3rd Cir. 2004) ("section 105 provides bankruptcy courts with powers of equity similar to those granted to federal courts under the All Writs Act").
[15] *In re Mirant Corp.*, 378 F.3d 511, 523 (5th Cir. 2004).
[16] See *In re Hall*, 368 B.R. 595, 602 (Bankr. W.D. Tex. 2007).
[17] See *In re Padilla*, 379 B.R. 643 (Bankr. S.D. Tex. 2007); *Perez v. Peake*, 373 B.R. 468 (S.D. Tex. 2007)); *In re Jacobson*, 378 B.R. 805 (Bankr. E.D. Tex. 2007).
[18] 11 U.S.C. § 521(i)(2) (allowing any party in interest to request the court to enter an order dismissing the case because of failure to meet the standards in § 521(i)(1)).
[19] *Hall*, 368 B.R. at 602.
[20] *Id.*
[21] *Id.* at 596.
[22] *Id.* at 601.
[23] *Id.* at 598.
[24] *Id.*
[25] *Id.* at 599-600 (interpreting § 521(i)(4) to hold that "the only basis on which a court can decline to enter the order of dismissal if requested is if the trustee files a motion within five days after a party-in-interest makes such a request, and the court finds debtor in good faith attempted to file his pay advices and the best interest of creditors would be served by administration of the case").
[26] *Id.* at 602.
[27] *Id.*
[28] See *In re Padilla*, 379 B.R. 643 (Bankr. S.D. Tex. 2007); *Perez v. Peake*, 373 B.R. 468 (S.D. Tex. 2007).
[29] *Perez*, 373 B.R. at 488.
[30] *Id.* at 469.
[31] *Id.*
[32] *Id.* at 487 (reasoning that "when a mortgagee in a Chapter 13 received the current monthly payment, as well as payment of arrearages under the plan, this arrangement constitutes the 'indubitable equivalent' of the mortgagees interest under 361(3)).
[33] *Id.* at 486-87.
[34] See *Id.* at 487.
[35] *Id.* at 488.
[36] 379 B.R. 643 (Bankr. S.D. Tex. 2007).
[37] *Id.*
[38] 378 B.R. at 811 (Bankr. E.D. Tex 2007).
[39] 11 U.S.C. §§ 1307 (b)-(c) provides:

> (b) On request of the debtor at any time, if the case has not been converted under section 706, 1112, or 1208 of this title, the court shall dismiss a case under this chapter. Any waiver of the right to dismiss under this subsection is unenforceable.
>
> (c) Except as provided in subsection (e) of this section, on request of a party in interest or the United States trustee and after notice and a hearing, the court may convert a case under this chapter to a case under chapter 7 of this title, or may dismiss a case under this chapter, whichever is in the best interests of creditors and the estate, for cause.

[40] *Jacobson*, 378 B.R. at 810.
[41] *Id.*
[42] *Id.*

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to the bankruptcy estate since all or substantially all of its work went toward reorganization and the case was ultimately liquidated.[13]

The bankruptcy court, after a lengthy discussion of the historical and procedural facts of the *Pro*-Snax decision, found that the Fifth Circuit's "identifiable, tangible and material benefit to the estate" analysis, adopted from cases prior to the 1994 amendments to section 330 and applied in cases awarding fees to debtor's counsel after the appointment of a trustee, to be *dictum* in *Pro-Snax,* applicable possibly only on its own facts and possibly only to the counsel in that matter.[14] The bankruptcy court noted that the issue of when the benefit to the estate is measured – either at the time at which the service is rendered or in hindsight – was created by lower courts in this jurisdiction interpreting the *Pro-Snax* language stating that "any work performed by legal counsel on behalf of a debtor must be of material benefit to the estate," along with the instruction that debtor's counsel's services must "result in an identifiable, tangible and material benefit."[15] The bankruptcy court noted that while a court must look to the benefit to the estate in determining whether professional fees are reasonable, which is in line with the *Pro-Snax* decision, under the express language of the statute, the analysis is made "at the time at which the service was rendered" and not in hindsight, contrary to the direct holdings in other lower court opinions.[16]

Based on this analysis, the bankruptcy court found that certain of the services rendered by the law firm, *i.e.* those performed before it was put on notice that the debtor's "affairs had collapsed," were reasonable at the time they were performed.[17] At the time such work was performed, the "case appeared to be headed to a consensual confirmation."[18] The facts later changed. Accordingly, the bankruptcy court found that services rendered after receiving notice that the debtor would not have a reasonable prospect of reorganizing were no longer beneficial to the estate at the time they were rendered and denied recovery of those fees.[19]

The bankruptcy court found, alternatively, that the *Pro-Snax* standard applies only to counsel for debtors and not to committee counsel.[20] The bankruptcy court found that counsel to a committee works for and "holds only a fiduciary duty to those whom it represents, not for the debtor or the estate generally and that "[o]ften times, the interests of equity holders, creditors, and the debtor diverge."[21] Thus, as counsel to the equity committee, the bankruptcy court found that the law firm should not be judged by the resulting benefit to the estate, but only as to the benefit conferred in the best interests of the committee.[22] The bankruptcy court therefore did not preclude an award to the law firm based upon the *Pro-Snax* standard.

On appeal to the district court,[23] the district court first considered whether the *Pro-Snax* standard is *dictum*. The district court noted there are generally two types of dictum - obiter dictum and judicial dictum.[24] Obiter dictum is "an observation or 'judicial comment made during the course of delivering a judicial opinion, but one that is unnecessary to the decision in the case and therefore not precedent.'"[25] Judicial dictum is "an opinion by a court on a question that is directly involved, briefed, and argued by counsel, and even passed on by the court, but that is not essential to the decision."[26] The court noted that dictum is not binding on lower courts, however "judicial dictum is generally entitled to greater weight."[27] Given these basic definitions, the district court stated that it was doubtful of whether the Fifth Circuit's adoption of the material benefit or hindsight test was dictum at all.[28] The district court found that the "language of the *Pro-Snax* opinion certainly suggests that the panel thought it was pronouncing on a point of law that was essential to the determination of a portion of the case."[29] However, the district court found, even if the *Pro-Snax* material benefit test was mere dictum, it nevertheless was judicial dictum.[30] The court then pointed to a number of lower court decisions within the Fifth Circuit that had uniformly interpreted *Pro-Snax*'s acceptance of the material benefit test as representing the governing law in the Fifth Circuit rather than dictum.[31]

The district court assumed that *Pro-Snax* created a hindsight standard. Recall that the bankruptcy court stated that *Pro-Snax* did not create a blanket obligation to view material benefit to the estate in hindsight, but that its progeny did. Nevertheless, the district court, in ruling on the ultimate issue of whether section 330 is incompatible with the hindsight application of the *Pro-Snax* standard, found that although "*Pro-Snax* adds a judicially-created hurdle for fee applicants to clear before being entitled to payment out of the estate" and that it agreed with the bankruptcy court that it "is sensible to read § 330 as manifesting an intent to allow compensation for work which, *at the time it was rendered*, seemed reasonably likely to benefit the debtor's estate," the *Pro-Snax* analysis can be "harmonized if the evaluation of attorney services is conceived of as a two-step inquiry."[32] First, the district court posits, you determine whether services are actual and necessary, which includes with a *Pro-Snax* analysis of whether the services result in an identifiable, tangible, and material benefit to the estate.[33] Once that threshold is crossed, you turn to a reasonableness analysis, done by computing the lodestar and then adjusting with the *Johnson* factors.[34] As such, the district court found that *Pro-Snax* and section 330 could be harmonized and rejected the bankruptcy court's analysis that the benefit to the estate should be determined at the time the services were rendered.[35] It appears that the district court was likely driven by the fact that "*Pro-Snax* remains the law of this circuit unless and until it is overruled."[36]

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With respect to the alternative ruling of the bankruptcy court that *Pro-Snax* did not even apply to this case, the court disagreed, finding that section 330 itself ties the compensability of a professional's services to the benefit to the estate.[37] The district court noted that the section makes no distinction between professionals working on behalf of the debtor versus those employed by official committees.[38] The district court noted that the "Fifth Circuit requires more of fee applicants than section 330 does on its face - under *Pro-Snax* an applicant must prove that its services *actually* resulted in a material benefit to the estate."[39] The court could perceive of no reason why the Fifth Circuit would apply a lesser standard to attorneys for an equity, or other official, committee.[40] Therefore, the court reversed the bankruptcy court, holding that services rendered by counsel for an equity committee were "actual, necessary services" within the meaning of section 330(a)(1)(A) only if they resulted in an identifiable, tangible, and material benefit to the bankruptcy estate.[41]

The district court's opinion in *Gadzooks* is currently on appeal to the Fifth Circuit. This issue is critical for all counsel employed pursuant to section 327 of the Bankruptcy Code seeking to recover fees from the bankruptcy estate pursuant to section 330. The affirmation of a hindsight test could render disastrous results for counsel and their clients, whether they are debtors, a committee, or other party governed by section 330, and create the very situation that the amendments to the Code sought to prevent – the flight of capable bankruptcy lawyers to more profitable areas of practice.

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[2] 157 F.3d 414 (5th Cir. 1998)

[3] *Id.* at 424-26. The Supreme Court subsequently agreed with the Fifth Circuit on this point in *Lamie v. United States Trustee*, 540 U.S. 526, 124 S.Ct. 1023, 157 L.Ed.2d 1024 (2004).

[4] See, e.g., Pennsylvania v. Delaware Valley Citizens' Council for Clean Air, 478 U.S. 546, 106 S.Ct. 548, 126 L.Ed.2d 439 (1986); Johnson v. Georgia Highway Express, Inc., 488 F. 2d 714 (5th Cir. 1974); In re First Colonial Corp. of America, 544 F. 2d 1291 (5th Cir.) cert. denied, 97 S. Ct. 1696 (1977)

[5] *Id.* at 426.

[6] Id.

[7] Id.

[8] Id. at 426, fn. 17

[9] *In re Mednet*, 251 B.R. 103 (9th Cir. BAP 2000); *In re Eggleston Works Loudspeaker Co.*, 253 B.R. 519 (6th Cir. BAP 2000); *In re Vu*, 366 B.R. 511 (D. Md. 2007).

[10] *In re Weaver*, 336 B.R. 115, 119 (Bankr. W.D. Tex. 2005); *In re Quisenberry*, 295 B.R. 855, 865 (Bankr. N.D. Tex. 2003).

[11] 352 B.R. 796 (Bankr. N.D. Tex. 2006)

[12] *Id.* at 800-03.

[13] *Id.* at 798.

[14] *Id.* at 809-10.

[15] *Id.* at 810.

[16] *Id.*

[17] *Id.* at 811.

[18] *Id.*

[19] *Id.*

[20] *Id.*

[21] *Id.* at 812.

[22] *Id.*

[23] *Kaye v. Hughes & Luce, LLP*, No. 3:06-CV-01863-B, 2007 WL 2059724 (N.D. Tex. July 13, 2007) (Slip Copy)

[24] *Id.* at *6.

[25] *Id.*

[26] *Id.*

[27] *Id.*

[28] *Id.* at *7.

[29] *Id.*

[30] *Id.*

[31] *Id.*

[32] *Id.* at *9; *but see In re Spillman*, 376 B.R. 543 (Bankr. W.D. Tex. 2007) (stating that a combined hindsight analysis consumes an "at the time the services were rendered" analysis).

[33] *Id. at *9*.

[34] *Id.*

[35] *Id.*

[36] *Id.* at *8.

[37] *Id.* at *11.

[38] *Id.* at *12.

[39] *Id.*

[40] *Id.*

[41] *Id.*