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CASE LAW UPDATE:

Fifth Circuit Bankruptcy Decisions

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APPEALS

Matter of Dorsey (Dorsey v. U.S. Dept. of Ed.), 870 F.3d 359 (5th Cir. September 1, 2017)

Issue: Whether a party can preserve an appeal of a judgment in an adversary proceeding by amending the statement of issues in an appeal from the main bankruptcy case to add issues related to the adversary proceeding.

Holding: Amending a statement of issues on appeal cannot revive an appeal on a separate matter if notice of appeal was not timely filed.

Pro se Chapter 7 Debtor filed an adversary proceeding to discharge his student loan debt under the undue hardship exception, claiming that a mental health issue did not allow him to work consistently. Although Debtor filed at least two proper notices of appeal to the district in the adversary proceeding, Debtor failed to appear at the trial in the adversary proceeding, and the bankruptcy court denied the Debtor's discharge of the student loan debt. Debtor did not file a notice of appeal of the final judgment in the adversary proceeding.

Meanwhile, the Department of Education and United Student Aid Funds, both defendants in the adversary proceeding, moved to reopen the Debtor's closed bankruptcy case to file proofs of claim. The Bankruptcy Court granted defendants' motion, and Debtor filed a proper notice of appeal of the court order reopening the main bankruptcy case. Debtor amended his statement of issues on appeal concerning the Bankruptcy Court's order reopening the case to add issues related to the student loan discharge adversary proceeding and designated the entire adversary proceeding as part of the record on appeal. The District Court found that it did not have jurisdiction to consider issues from the adversary proceeding because Debtor had failed to file a timely notice of appeal in that case.

The Fifth Circuit found that it had no jurisdiction to consider any issues related to the adversary proceeding because of Debtor's failure to timely file a notice of appeal in that proceeding. The Court agreed with other circuits in finding that a proper notice of appeal filed in the main bankruptcy case did not preserve appellate jurisdiction of final orders in an adversary proceeding within the main case since the proceedings are treated as distinct for purposes of appeal. The Court also rejected the Debtor's contention that the amended statement of issues preserved issues arising out of the adversary proceeding on appeal, finding that the amended statement of issues did not meet the substantive requirements of a notice of appeal under Bankruptcy Rule 8000(3), including the requirement that the notice of appeal identify parties to the appeal and the requirement that the notice attach the judgment, order, or decree being appealed. The Court also found that Debtor had not committed a technical error, pointing to the previous proper notices of appeal that Debtor had filed and Debtor's acknowledgment that he sought to amend, rather than file a new notice of appeal, to avoid paying a new filing fee.

ATTORNEYS' FEES

In re Riley, 577 B.R. 497 (Bankr. W.D. La. September 29, 2017) (Kolwe, J.)

Issue: Whether a Ch. 13 debtor's attorney is entitled to receive reimbursement of filing fees and other prepetition costs through the Ch. 13 plan in addition to the "no-look" attorney fee allowed under the local rules.

Holding: There is no entitlement to reimbursement of pre-petition expenses in addition to the allowed "no-look" fee since such expenses are not administrative expenses of the estate because: (i) they are not

> actual, necessary costs of preserving the estate; and (ii) they are not reimbursable expenses to a professional providing services to the estate.

In a Ch. 13 "no money down" bankruptcy case, Debtor's counsel agreed to advance the funds to pay the filing fee, credit counseling fee, and a credit report fee on behalf of the debtor, with the understanding that the advances would be reimbursed through the confirmed plan in addition to payment of the no-look attorney's fee allowed under the applicable standing order. In support of confirmation of the proposed plan, Debtor's counsel submitted an affidavit from the Debtor that stated that she filed her bankruptcy petition to stop repossession of her car and would not have been able to pay the Ch. 13 filing fee up front. Additionally, counsel represented to the Bankruptcy Court at the confirmation hearing that many of his clients would be denied access to the bankruptcy courts if he did not pay the filing fees and other costs for his clients. The Bankruptcy Court confirmed the Debtor's plan, but, acknowledging that virtually all attorneys representing Chapter 13 debtors before the Court filed no-money-down cases, reserved the question of counsel's entitlement to reimbursement of the pre-petition expenses for further consideration.

Upon consideration, the Bankruptcy Court concluded that Debtor's counsel was not entitled to reimbursement for pre-petition expenses advanced on behalf of the Debtor in addition to the standing order no-look fee through the Ch. 13 plan. The Court found that the advances were not reimbursable expenses for preservation of the Debtor's estate under Section 503(b)(1)(A) since the pre-petition fees were expenses of the Debtor, not the estate. Further, the Court found that the filing fee, credit counseling fee, and credit report fee did not provide a benefit to the estate since they served only to satisfy the personal obligation of the Debtor to pay those costs. The diversion of a portion of the Debtor's post-petition income for the payment of pre-petition expenses would actually harm unsecured creditors who are ordinarily entitled to receive all of the Debtor's disposable income during the duration of the plan.

Additionally, the Bankruptcy Court could find no basis for reimbursement of the pre-petition expenses under Sections 330(a) and 503(b)(2). Although the Bankruptcy Court agreed that the reference to allowed compensation in Section 330(A)(4)(B) likely includes reimbursement of expenses, it ultimately concluded that the standing order no-look fee is inclusive of all allowable expenses. Accordingly, Debtor's counsel must file a formal fee application setting forth both compensation and expenses requested if he wishes to receive compensation or reimbursement in addition to the allowed no-look fee. Even if the request of Debtor's counsel was construed as a fee application, however, the Bankruptcy Court found that reimbursement of the filing fee and other pre-petition expenses would not be allowed under Section 330 since these expenses are essentially the debtor's cost of admission, and it would be improper to shift this cost onto creditors by allowing the debtor's attorney to be reimbursed for these expenses with post-petition income through a plan.

The Bankruptcy Court concluded by noting that Rule 1006(b) gives a bankruptcy court authority to allow the filing fee to be paid in installments, giving the bankruptcy court discretion to determine whether it is appropriate to shift the cost of the filing fee to unsecured creditors. If the court were to allow debtor's attorneys to simply pay the filing fee on behalf of their Ch. 13 clients, whether for the client's convenience or necessity, and then be reimbursed from the bankruptcy estate, it would effectively eviscerate this rule. The discretion to determine whether a filing fee should be charged to a debtor's estate is not given to the debtor's attorney. That discretion is reserved to the bankruptcy court, and only in situations where the debtor can show that the filing fee cannot be paid except in installments.

DISCHARGEABILITY

In re Koukhtiev (Hiner v. Koukhtiev), 576 B.R. 107 (Bankr. S.D. Tex. November 17, 2017) (Bohm, J.).

Issue: The dischargeability of a judgment debt incurred when a debtor, who had no ownership interest in a software patent and other intellectual property, refused to turn over the software source code to its owner and sold copies of the software through a d/b/a without software owner's knowledge.

Holding: The judgment debt is non-dischargeable under Section 523(a)(6) as a debt incurred by willful, malicious injury and also under Section 523(a)(2)(A) as a debt incurred through actual fraud, applying the post-*Husky* understanding of actual fraud.

Plaintiff, a Ukranian music teacher who immigrated to the U.S., developed a music teaching methodology to teach students to read music and play the piano interactively through a computer program. Plaintiff hired the Debtor to develop a software program that used Plaintiff's methodology, which Plaintiff eventually marketed as the "Soft Way to Mozart" program. Plaintiff's retention of Debtor was subject to a work agreement that clearly established that Debtor waived any interest in the ownership of the work product and any related intellectual property and subjected Debtor to a confidentiality and nondisclosure agreement. Plaintiff and Debtor also had an intimate personal relationship, and Debtor moved into Plaintiff's Houston home during the time that they developed the software program. After their relationship ended on contentious terms, Debtor moved out of Plaintiff's home and left the computer that hosted the source code to the software program, although Debtor refused to give Plaintiff access to the source code housed on the computer, which was necessary for Plaintiff to make modifications to the program and continue to sell it. Plaintiff eventually was forced to hire software engineers to access the source code on the computer and create a new executable file at a significant cost. Shortly after this period of time, Debtor began to sell copies of the software on Amazon under a different name and kept all the profits from the sale without disclosing them to Plaintiff.

Plaintiff sued Debtor in state court and won a judgment compensating her for the lost profits from the Debtor's sales of the software, the Plaintiff's cost in creating a new executable file of the software after Debtor refused to turn over the source code, and for her attorneys' fees and costs for prosecuting the lawsuit. After the Debtor initiated a Chapter 7 bankruptcy proceeding, Plaintiff filed an objection to discharge of her judgment under Sections 523(a)(6) and 523(a)(2)(A).

The Bankruptcy Court easily agreed that Plaintiff's judgment against Debtor was nondischargeable under Section 523(a)(6). The Court found that Debtor's refusal to turn over the source code, knowing that the source code was necessary to make modifications to and to sell the program, reflected a subjective motive to cause Plaintiff harm as well as an objective, substantial certainty that it would cause Plaintiff harm. Furthermore, because Debtor clearly had no ownership in the software and knew that Plaintiff was not aware of his sales of the program under a different name, the Court found that there was an objective, substantial certainty that selling the software under a different name would cause harm to Plaintiff by depriving her of her rightful share of the proceeds.

Yet the Court struggled with Plaintiff's arguments of actual fraud under Section 523(a)(2)(A), acknowledging that the judgment would have been dischargeable under pre-*Husky* law in the 5th Circuit. The Supreme Court's 2016 *Husky* opinion vastly expanded the meaning of actual fraud under Section 523(a)(2)(A) to include fraudulent conveyance

schemes, even when those schemes *do not involve a false representation*. According to the Supreme Court, any fraud that involves moral turpitude or intentional wrong is sufficient to prove actual fraud. Accordingly, the Bankruptcy Court found that Debtor's actions constituted actual fraud pursuant to the Supreme Court's "fraud with wrongful intent" definition since the court found that the Debtor intended, through non-disclosure and deceit, to deprive Plaintiff of the proceeds from the sales of the software program. The Bankruptcy Court found additional support for this conclusion in Texas law, which holds that a cause of action for surreptitious conversion of property constitutes fraud. *See Pena v. First State Bank & Tr. Co.*, 404 S.W.2d 56, 59 (Tex. App. – Corpus Christi 1966).

In re Thomas (Thomas v. U.S. Dept. of Ed.), 561 B.R. 481 (Bankr. N.D. Tex. December 8, 2017) (Hale, J.).

Issue: Discharge of student loan debt under the Fifth Circuit's *Gerhardt* standard for undue hardship.

Holding: No discharge allowed since it is virtually impossible for any debtor to meet the exacting standard for "total incapacity" under *Gerhardt*.

Debtor attended two semesters of community college in 2012 when she was 57 years old. To pay the tuition for her two semesters, Debtor borrowed $7,000 through the federal direct loan program. After the loans went into repayment status in December 2013, Debtor made two payments on the loans in 2014 totaling less than $100, but did not make any other payments on the loans. Debtor has not applied for a discharge through the Department of Education based on total disability, which would allow the loans to be administratively discharged if Debtor could show a disability and a proven inability to work any position. Further, Debtor has not applied for the income-based repayment plan, which would allow Debtor to make $0 monthly payments as long as her income remained less than $15,930 a year.

Debtor, now 62, was diagnosed with diabetes in the mid-1980's and now suffers from diabetic neuropathy, a debilitating condition that causes muscle weakness and pain and numbness in her legs and feet after standing for extended periods of time. Although the condition is treatable, Debtor continues to suffer its painful symptoms. There is no cure for diabetic neuropathy. Debtor is able to be employed if the job is sedentary. Debtor lost her long-term job unexpectedly in 2016 and has been unable to sustain employment since 2016 due to her medical condition. Despite continuing to search for full-time employment, the Debtor has no monthly income other than the $194 per month she receives in food stamps. Debtor's monthly expenses exceed her meager monthly income, her car has been repossessed, and she faces eviction from her apartment. She does not qualify for Medicaid or Medicare and receives medical treatment for her condition through a charitable program at a local hospital.

Debtor filed a Ch. 7 petition in 2017 and petitioned the Bankruptcy Court to discharge her student loan debt on the basis that repayment of her student loans would impose an undue hardship under Section 523(a)(8). The Bankruptcy Court found that, although Debtor's current situation was certainly dire, that she nonetheless did not meet the standard of "total incapacity" required under the Fifth Circuit's *Gerhardt* test for undue hardship, which is not defined in the Bankruptcy Code. In order to show undue hardship, *Gerhardt* requires: (1) that the debtor cannot maintain, based on current income and expenses, a minimal standard of living for himself and his dependents if forced to repay the loans; (2) that additional circumstances exist indicating that this state of affairs is likely to persist for a significant portion of the repayment period of the student loans; and (3) that the debtor has made good faith efforts to repay the loans. *See U.S. Dept. of Ed. v. Gerhardt (In re Gerhardt)*, 348 F.3d 89, 91 (5th Cir. 2003) (citing *Brunner*

v. New York State Higher Ed. Services Corp., 831 F.2d 395, 396 (2d. Cir. 1987)).

With respect to the first factor, the Bankruptcy Court found that Debtor had clearly established that her monthly expenses exceeded her monthly income. With respect to the second factor, the Fifth Circuit has found that a showing of dire financial condition is not enough – the circumstances must be outside the debtor's control and result in "total incapacity" to pay debts now and in the future. The Debtor conceded that she is not able to show she is completely incapable of employment now or in the future since she is able to maintain sedentary employment. Consequently, she cannot meet the exacting standard for "total incapacity." Finally, with respect to the third factor, the Bankruptcy Court questioned whether Debtor's failure to apply for discharge or other relief available through the Department of Education based on her disability necessarily precluded a finding that Debtor has made a good faith effort to repay the loans. Nevertheless, Debtor's failure to satisfy the second *Gerhardt* factor meant the Bankruptcy Court did not have to make a finding on the third factor.

In its conclusion, the Bankruptcy Court noted that it has not discharged a single student loan debt over the lender's objection in fifteen years because of the necessary finding of "total incapacity." The Bankruptcy Court acknowledged that the "total incapacity" requirement makes the *Gerhardt* standard even higher than the *Brunner* standard upon which it was based. The Bankruptcy Court encouraged any reviewing court to offer guidance concerning the appropriate standard to apply as well as guidance of the weight that must be afforded a debtor's participation in alternative repayment plans in the good faith analysis.

EXEMPTIONS

In matter of Ayobami (Peake v. Ayobami, 879 F.3d 152 (5th Cir. Jan. 3, 2018)).

Issue: May a debtor claiming federal exemptions under §522 of the Bankruptcy Code ever exempt a 100% interest in an asset?

Holding: Yes, a debtor may do so in certain cases because the relevant provisions of §522 cap the value of the asset a debtor may exempt, not the debtor's interest in that asset.

Using the new Schedule C form, Debtor checked the box indicating her intent to exempt 100% of fair market value, up to any applicable statutory limit, for 14 of her 17 exemptions. Debtor claimed the exemptions under Section 522(d)(1), (3)-(5), which cap the value of a debtor's interest that may be exempted at a designated statutory limit. The Debtor also assigned her exempt interest a dollar value within the statutory limits of the applicable subsection.

Trustee objected that a debtor may never exempt a 100% interest in an asset under Section 522(d)(1)-(6) since allowing such an exemption effectively removes the entire asset from the bankruptcy estate. Since the relevant subsections of Section 522(d) place a monetary-value cap on the claimed exemptions, the Trustee argues, the exemption itself must be limited to the specific amount, not an indefinite exemption in-kind to be determined at a later date. The court allowed the Debtor's exemptions, and the parties jointly requested direct certification to the Fifth Circuit. The Bankruptcy Court certified the specific issue stated above directly to the Fifth Circuit, which granted leave.

The Fifth Circuit answered the certified question in the affirmative, finding that Section 522(d) caps the value of the asset that the debtor may exempt, not the debtor's interest in the asset. The language of Section 522(d) does not expressly limit the amount of a debtor's interest that may be exempt, although there are circumstances where exempting a 100% interest in an asset will not be allowed because value of

the interest exceeds the statutory cap. Consequently, if a debtor's entire interest in an asset is less than or equal to any dollar-value limitation imposed by Section 522(d), then the debtor may exempt her 100% interest in that asset.

The opinion leaves unanswered a corresponding question of whether claiming a 100% interest in an asset allows a debtor to "walk away" with the asset itself and potentially benefit from its post-petition appreciation, focusing instead only on the question directly certified. The Fifth Circuit notes, however, that the Supreme Court has questioned whether a claim to exempt the full value of equipment would, if unopposed, entitled the debtor to the equipment itself as opposed to payment equal to the equipment's full value.

FAIR DEBT COLLECTION PRACTICES ACT

Obduskey v. Wells Fargo, 839 F.3d 1216 (10th Cir. 2018), *cert granted* 138 S.Ct. 2710 (June 28, 2018).

Issue: Whether non-judicial foreclosure fits within the category of debt collection under the FDCPA.

Holding: A entity engaged in non-judicial foreclosure is not a debt collector under the FDCPA and is therefore not subject to its requirements.

Homeowner defaulted on his home mortgage with Wells Fargo. Wells Fargo hired a law firm to conduct a non-judicial foreclosure under Colorado law, which sent an undated letter to the homeowner stating its intent to initiate foreclosure proceedings on behalf of Wells Fargo. Homeowner responded to the letter disputing the debt. The law firm did not respond to homeowner's dispute of the debt, but instead initiated foreclosure proceedings. Homeowner sued law firm and Wells Fargo for violation of the Fair Debt Collection Practices Act, including the failure to respond to a properly delivered notice requesting debt validation, and other related causes of action under Colorado law.

The District Court granted defendants' motion to dismiss homeowner's claims under the FDCPA, finding that the law firm did not qualify as a debt collector because foreclosure proceedings are not a collection of a debt. On appeal, the 10th Circuit considered whether the FDCPA applies to non-judicial foreclosure proceedings.

The 10th Circuit acknowledged that the circuit courts are split on the issue of whether the FDCPA applies to non-judicial foreclosure proceedings specifically or enforcement of security interests generally, citing that the 5th Circuit has held that of an attorney enforcing a security interest may still qualify as a debt collector. *See Kaltenbach v. Richards*, 464 F.3d 524 (5th Cir. 2006) (holding that a party who satisfies the FDCPA § 1692a(6)'s general definition of a "debt collector" is a debt collector for the purposes of the entire FDCPA even when enforcing security interests). Splitting with the Fourth, Fifth, and Sixth Circuits, the 10th Circuit found for the defendants that a non-judicial foreclosure is not covered by the FDCPA. The Court reasoned that a non-judicial foreclosure is unique from a judicial foreclosure (which is covered under the act) because a creditor in a non-judicial foreclosure is collecting a debt against collateral, not collecting money for the payment of a debt. A creditor in a non-judicial foreclosure may collect a deficiency against a debtor only after the non-judicial foreclosure sale has occurred, and only through a separate action. Therefore, a trustee may obtain proceeds only from the sale of the foreclosed property, and no more. On the other hand, the Court observed that, had the defendants attempted to induce the homeowner to pay money by threatening foreclosure, then the act might have applied.

The Court found that policy considerations supported its decision as well. For instance, the

Colorado non-judicial foreclosure law requires the foreclosing entity to provide notice of the foreclosure to all parties that have acquired an interest in the property, which would violate the FDCPA's prohibition on communicating with third parties. Additionally, the Colorado non-judicial foreclosure procedure requires the foreclosing entity to post notice of the foreclosure on the door of the subject property and mail it to the mortgagor, regardless of representation, whereas the FDCPA prohibits a debt collector from directly communicating with a debtor after the collector knows that the debtor is represented by an attorney. Allowing the FDCPA to preempt the Colorado non-judicial foreclosure law would therefore frustrate the purposes of both the FDCPA and the state non-judicial foreclosure law. The 10th Circuit rejected the argument that its holding will immunize all debt secured by real property from the FDCPA, finding that its holding is limited to non-judicial foreclosure proceedings and the specific facts of the case. The 10th Circuit left open the possibility that a non-judicial foreclosure could violate the FDCPA if the debt collector leveraged the foreclosure into payment of money from the debtor.

HOMESTEAD

Matter of DeBerry (Lowe v. DeBerry), 884 F.3d 526 (5th Cir. March 7, 2018)

Issue: Whether the proceeds of a homestead sold after the filing of a Chapter 7 petition remain exempt from the debtor's estate if they are not reinvested within the time frame required to invoke the proceeds rule of Texas homestead law.

Holding: A debtor, who owned the homestead property on the Chapter 7 petition date and claimed a homestead exemption to which no objection was filed, can sell homestead property post-petition without subjecting homestead proceeds to administration of trustee if he does not reinvest them in another homestead within six months of the postpetition sale.

Debtor filed Chapter 7 bankruptcy petition and listed his San Antonio home as exempt under Texas law. No objections were filed to the exemption. Seven months later, the Bankruptcy Court granted Debtor's motion for authorization to sell the home. Debtor did not reinvest the proceeds in another home after the sale. Instead, Debtor transferred the money to his wife and to a law firm for the benefit of two partners who represented him in a criminal matter.

Trustee filed an adversary proceeding against the Debtor and the transfer recipients alleging that the estate was entitled to the homestead proceeds since they were not reinvested into another homestead within six months from the sale. The Bankruptcy Court granted the Debtor's motion to dismiss, finding that when a Chapter 7 debtor sells his exempted Texas homestead postpetition, the proceeds from the sale are likewise exempted. The District Court reversed.

While the appeal was pending before the Fifth Circuit, the Court decided *Hawk v. Engelhart*, which held that funds withdrawn from an exempted retirement account after the filing of a Chapter 7 bankruptcy do not lose their exempt status even if the money is not redeposited in a similar account within 60 days pursuant to Texas's proceeds rule.

The Court found for the Debtor, extending the *Hawk* analysis of unconditional and conditional exemptions to homestead proceeds to hold that an unconditionally exempted property interest that is subsequently transformed into a new nonexempt property interest remains excluded from a Chapter 7 bankruptcy estate. The Court reasoned that, since the purpose of the proceeds rule for homestead proceeds is to expand the scope of the exemption, it would be inappropriate to allow the Trustee to use the proceeds rule to limit the exemption in bankruptcy. The Court also sought to avoid the

uncertainty arising from a system of quasi-exempt property that could never be fully exempt until a case was either closed or converted. Furthermore, the Court sought to avoid the arbitrary results that would occur if protection for the proceeds of postpetition homestead sales depended upon the aggressiveness of the trustee in closing a case.

The Court noted, however, that the result would necessarily be different under Chapter 13, which contains a provision mandating that all property the debtor acquires after the commencement of the case but before the case is closed, dismissed, or converted becomes part of the Chapter 13 estate.

Matter of Lopez (Viegelahn v. Lopez), 897 F.3d 663 (5th Cir. July 31, 2018).

Issue: Whether a debtor may dismiss a Ch. 13 case and retain post-petition, non-exempt homestead sale proceeds.

Holding: Unless the court for cause orders otherwise, homestead proceeds must be returned to a debtor upon voluntary dismissal of his bankruptcy case, and a Ch. 13 debtor may in good faith dismiss a voluntary proceeding in order to retain proceeds from the postpetition sale of his homestead.

Several years into Ch. 13 Debtor's plan, Debtor filed a *nunc pro tunc* motion to sell her homestead, which had been exempted under Texas law. The motion was filed *nunc pro tunc* since Debtor had sold her homestead three years before filing the motion in exchange for a wrap-around note with a balloon payment. Debtor intended to use a portion of the proceeds from the homestead sale to pay for a necessary eye surgery. The Trustee objected to the motion and claimed that the homestead proceeds, which had become non-exempt after the Debtor did not reinvest them in another homestead after six months from the sale of the home, had become property of the estate. The Bankruptcy Court approved the *nunc pro tunc* sale motion but ordered that the net sale proceeds after payment of liens and ad valorem claims secured by the property be submitted to the Trustee.

The Trustee then filed a motion to modify the Debtors' plan to distribute the net sale proceeds to creditors. Debtor filed a counter-motion to modify the plan proposing to remit a lump sum of the sale proceeds to the estate less Debtor's medical costs related to her eye surgery. The Bankruptcy Court conducted a hearing on the competing motions and indicated, at the close of the hearing, that it would allow the Debtor the pay for her eye surgery but require the balance of the proceeds to be turned over to the Trustee, unless the Debtor decided to dismiss her case, in which case, she could keep all of the proceeds but would not receive a discharge. The Debtor moved to dismiss the case, which the Bankruptcy Court granted over the Trustee's objection that the dismissal was requested in bad faith. The Bankruptcy Court also ordered the Trustee to turn over the homestead proceeds to the Debtor after payment of the Trustee's commission. On appeal to the District Court, the District Court found that the homestead proceeds should be distributed to creditors under the Chapter 13 plan, even though it was defunct upon dismissal of the case. The District Court also found, reversing the Bankruptcy Court, that cause existed under Section 349(b) to order the proceeds to be distributed to creditors rather than being revested in the Debtor.

The Fifth Circuit reversed the District Court, finding that the Debtor dismissed the case in good faith and was entitled to receive all of the homestead sale proceeds from the Trustee. The Court recognized that a debtor generally has a right to voluntarily dismiss her case under §1307(b) at any time, although the bankruptcy court may deny dismissal for bad-faith conduct or abuse of the bankruptcy process. The Court found that, since the Debtor owned the homestead at the beginning of the case, the proceeds from the homestead should be revested in the Debtor upon dismissal of the case

according to §349(b)(3). The Court also found that a trustee lacks inherent authority to distribute property to creditors upon dismissal since the trustee's authority is limited to the distribution of funds pursuant to the express terms of a plan. Accordingly, §349(b)(3) requires the Trustee to return to the Debtor the proceeds from a postpetition sale of an exempt homestead upon the Debtor's voluntary dismissal of a Chapter 13 case.

Finally, the Court found that there was no basis to reverse the Bankruptcy Court's findings of fact that there was no cause to find a deviation from the §349(b)(3) revesting requirement. The Court found no evidence that the Bankruptcy Court had factually erred since the record showed that Debtor had proposed remitting a sum of the homestead proceeds to help reduce arrearages owed under the plan, had made payments under the plan for at least four years, and had moved to dismiss her case only after the bankruptcy court had clearly stated that Debtor could voluntarily dismiss the case and receive all of the homestead proceeds as an alternative to discharge. Additionally, the record showed that Debtor had stopped making plan payments only after she stopped receiving payments under the wrap-around note. Taken together, the Court found that these considerations undermined the Trustee's argument that the Debtor had acted in bad faith or abused the bankruptcy process.

JUDICIAL ESTOPPEL

Norris v. Causey, 869 F.3d 360 (5th Cir. August 22, 2017).

Issue: Whether a plaintiff's failure to list a breach of contract claim on his bankruptcy schedules can subsequently be raised by a defendant under Rule 60(b) as a basis for relief from a final judgment if the issue was not raised before trial.

Holding: A plaintiff's failure to list a breach of contract claim on his bankruptcy schedules gives rise to a party-in-interest challenge, not a standing challenge, which can be waived if not presented before trial.

Debtor and twin brothers Karry and Garry Causey entered into a joint venture agreement to renovate hurricane damaged properties in New Orleans. The agreement provided that Debtor would supply financing to purchase the properties and conduct the repairs and the Causey brothers would manage the renovation work and accounting for the projects. Debtor borrowed over $90,000 to invest into the project, but the Causey brothers failed to move forward with the renovations, spending the money on personal items instead. The failed investment caused Debtor to file a Chapter 7 bankruptcy in Michigan. Debtor did not list the breach of contract claim against the Causeys in his bankruptcy schedules, although the Trustee's interim reports identified a "potential lawsuit regarding LA property." The Trustee's final report abandoned the claim to the Debtor, which became final in 2012 when the bankruptcy court approved the final report and closed the case.

The Debtor subsequently filed a lawsuit against the Causeys on the breach of contract claim. Karry appeared in the lawsuit and defended against the claim, but Garry failed to appear despite various efforts. The District Court entered judgment against both brothers. After the commencement of the appeal from the District Court, the Michigan Bankruptcy Court reopened Debtor's bankruptcy case because of Debtor's intentional misleading of the court as to his assets, including the undisclosed claim against the Causey brothers. The Causey brothers filed motions in the District Court asking the court to set aside the judgment under Rule 60(b)(4) since Debtor did not have standing to pursue the claim and the Trustee was the real party in interest. The District Court denied the request, finding that the trustee could be substituted as the plaintiff in place of the Debtor to cure the real party-in-interest objection.

The Fifth Circuit agreed that real-party-in-interest challenges are non-jurisdictional and do not entitle a defendant to relief under Rule 60(b)(4) for a judgment entered in favor of a plaintiff who was not the real party-in-interest. An argument that the plaintiff is not the real party in interest is an affirmative defense that must be asserted prior to trial or waived. In support, the Court noted that Rule 17(a)(3) provides that a case may not be dismissed for a failure to prosecute in the name of a real party in interest until, after an objection, a reasonable time has been allowed for the proper party to substitute into the action.

The Court did correct the District Court's finding that the trustee could be substituted as the plaintiff, however. Since the Causey brothers did not raise the real party in interest challenge until after judgment had been entered under Rule 60, the objection to Debtor's interest in pursuing the claim under judicial estoppel had been forfeited.