BANKRUPTCY: 2014–2015

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I. INTRODUCTION

This Survey Article reviews seven selected bankruptcy opinions of the United States Court of Appeals for the Fifth Circuit decided between July 1, 2014, and June 30, 2015. While this Survey includes fewer selections than previous years (explained below), the period contained significant decisions, including reversing the *In re Pro-Snax* material benefit rule on professional fee applications and limiting the affirmative defense of a good faith transferee under 11 U.S.C. § 547(c).

The Survey includes three major decisions. Most importantly for bankruptcy attorneys, an en banc opinion resolved a long-standing circuit split regarding how bankruptcy courts evaluate professionals' fee applications under 11 U.S.C. § 330.[1] A grateful bankruptcy bar was relieved when the Fifth Circuit reversed the *In re Pro-Snax* material benefit test and replaced it with the reasonableness test in *Barron & Newburger P.C. v. Texas Skyline, Ltd. (In re Woerner)*.[2] In the second major case, *Templeton v. O'Cheskey (In re American Housing Foundation)*, the Fifth Circuit made two significant rulings. First, in an issue of first impression for a circuit court, it held that a debtor's affiliates include indirect subsidiaries, provided that the debtor actively controls those subsidiaries.[3] Second, the *In re American Housing Foundation* court ruled that 11 U.S.C. § 510(b) requires bankruptcy courts to subordinate claims based on the debtor's guaranty of equity investments in debtor affiliates.[4] The third major case clarified the extent of a good faith transferee's affirmative defense under 11 U.S.C. § 547(c).[5] The *Williams v. FDIC (In re Positive Health Management)* court held that the defense only protects the transferee for the amount the transferee gave the debtor.[6] The transferee is liable to return any amount beyond that.[7]

Two important cases dealt with federal courts' authority related to bankruptcy court proceedings. In *Jacuzzi v. Pimienta*, the Fifth Circuit held that a federal court always has authority to hear a collateral attack on a bankruptcy court judgment based on the court's lack of jurisdiction.[8] In *Firefighters' Retirement System v. CITCO Group Ltd.*, the Fifth Circuit interpreted 28 U.S.C. § 1334 to mean that a district court may not

1. Barron & Newburger, P.C. v. Tex. Skyline, Ltd. (*In re* Woerner), 783 F.3d 266, 277–78 (5th Cir. Apr. 2015).
2. *Id.*
3. Templeton v. O'Cheskey (*In re* Am. Hous. Found.), 785 F.3d 143, 155–57 (5th Cir. Apr. 2015).
4. *Id.*
5. Williams v. FDIC (*In re* Positive Health Mgmt.), 769 F.3d 899, 904–05 (5th Cir. Oct. 2014).
6. *Id.*
7. *Id.*
8. Jacuzzi v. Pimienta, 762 F.3d 419, 421–22 (5th Cir. Aug. 2014) (per curiam).

permissively abstain from hearing a case that arises under or relates to a Chapter 15 bankruptcy.[9]

Lastly, the survey period included two cases that clarified previous precedents in expected ways. The *Thaw v. Moser (In re Thaw)* court applied the dicta from last year's decision, *In re Odes Ho Kim*, to hold that a non-debtor spouse does not have a Takings Clause claim for loss of his or her homestead rights when a bankruptcy court orders the sale of the homestead if the non-debtor spouse acquired the homestead after the enactment of the Bankruptcy Abuse Prevention and Consumer Protection Act (BAPCPA).[10] The *Cantu v. Schmidt (In re Cantu)* court applied the holding in *In re Swift* to clarify some confusion raised by another Fifth Circuit case, *In re Wheeler*.[11] The *In re Cantu* court held that courts should *not* use the pre-petition-relationship test to determine when a debtor's cause of action accrues.[12] Instead, bankruptcy courts should look to state law pursuant to 11 U.S.C. § 541.[13]

Finally, the Survey includes fewer selections than previous periods because the Supreme Court rendered some opinions moot. In *Galaz v. Galaz (In re Galaz)*, the Fifth Circuit held that, under *Stern v. Marshall*, a bankruptcy court cannot issue a final decision even when the parties expressly or impliedly consent.[14] Shortly thereafter, in a separate case, the Supreme Court ruled that parties can expressly or impliedly consent to the bankruptcy court issuing a final decision.[15] In *Viegelahn v. Harris (In re Harris)*, the Fifth Circuit held that undistributed funds held by a Chapter 13 trustee should be distributed to creditors when the case is converted to Chapter 7.[16] The Supreme Court granted certiorari and unanimously reversed, holding that the undistributed funds should be returned to the debtor.[17] In *Husky International Electronics, Inc. v. Ritz (In re Ritz)*, the Fifth Circuit held that the exception to discharge for actual fraud under 11 U.S.C. § 523(a)(2)(A) requires a false representation, creating a circuit split.[18] The

9. Firefighters' Ret. Sys. v. CITCO Grp. Ltd., 788 F.3d 425, 433 (5th Cir. June 2015), *withdrawn and superceded*, 796 F.3d 520 (5th Cir. Aug. 2015).

10. Thaw v. Moser (*In re* Thaw), 769 F.3d 366, 369–70 (5th Cir. Oct. 2014).

11. Cantu v. Schmidt (*In re* Cantu), 784 F.3d 253, 258–59 (5th Cir. Apr. 2015) (citing Wheeler v. Magdovitz (*In re* Wheeler), 137 F.3d 299 (5th Cir. 1998)).

12. *Id.* at 259.

13. *Id.* at 259–60.

14. Galaz v. Galaz (*In re* Galaz), 765 F.3d 426, 431–32 (5th Cir. Aug. 2014).

15. Wellness Int'l Network, Ltd. v. Sharif, 135 S. Ct. 1932, 1949 (2015).

16. Viegelahn v. Harris (*In re* Harris), 757 F.3d 468, 470–71 (5th Cir. July 2014), *rev'd*, 135 S. Ct. 1829 (2015).

17. *Viegelahn*, 135 S. Ct. at 1835.

18. Husky Int'l Elecs., Inc. v. Ritz (*In re* Ritz), 787 F.3d 312, 316 (5th Cir. May 2015).

Supreme Court granted certiorari and scheduled oral arguments for March 2016.[19]

II. ESTATE PROPERTY: COURTS SHOULD NOT USE THE PRE-PETITION TEST TO DETERMINE WHEN THE DEBTOR'S LEGAL CLAIMS ACCRUE (*IN RE CANTU*)

In *Cantu v. Schmidt (In re Cantu)*, the Fifth Circuit clarified that courts should use the pre-petition-relationship test to determine whether claims *against* the debtor exist, but should not apply the test to determine when a cause of action *of* the debtor accrues.[20] Instead, courts should apply the applicable state law's accrual test.[21]

In May 2008, Marco and Roxanne Cantu, along with their wholly owned entity, filed for Chapter 11 bankruptcy.[22] The Cantus hired Ellen Stone as their attorney.[23] Stone represented the Cantus and the entity for one year and charged the estate $202,915.[24] Stone committed several serious errors during the pendency of the Chapter 11 reorganization, including filing a plan of reorganization that was not confirmable.[25] In December 2008, creditors moved to convert the bankruptcy to a Chapter 7 liquidation.[26] The bankruptcy court granted the motion and appointed a Chapter 7 trustee.[27]

After conversion, the Cantus sued Stone for misconduct including, *inter alia*, legal malpractice and gross negligence stemming from her representation in Texas state court.[28] The case was eventually removed to the bankruptcy court.[29] The trustee intervened, claiming that any recovery related to her misconduct belonged to the estate.[30] Stone settled the suit for $281,711 and placed the settlement in the court registry while the Cantus and the trustee disputed proper ownership.[31]

The legal question was: When did the misconduct causes of action accrue? In Chapter 11, the estate generally includes all property acquired post-petition.[32] But if the case converts to Chapter 7, the debtor retains all

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19. *Supreme Court of the United States Granted & Noted List Cases for Argument in October Term 2015*, SUP. CT. U.S., http://www.supremecourt.gov/grantednotedlist/15grantednotedlist (last updated Jan. 26, 2016).

20. Cantu v. Schmidt (*In re* Cantu), 784 F.3d 253, 259 (5th Cir. Apr. 2015).

21. *Id.* at 259–60.

22. *Id.* at 255.

23. *Id.* at 256.

24. *Id.*

25. *Id.*

26. *Id.*

27. *Id.*

28. *Id.* at 256–57.

29. *Id.* at 257.

30. *Id.*

31. *Id.*

32. *See* 11 U.S.C. § 541(a)(1) (2012).

property acquired after conversion.[33] Thus, if the cause of action accrued pre-conversion, then the trustee owned the claims.[34] If the cause of action accrued post-conversion, then the Cantus owned the claims.[35]

The bankruptcy court analyzed when the misconduct claims arose using two different legal standards: (1) the "accrual" test and (2) the "pre-petition" test.[36] Under both theories, the malpractice action accrued pre-conversion and therefore belonged to the estate.[37] The bankruptcy court granted the trustee's summary judgment motion on those grounds.[38] The Cantus appealed and the district court affirmed.[39] The Cantus appealed to the Fifth Circuit.[40]

The Fifth Circuit affirmed the bankruptcy court's determination but clarified the legal standards involved.[41] Citing *In re Swift*, the panel held that because a cause of action is property, the bankruptcy court should look to state law to determine when it accrues.[42] The panel clarified that the bankruptcy court should not have applied the pre-petition test.[43] Bankruptcy courts apply the pre-petition test to determine if a party has a claim against the estate that can be modified or discharged under the Bankruptcy Code.[44] It is a distinct legal inquiry from when a cause of action accrues.[45]

The bankruptcy court's confusion stemmed from an earlier case, *In re Wheeler*.[46] In *In re Wheeler*, the court applied both the accrual test and the pre-petition test to determine when a cause of action accrued.[47] The panel clarified that the *In re Wheeler* decision's application of the pre-petition test was inappropriate.[48] The panel noted that the pre-petition test specifically addressed the definition of "claim against the debtor" under 11 U.S.C. § 101(5)(A), which is federal law.[49] In contrast, legal claims are property of the estate, which are defined by 11 U.S.C. § 541 and state law.[50] *In re Swift* controlled because (1) *In re Wheeler* did not rely on application of the

33. *See In re Cantu*, 784 F.3d at 257–58.
34. *See id*. at 257.
35. *See id*. at 258.
36. *See id*. at 257.
37. *Id.*
38. *Id.*
39. *Id.*
40. *Id.*
41. *See id*. at 259.
42. *Id.* at 258 (citing State Farm Life Ins. Co. v. Swift (*In re* Swift), 129 F.3d 792, 795 (5th Cir. 1997)).
43. *Id.*
44. *Id.*
45. *Id.*
46. *Id.* (citing Wheeler v. Magdovitz (*In re* Wheeler), 137 F.3d 299, 299 (5th Cir. 1998)).
47. *Id.*
48. *Id.*
49. *Id.* at 259.
50. *Id.*

pre-petition test and (2) *In re Swift* pre-dated *In re Wheeler* and was binding precedent under the Fifth Circuit's rule of orderliness.[51]

The panel next reviewed the bankruptcy court's application of the accrual test. Like most states, under Texas law, the accrual test requires some injury to occur before a lawsuit can begin.[52] The Fifth Circuit determined that Stone's misconduct injured the Chapter 11 estate in a number of ways before conversion, most critically by filing an unconfirmable plan and by charging the estate fees before conversion when she was unqualified to fulfill her duties as debtors' counsel.[53] This wasted time and money and prevented the creditors' chance to garner a greater recovery through a successful plan of reorganization.[54] Moreover, the settlement could be analogized to a rescinded contract.[55] Thus, the misconduct accrued pre-conversion and belonged to the Chapter 11 estate.[56] The panel noted that Stone misrepresented her qualifications when seeking appointment as counsel.[57] By settling the misconduct claims, Stone reimbursed $202,915.06 in attorney's fees, which she obtained under false pretenses.[58] Moreover, the Cantus' original complaint sought fee reimbursement as part of the damages.[59]

In response, the Cantus asserted that Stone *could* have fixed the injuries before conversion, and therefore the misconduct should accrue to them.[60] The panel did not agree. First, the lost attorney's fees could not be remedied absent money payment.[61] Second, under the accrual theory, the injury that triggers the cause of action does not need to be irrevocable.[62]

III. ABSTENTION: DISTRICT COURTS MAY NOT PERMISSIVELY ABSTAIN FROM PROCEEDINGS ARISING UNDER OR RELATED TO CHAPTER 15 CASES (*FIREFIGHTERS' RETIREMENT SYSTEM V. CITCO GROUP LTD.*)

In *Firefighters' Retirement System v. CITCO Group Ltd.*, the Fifth Circuit held that "a district court cannot permissively abstain from exercising jurisdiction in proceedings related to Chapter 15 cases."[63]

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51. *Id.* at 259–60.
52. *Id.* at 260.
53. *Id.* at 261–62.
54. *Id.* at 262.
55. *Id.*
56. *Id.* at 262–63.
57. *Id.* at 262.
58. *Id.*
59. *Id.* at 257.
60. *Id.* at 262.
61. *Id.*
62. *Id.*
63. Firefighters' Ret. Sys. v. CITCO Grp. Ltd., 788 F.3d 425, 433 (5th Cir. June 2015), *withdrawn and superseded*, 796 F.3d 520 (5th Cir. Aug. 2015).

Three Louisiana pension funds invested in a Cayman Islands fund (the Leveraged Fund) that was part of a larger fund (the Master Fund).[64] In June 2012, the Master Fund filed for bankruptcy in New York.[65] The pension funds sued various organizations related to their investments in Louisiana state court.[66]

The defendants removed the case to federal court based on bankruptcy jurisdiction and diversity jurisdiction.[67] In July 2013, the pension funds moved to remand, arguing "the district court lacked subject matter jurisdiction under either bankruptcy or diversity theories."[68] In January 2014, while the district court considered the motions, the Leveraged Fund filed for Chapter 15 (international) bankruptcy in New York.[69] The dispute between the pension funds and the defendants was now related to multiple bankruptcies: the Chapter 11 case (the Master Fund) and the Chapter 15 case (the Leveraged Fund).[70] The defendants notified the court about the change in circumstances.[71] In 2014, over the defendants' objections, the district court remanded the case based on permissive abstention under 28 U.S.C. §§ 1334(c)(1) and 1452(b).[72] The district court did not address the Chapter 15 bankruptcies or diversity jurisdiction.[73]

The defendants appealed and asserted that the district court could not permissively dismiss a diversity case or a case related to a Chapter 15 bankruptcy.[74] The Fifth Circuit affirmed based on the district court's treatment of the Chapter 15 bankruptcy.[75]

First, the Fifth Circuit recognized that a remand order is not generally reviewable per the relevant statutes.[76] Nonetheless, the Supreme Court in *Quackenbush v. Allstate Insurance Co.* recognized an exception to a similar rule in an analogous statute—an appellate court does have authority to review a remand order *if* the district court remanded for reasons not found in the statute.[77] Here, the Fifth Circuit held that the district court failed to consider the entirety of 28 U.S.C. § 1334, and therefore it had authority to review the remand order.[78]

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64. *Firefighters' Ret. Sys*., 796 F.3d at 523.
65. *Id.*
66. *Id.*
67. *Id.*
68. *Id.*
69. *Id.*
70. *Id.*
71. *Id.*
72. *Id*.
73. *Id.* at 523–24.
74. *Id.* at 524.
75. *Id.*
76. *Id.*; *see* 28 U.S.C. §§ 1334(d), 1452(b) (2012).
77. *Firefighters' Ret. Sys.*, 796 F.3d at 525 (citing Quackenbush v. Allstate Ins. Co., 517 U.S. 706, 711–12 (1996)).
78. *Id.*

Second, the Fifth Circuit held that the district court violated the permissive abstention statute. Section 1334(c)(1) states that a court "may permissively abstain from certain bankruptcy cases '[e]xcept with respect to a case under Chapter 15'" of Title 11.[79] Thus, the district court violated the plain terms of the statute by remanding a case related to a Chapter 15 bankruptcy.[80]

The pension funds objected, claiming that the clause "a case under chapter 15" applied to a Chapter 15 bankruptcy case only, and did not apply to proceedings that were "related to" or "arising under" the Chapter 15 bankruptcy.[81] The panel disagreed. Other parts of the same clause referred to "a particular proceeding arising under title 11 or arising in or related to a case under title 11."[82] Thus, when read in context, the term *case* applied to both the primary bankruptcy case and related proceedings.[83] Other bankruptcy courts have held similarly.[84]

Third, the Fifth Circuit considered whether the district court could rely on § 1452 to remand the case. Unlike § 1334, § 1452 does not explicitly prohibit remanding cases related to Chapter 15 bankruptcies.[85] Citing *In re Lazar* and *Erlenbaugh v. United States*, the panel held that § 1452 should be read in conjunction with § 1334 under the doctrine of *in pari materia*.[86] The panel noted that the laws were related because § 1452 expressly references § 1334 to define jurisdiction over bankruptcy cases.[87] Thus, because § 1334 prohibited remanding a Chapter 15 proceeding, so did § 1452.[88]

Finally, the Fifth Circuit addressed the pension funds' argument that removal is judged at the time of removal. The pension funds asserted that, because the parties filed the Chapter 15 bankruptcies after the removal date, the district court correctly ignored them.[89] The panel rejected this argument. It noted that removal and remand were subject to different rules.[90] Critically, the panel judged the district court's remand order at the time of the remand,

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79. *Id.* (alteration in original) (quoting 28 U.S.C. § 1334(c)(1)).

80. *Id.*

81. *See id.* at 526–27 (quoting U.S.C. §§ 1134(d), 1452(b)).

82. *Id.* at 527.

83. *Id.*

84. *See, e.g.*, British Am. Ins. Co. v. Fullerton (*In re* British Am. Ins. Co.), 488 B.R. 205, 238–39 (Bankr. S.D. Fla. 2013) (adopting the latter interpretation); Fairfield Sentry Ltd. v. Amsterdam (*In re* Fairfield Sentry Ltd.), 452 B.R. 64, 83 (Bankr. S.D.N.Y.), *rev'd on other grounds*, 458 B.R. 665 (S.D.N.Y. 2011).

85. *Firefighters' Ret. Sys.*, 796 F.3d at 527.

86. *Id.* (citing Schulman v. California (*In re* Lazar), 237 F.3d 967 (9th Cir. 2001) and Erlenbaugh v. United States, 409 U.S. 239 (1972)).

87. *Id.*

88. *Id.*

89. *Id.* at 528.

90. *Id.*

not the time of removal.[91] Because the Chapter 15 bankruptcies existed at the time of the remand order, the district court should have considered them.[92]

IV. HOMESTEAD RIGHTS: A NON-DEBTOR SPOUSE HAS NO TAKINGS CLAUSE CLAIM WHEN A BANKRUPTCY COURT ORDERS THE SALE OF HER HOMESTEAD IF SHE PURCHASED THE PROPERTY AFTER 2005 (*IN RE THAW*)

In *Thaw v. Moser (In re Thaw)*, the Fifth Circuit held "that the forced sale of the property by operation of § 363 does not constitute a taking of" a non-debtor spouse's homestead interest when the spouse "acquired the property after the enactment of BAPCPA, [because] there is no 'gratuitous confiscation,' and the sale is not 'so unreasonable or onerous as to compel compensation.'"[93]

In October 2009, Stanley and Kernell Thaw purchased a $1.75 million home in an attempt to hide and shield assets from creditors.[94] In December 2011, Stanley, but not Kernell, filed for Chapter 7 bankruptcy.[95] The bankruptcy court ordered a sale of the house under 11 U.S.C. § 363.[96] Applying 11 U.S.C. § 522(o), the bankruptcy court ruled that Stanley's homestead exemption should be reduced to zero due to bad faith actions, which meant the sale could proceed.[97] Kernell objected to the sale, claiming that she had an independent homestead right under Texas law that was not limited by 11 U.S.C. § 522 and that the homestead right prohibited the sale.[98] Alternatively, she claimed that the sale was an unconstitutional taking.[99] The bankruptcy court denied the objection, ruling that Kernell did not have a separate and distinct homestead exemption that would prevent the sale of the homestead.[100] Kernell appealed. The district court affirmed, reasoning that Kernell had no vested property interest in the homestead exemption.[101] Kernell appealed. The Fifth Circuit affirmed for alternate reasons.[102]

First, the Fifth Circuit confirmed that the bankruptcy court had authority to order the sale despite Kernell's homestead right. Citing *Kim v. Dome Entertainment Center (In re Kim)*, the Fifth Circuit noted that a bankruptcy court had authority to order the sale of a debtor's homestead even if the non-debtor spouse had a vested homestead right in the property because

91. *Id.*
92. *Id.*
93. Thaw v. Moser (*In re* Thaw), 769 F.3d 366, 372 (5th Cir. Oct. 2014).
94. *Id.* at 368.
95. *Id.*
96. *Id.*
97. *Id.*
98. *Id.*
99. *Id.*
100. *Id.*
101. *Id.*
102. *Id.*

federal law (i.e., the Bankruptcy Code) superseded state law (i.e., the homestead property right).[103]

Second, the Fifth Circuit held that Kernell did not have a claim under the Takings Clause because she acquired the property after the BAPCPA amendments in 2005.[104] The BAPCPA amendments gave bankruptcy courts authority to sell a homestead over the objections of a non-debtor spouse.[105] Applying Supreme Court case law involving the Tax Code, the Fifth Circuit held in *In re Odes Ho Kim* that "when a federal statute permits a person's property [i.e., homestead rights] to become liable for the debts of another, a Takings Clause objection could not be successfully interposed if the property interest 'came into being after enactment of the provision.'"[106] In *United States v. Rodgers*, the Supreme Court ruled there was no Takings Clause objection when the U.S. government sold a person's homestead under the Tax Code, notwithstanding the spouse's independent homestead rights, provided the person acquired the homestead after Congress passed the particular Tax Code provision.[107] The Fifth Circuit applied the same logic to the Bankruptcy Code and held there were no Takings Clause objections provided that Kernell acquired the homestead after the passage of the particular Bankruptcy Code provision.[108] Because she did acquire the homestead well after 2005, she had no Takings Clause claim.[109]

Kernell objected, claiming that the loss of her homestead right was a "gratuitous confiscation."[110] The panel disagreed. The panel noted that the Bankruptcy Code provided a non-debtor spouse some protections and compensation through 11 U.S.C. § 363(j).[111] This fit within the framework applied in *Rodgers*, in which the Supreme Court noted that the Tax Code includes a provision that requires the proceeds of the sale be distributed with respect to the interests of all parties, including the spouse.[112]

Kernell next claimed that the Supreme Court imposed a new Takings Clause rule that "allows a landowner to assert that a particular exercise of the State's regulatory power is so unreasonable or onerous as to compel compensation."[113] The panel disagreed. Again, the panel noted that 11 U.S.C. § 363(j) provides protections against Kernell suffering "unreasonable or onerous [harm] as to compel compensation."[114] Moreover, Kernell did not

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103. *Id.* at 369.
104. *Id.*
105. *Id.*
106. *Id.* (quoting Odes Ho Kim v. Dome Entm't Ctr. (*In re* Odes Ho Kim), 748 F.3d 647, 657 (5th Cir. 2014)).
107. *Id.* at 370 (citing United States v. Rodgers, 461 U.S. 677 (1983)).
108. *Id.*
109. *Id.*
110. *Id.*
111. *Id.* at 371.
112. *Id.*
113. *Id.* (quoting Palazzolo v. Rhode Island, 533 U.S. 606, 627 (2001)).
114. *Id.*

suffer from the loss of reasonable investment-backed expectations.[115] "Since BAPCPA was in effect before the Thaws purchased the property, and because the Thaws purchased the property after they had knowledge of the judgment against Stanley, Kernell was on constructive notice of how the Bankruptcy Code would operate in the event of Stanley's bankruptcy."[116]

V. GOOD FAITH TRANSFEREE: THE 11 U.S.C. § 548(C) GOOD FAITH DEFENSE IS LIMITED TO THE AMOUNT OF VALUE THE TRANSFEREE GAVE TO THE DEBTOR (*IN RE POSITIVE HEALTH MANAGEMENT*)

In *Williams v. FDIC (In re Positive Health Management)*, the Fifth Circuit held that a good faith transferee only has an affirmative defense under 11 U.S.C. § 548(c) up to the amount of value it gave the debtor.[117] Bankruptcy courts must net the value paid by the transferee against the value received from the debtor, and the transferee must pay the difference.[118]

Positive Health Management operated a pain management clinic out of a building in Garland, Texas.[119] An affiliate owned the Garland building, which was subject to a mortgage to First National Bank.[120] Despite having no obligation to do so, Positive Health Management paid First National Bank $367,681.[121] In March 2008, Positive Health Management stopped paying, and First National Bank foreclosed on the Garland building.[122] Positive Health Management then filed for bankruptcy.[123]

The trustee sued First National Bank to recover the $367,681 as a fraudulent transfer.[124] The bankruptcy court held that the transfers were made "with actual intent to hinder, delay, or defraud" and were recoverable under 11 U.S.C. § 548(a)(1)(A).[125] First National Bank asserted a good faith transferee defense under 11 U.S.C. § 548(c), claiming that it gave value to Positive Health Management in exchange for the money in two ways: (1) by allowing Positive Health Management to continue operations and earn millions in revenue and (2) by not foreclosing on the property and collecting reasonable rent.[126] The bankruptcy court agreed, estimating that First National Bank forewent $253,333 in rent and finding that Positive Health Management had given "reasonably equivalent value" in return for the

115. *Id.*
116. *Id.* at 371–72.
117. Williams v. FDIC (*In re* Positive Health Mgmt.), 769 F.3d 899, 908–09 (5th Cir. Oct. 2014).
118. *Id.*
119. *Id.* at 902.
120. *Id.*
121. *Id.*
122. *Id.*
123. *Id.*
124. *Id.*
125. *Id.*
126. *Id.*

$367,681 in payments.[127] Thus, First National Bank had a complete defense against the fraudulent transfer claim.[128] The district court adopted the bankruptcy court's findings.[129]

After the district court entered the judgment, the trustee moved to amend the ruling, claiming that the finding of $253,333 in rental value was unreliable.[130] The district court referred the case back to the bankruptcy court. The trustee hired an expert to challenge the $253,333 estimation, but the expert did not provide his own valuation.[131] The bankruptcy court found that the trustee failed to offer any evidence about the real rental value of the Garland building and that its initial estimate to be uncontested.[132] The district court adopted the bankruptcy court's determinations.[133] The trustee appealed.[134] The Fifth Circuit reversed in part and remanded.[135]

First, the Fifth Circuit held that the bankruptcy court erred in its value analysis.[136] To establish a defense under 11 U.S.C. § 548(c), the good faith transferee must show that it gave value to the debtor.[137] In *In re Hannover Corp.*, the Fifth Circuit held that when analyzing an affirmative defense under § 548(c), the court measures value by looking "not to 'the transferor's gain,' but rather to the value that the transferee gave up as its side of the bargain."[138] Accordingly, any benefit that Positive Health Management received by maintaining operations was not relevant to the affirmative defense because it did not focus on what First National Bank gave up.[139] However, the bankruptcy court's analysis of foregone rent properly applied the *Hannover* test because it did focus on what First National Bank gave up.[140]

Second, the Fifth Circuit held that the bankruptcy court did not err by estimating rent to be $253,333.[141] The trustee claimed that the bankruptcy court erred by relying on a January 2006 appraisal to estimate rental rates for September 2006 to March 2008.[142] The panel disagreed, holding that it was a factual determination and only reversible for clear error.[143] The panel held

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127. *Id.*
128. *Id.*
129. *Id.* at 903.
130. *Id.*
131. *Id.*
132. *Id.*
133. *Id.*
134. *Id.*
135. *Id.* at 909.
136. *Id.* at 904–05.
137. *Id.* at 903–04.
138. *Id.* at 904 (citing Jimmy Swaggart Ministries v. Hayes (*In re* Hannover Corp.), 310 F.3d 796, 802 (5th Cir. 2002)).
139. *Id.* at 905.
140. *Id.*
141. *Id.*
142. *Id.*
143. *Id.* at 905–06.

that the bankruptcy court did not err by relying on the 2006 appraisal and that to hold otherwise "would present significant practical problems for trial judges who often must make findings of fact based on imperfect evidence."[144]

Finally, the Fifth Circuit considered whether First National Bank had a complete defense against the trustee's recovery or only a partial defense. First National Bank received $367,681 but only gave $253,333, a difference of $114,348.[145] The trustee argued that § 548(c) only provides a defense for the amount given and that the trustee should recover the difference of $114,348.[146] The Fifth Circuit agreed. Citing § 548(a)(1)(B)(i), First National Bank tried to argue that "value" in § 548(c) means "reasonably equivalent value."[147] Because $253,333 was close to $367,681, it was a "reasonably equivalent value" and provided a complete defense to recovery.[148] The panel disagreed for several reasons. First, the term "reasonably equivalent value" does not appear in § 548(c); it appears only when defining constructive fraudulent transfers in a separate provision.[149] Second, while some bankruptcy courts had held that "value" means "reasonably equivalent value," several courts had ruled the opposite.[150] Third, the *Collier* treatise takes the position that the terms are different.[151] Fourth, the Uniform Fraudulent Transfer Act used the phrase "reasonably equivalent value" when defining the analogous defense under state law.[152] Thus, the legislature could have easily drafted the federal statute to cover reasonably equivalent value but did not.[153]

Finally, the panel noted that the language of § 548(c) reads that a good faith transferee "may retain any interest transferred . . . *to the extent* that such transferee . . . gave value to the debtor in exchange for such transfer or obligation."[154] The "to the extent" language limited the affirmative defense to the value given, which required netting the difference.[155]

The panel noted that courts net payments between transferees and debtors in this manner in Ponzi scheme cases.[156] The panel recognized "that not all cases will lend themselves to valuation at a precise dollar amount,"

144. *Id.*
145. *Id.* at 906.
146. *Id.*
147. *Id.*
148. *Id.*
149. *Id.* at 907.
150. *Id.* at 906–07; *see* Leonard v. Coolidge (*In re* Nat'l Audit Def. Network), 367 B.R. 207, 223 (Bankr. D. Nev. 2007); *cf.* Salven v. Munday (*In re* Kemmer), 265 B.R. 224, 234–35 (Bankr. E.D. Cal. 2001) ("noting, in the context of 11 U.S.C. § 550(a), which sets out a trustee's right of recovery from an avoided fraudulent transfer, that 'value' is not necessarily synonymous with either 'reasonably equivalent value' [under section 548(a)(1)(B)] or 'fair market value'" (alteration in original)).
151. *In re Positive Health Mgmt.*, 769 F.3d at 907.
152. *Id.*
153. *Id.*
154. *Id.* at 906 (alteration in original) (quoting 11 U.S.C. § 548(c) (2012)).
155. *Id.* at 907.
156. *Id.* at 908.

which would allow netting, but determined that most cases would allow for it and that netting properly balanced the interests of other creditors against those of the transferee.[157] The Fifth Circuit reversed the district court and rendered judgment in favor of the trustee for $114,348.[158]

VI. JURISDICTION: FEDERAL COURTS HAVE SUBJECT MATTER JURISDICTION TO HEAR COLLATERAL ATTACKS BASED ON LACK OF JURISDICTION AGAINST BANKRUPTCY COURT RULINGS (*JACUZZI V. PIMIENTA*)

In *Jacuzzi v. Pimienta*, the Fifth Circuit held that a district court has federal question subject matter jurisdiction to hear a declaratory judgment collateral attack on whether a bankruptcy court judgment is void for lack of proper service.[159]

The Jacuzzis sued in district court, seeking a declaratory judgment that a bankruptcy court judgment against them was void because they did not receive proper service.[160] The district court dismissed the case, holding that there was no federal subject matter jurisdiction because, under the well-pleaded complaint rule, "a plaintiff cannot bring a declaratory judgment action that merely raises federal issues that would be defenses to an underlying state cause of action."[161] The district court interpreted the Jacuzzis' challenge to the bankruptcy court judgment as an affirmative defense only.[162]

The Fifth Circuit reversed, holding that "*any* judgment may be collaterally attacked if it is void for lack of jurisdiction."[163] The question whether a district court has federal question subject matter jurisdiction is whether the collateral attack involves federal issues.[164] The panel held that the Jacuzzis' claim raised several federal questions (i.e., whether the court complied with federal due process rights, whether a federal court had subject matter jurisdiction, and whether the federal court complied with federal service of process rules).[165] Accordingly, the district court had subject matter jurisdiction based on federal question jurisdiction.[166] The panel noted that the Fourth Circuit agreed in a similar situation.[167]

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157. *Id.* at 909.
158. *Id.*
159. Jacuzzi v. Pimienta, 762 F.3d 419, 421 (5th Cir. Aug. 2014) (per curiam).
160. *Id.* at 420.
161. *Id.*
162. *See id*.
163. *Id.*
164. *Id.* at 421.
165. *Id.*
166. *Id.* at 421–22.
167. *Id.* at 421 (citing Spartan Mills v. Bank of Am. Ill., 112 F.3d 1251, 1255 (4th Cir. 1997)).

VII. PROFESSIONAL FEES: COURTS EVALUATE PROFESSIONAL FEE APPLICATIONS UNDER 11 U.S.C. § 330 BASED ON WHETHER THE SERVICES WERE "REASONABLE AT THE TIME" THEY WERE RENDERED (*IN RE WOERNER*)

In an en banc proceeding in *Barron & Newburger, P.C. v. Texas Skyline, Ltd. (In re Woerner)*, the Fifth Circuit reversed the *In re Pro-Snax* material benefit test to evaluate whether an attorney has earned compensation under 11 U.S.C. § 330 and replaced it with a "reasonable at the time" test.[168]

Barron & Newburger (Barron) represented Clifford Woerner in his Chapter 11 bankruptcy.[169] Between May 2010 and April 2011, Barron filed critical pleadings, negotiated with creditors, and investigated for concealed assets.[170] In April 2011, the bankruptcy court converted the case to Chapter 7 and terminated Barron's services.[171]

Pursuant to 11 U.S.C. § 330, Barron applied in excess of $130,000 in fees.[172] The bankruptcy court applied the material benefit test.[173] Quoting *In re Pro-Snax*, the bankruptcy court held that fee applications "must prove that the service resulted in an 'identifiable, tangible, and material benefit to the bankruptcy estate.'"[174] The bankruptcy court awarded expenses but disallowed most of the requested attorney fees because Barron's efforts did not result in success.[175] Barron appealed and the district court affirmed.[176] Barron appealed again and the Fifth Circuit panel affirmed, holding that *In re Pro-Snax* was binding case law.[177] Barron moved for an en banc rehearing to reverse *In re Pro-Snax*, which the Fifth Circuit granted.[178] The Fifth Circuit reversed *In re Pro-Snax* in part and remanded to the bankruptcy court for further fact findings.[179]

Under Chapter 11, a debtor in possession may retain professionals (i.e., attorneys) with court permission under 11 U.S.C. § 327.[180] After the court approves the retention, the professional must seek compensation in a separate motion.[181] Under § 330(a)(1)(A), the professional may request "reasonable

168. Barron & Newburger, P.C. v. Tex. Skyline, Ltd. (*In re* Woerner), 783 F.3d 266, 277 (5th Cir. Apr. 2015) (en banc).
169. *Id.* at 269.
170. *Id.*
171. *Id.*
172. *Id.* at 270.
173. *Id.* at 271.
174. *Id.* at 270 (quoting Andrews & Kurth L.L.P. v. Family Snacks, Inc. (*In re* Pro-Snax Distribs., Inc.), 157 F.3d 414, 426 (5th Cir. 1998)).
175. *Id.* at 268.
176. *Id.*
177. *Id.* (citing *In re* Woerner, 758 F.3d 693, 702 (5th Cir. July 2014)).
178. *Id.* (citing *In re* Woerner, 771 F.3d 820, 820 (5th Cir. Nov. 2014)).
179. *Id.* at 277–78.
180. *Id.* at 271–72 (citing 11 U.S.C. § 327 (2012)).
181. *Id.* at 272 (citing 11 U.S.C. § 328).

compensation for actual, necessary services rendered."[182] The court may exercise its discretion to award compensation that is less than requested and to "consider the nature, the extent, and the value of" the legal services provided.[183]

In *In re Pro-Snax*, the Fifth Circuit interpreted the provisions in 11 U.S.C. § 330, ruled that the bankruptcy court should evaluate a fee application using a hindsight approach, and adopted the material benefit test.[184] Under the material benefit test, the court determines whether the services "*resulted* in an identifiable, tangible, and material benefit to the bankruptcy estate."[185] Professionals who did not succeed (i.e., unsuccessful litigation) would not be compensated.[186] The *In re Pro-Snax* court rejected the "reasonableness" test of "whether the services were objectively beneficial toward the completion of the case *at the time they were performed*."[187]

The *In re Woerner* court reversed *In re Pro-Snax* on this point and held that bankruptcy courts should apply the prospective reasonable at the time test for several reasons.[188]

First, the text of § 330 requires a prospective approach. Section 330(a)(3)(C) requires the court to determine "whether the services were necessary to the administration of, or beneficial *at the time at which the service was rendered*."[189] Similarly, § 330(a)(4)(A)(ii) prohibits a court from allowing any compensation for efforts that "were not reasonably likely to benefit the debtor's estate."[190] Thus, the statute itself envisioned compensating attorneys "for good gambles—that is, services that were objectively reasonable at the time they were made—even when those gambles do not produce an 'identifiable, tangible, and material benefit.'"[191]

Second, the legislative history demonstrated that Congress intentionally adopted a prospective approach. Prior to drafting the 1994 amendments, § 330 did not include the language "at the time at which the service was rendered."[192] The Senate added the language later, demonstrating that Congress did not intend to impose an actual benefit requirement.[193]

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182. *Id.* (quoting 11 U.S.C § 330(a)(1)(A)).

183. *Id.* (quoting 11 U.S.C. § 330(a)(2)–(3)).

184. *Id.* (citing Andrews & Kurth L.L.P. v. Family Snacks, Inc. (*In re* Pro-Snax Distribs., Inc.), 157 F.3d 414 (5th Cir. 1998)).

185. *Id.* (quoting *In re Pro-Snax Distribs., Inc*., 157 F.3d at 426).

186. *See id*. at 272–73.

187. *Id.* at 273 (quoting *In re Pro-Snax Distribs., Inc.*, 157 F.3d at 426).

188. *Id.* at 276–77. In *In re Pro-Snax Distribs., Inc.*, the Fifth Circuit also held that a professional may not be compensated for work done after the appointment of a Chapter 11 trustee. *In re Pro-Snax Distrib., Inc.*, 157 F.3d at 416. The *In re Woerner* court did not modify that ruling. *In re Woerner*, 783 F.3d at 273.

189. *In re Woerner*, 783 F.3d at 273 (quoting 11 U.S.C. § 330(a)(3)(C) (2012)).

190. *Id.* (quoting 11 U.S.C. § 330(a)(4)(A)(ii)).

191. *Id.* at 274.

192. *Id.* at 275.

193. *Id.*

Third, the *In re Pro-Snax* decision created a significant circuit split.[194] The Second,[195] Third,[196] and Ninth[197] Circuits rejected the material benefit test in favor of a prospective standard.[198] Circuit court decisions that adopted a material benefit test analyzed a pre-1994 version of § 330.[199] The panel decided to end the split.

Accordingly, the Fifth Circuit issued a new reasonable at the time test that was consistent with the other circuits.[200]

> In assessing the likelihood that legal services would benefit the estate, courts adhering to a prospective standard ordinarily consider, among other factors, the probability of success at the time the services were rendered, the reasonable costs of pursuing the action, what services a reasonable lawyer or legal firm would have performed in the same circumstances, whether the attorney's services could have been rendered by the Trustee and his or her staff, and any potential benefits to the estate (rather than to the individual debtor).[201]

Success, while relevant, is no longer dispositive.[202]

Having defined the new reasonable at the time standard, the Fifth Circuit remanded the case to the bankruptcy court to apply the new standard and develop the record for a new determination.[203]

VIII. CLAIM SUBORDINATION: CLAIMS BASED ON THE DEBTOR'S GUARANTY OF EQUITY INVESTMENTS IN THE DEBTOR'S AFFILIATES ARE SUBORDINATED UNDER 11 U.S.C. § 510 (*IN RE AMERICAN HOUSING FOUNDATION*)

In *Templeton v. O'Cheskey (In re American Housing Foundation)*, the Fifth Circuit held that a debtor's affiliates include companies that are the debtor's subsidiaries' subsidiaries if the debtor exercises control over those shell subsidiaries.[204] The Fifth Circuit also held that guarantees of equity investments by the debtor must be subordinated under 11 U.S.C. § 510(b).[205]

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194. *Id*.
195. *In re* Ames Dep't Stores, Inc., 76 F.3d 66, 71 (2d Cir. 1996), *abrogated by* Lamie v. U.S. Trustee, 540 U.S. 526 (2004).
196. *In re* Top Grade Sausage, Inc., 227 F.3d 123, 131–32 (3d Cir. 2000), *abrogated by Lamie*, 540 U.S. 526.
197. Smith v. Edwards & Hale, Ltd. (*In re* Smith), 317 F.3d 918, 926–27 (9th Cir. 2002), *abrogation recognized by In re* Wind N' Wave, 509 F.3d 938 (9th Cir. 2007).
198. *In re Woerner*, 783 F.3d at 275.
199. *Id*.
200. *Id.* at 276.
201. *Id.*
202. *Id.*
203. *Id.* at 277–78.
204. Templeton v. O'Cheskey (*In re* Am. Hous. Found.), 785 F.3d 143, 155–57 (5th Cir. June 2015).
205. *Id.* at 152–57.

The American Housing Foundation (AHF) was a nonprofit enterprise dedicated to developing low-income housing projects.[206] AHF organized a number of limited partnership subsidiaries to raise money to fund certain projects.[207] AHF (or its wholly controlled subsidiary) would serve as the general partner while the investors would be limited partners.[208] Robert Templeton invested $2 million in five of the AHF limited partnerships.[209] As part of the investment, AHF guaranteed Templeton's investment (the Guaranties).[210] Templeton also received significant tax benefits.[211] Finally, one of the limited partnerships made quarterly interest payments to Templeton for over a year.[212]

AHF's founder mismanaged AHF and misappropriated funds from many of its limited partnerships.[213] Moreover, AHF also used another limited partnership, AHF Development, Ltd. (AHFD), as a conduit to transfer funds to finance illegitimate activities.[214] AHFD made the interest payments that Templeton received.[215] When the 2008–2009 financial crisis struck, AHF could not maintain its activities.[216] AHF filed for Chapter 11 bankruptcy in June 2009.[217]

The bankruptcy court quickly appointed a Chapter 11 trustee.[218] In December 2010, the bankruptcy court approved a plan of reorganization (the Plan).[219] Under the Plan, unsecured creditors were designated as Class 17 and received 20%–40% of their claims.[220] Subordinated unsecured creditors were designated as Class 18 creditors and received nothing.[221] In October 2009, Templeton submitted a proof of claim under the Guaranties.[222] Templeton submitted an amended proof of claim alleging breach of fiduciary duty and fraud against AHF related to his investment in the limited partnerships.[223]

The trustee sued to subordinate the Templeton claim on various grounds.[224] The trustee also sued to recover all the interest payments

206. *Id.* at 146.
207. *Id.*
208. *Id.*
209. *Id.* at 147.
210. *Id.*
211. *Id.* at 148.
212. *See id.*
213. *Id.*
214. *Id.*
215. *Id.*
216. *Id.*
217. *Id.*
218. *Id.*
219. *Id.*
220. *Id.* at 149.
221. *Id.*
222. *Id.* at 149–50.
223. *Id.* at 150.
224. *Id.*

Templeton received as both fraudulent transfers under 11 U.S.C. §§ 544 and 548 and voidable preferences under § 547.[225]

After a twenty-five day trial, the bankruptcy court ruled on all three issues.[226] First, it subordinated the Templeton claim from Class 17 (general unsecured claims) to Class 18 (subordinated unsecured claims) under 11 U.S.C. § 510(b).[227] Templeton invested in securities (LP units) of the debtor's affiliate.[228] Accordingly, § 510(b) mandated that the Templeton claim be subordinated.[229] Second, the bankruptcy court denied the fraudulent transfer action to recover interest payments.[230] The bankruptcy court did not rule whether the trustee proved a fraudulent transfer case.[231] Rather, the court held that Templeton had a complete affirmative defense under 11 U.S.C. § 548(c) because "Templeton 'gave value and did so in good faith for his investments.'"[232] Third, the bankruptcy court did award the trustee $157,000 for interest payments that Templeton received ninety days before the bankruptcy.[233]

Both sides appealed to the district court, which affirmed the decision in its entirety. Both sides appealed to the Fifth Circuit. The Fifth Circuit affirmed in part and remanded the remainder for further fact-finding.

A. Subordination

First, the Fifth Circuit addressed whether the bankruptcy court erred in subordinating Templeton's claim to Class 18.[234] The panel affirmed the ruling. Section 510(b) requires that any claim for damages "arising from rescission of a purchase or sale of a security of the debtor or of an affiliate of the debtor . . . shall be subordinated to all claims or interests that are senior to or equal . . . such security."[235] The section is meant to ensure that creditors are paid before equity and that equity holders do not attempt to convert their equity investment into unsecured claims through litigation such as securities litigation.[236]

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225. *Id.*
226. *Id.*
227. *Id.* at 150–51.
228. *Id.* at 151.
229. *Id.*
230. *Id.*
231. *Id.*
232. *Id.* (quoting the bankruptcy court).
233. *Id.*
234. *Id.* at 152. The panel noted that the bankruptcy court suggested in dicta that the Templeton claim could be equitably recharacterized as equity under Texas law and *In re Lothian Oil, Inc. Id.* (citing Grossman v. Lothian Oil Inc. (*In re* Lothian Oil Inc.), 650 F.3d 539, 543 (5th Cir. 2011)). The panel did not reach this issue because the bankruptcy court order only subordinated the claim based on 11 U.S.C. § 510(b). *Id.*
235. *Id.* at 153 (quoting 11 U.S.C. § 510(b) (2012)).
236. *Id.* (citing SeaQuest Diving, LP v. S&J Diving, Inc. (*In re* SeaQuest Diving, LP), 579 F.3d 411, 417 (5th Cir. 2009)).

Here, the panel held that Templeton's claims were for damages that arose from the purchase of securities by AHF's affiliates.[237] Both the Guaranties and Templeton's tort claims related to Templeton's purchase of LP units.[238] Templeton objected on two grounds. First, he claimed that the Guaranties were separate contract rights independent from the equity purchase.[239] The panel rejected this argument.[240] Normally, guaranties represent a recovery for an unpaid debt.[241] In this case, however, the Guaranties were related to an equity investment.[242] The bankruptcy court found that the Guaranties were "intimately intertwined" with the equity investment into the limited partnerships.[243] "Although Templeton is suing for the breach of the guaranties of his LP interests (rather than suing directly for repayment of his equity investments in the LPs), this is exactly the elevation of form over substance that Section 510(b) seeks to avoid—by subordinating claims that functionally seek to 'recover a portion of claimants' equity investment[s].'"[244] Other circuit courts recognized that breach of contract claims could be related to equity investments and then be subordinated.[245]

Second, Templeton claimed that the limited partnerships were not AHF affiliates.[246] The panel rejected this argument and affirmed the bankruptcy court's finding that all the limited partnerships were AHF affiliates.[247] The Plan itself made that determination, which Templeton was bound by and did not object to.[248] Moreover, the Bankruptcy Code's definition of "affiliate" covered the limited partnerships.[249] An affiliate is defined as a "person whose business is operated under a lease or operating agreement by a debtor, or person substantially all of whose property is operated under an operating agreement with the debtor."[250] All the limited partnerships were persons.[251] Moreover, the panel held that LP agreements qualify as operating agreements

237. *Id.*
238. *See id.* at 153–54.
239. *See id.* at 154.
240. *Id.*
241. *Id.* at 150.
242. *Id.* at 154.
243. *Id.*
244. *Id.* (alteration in original) (citing SeaQuest Diving, LP v. S&J Diving, Inc. (*In re* SeaQuest Diving, LP), 579 F.3d 411, 421 (5th Cir. 2009)).
245. *Id.* (citing *In re SeaQuest Diving, LP*, 579 F.3d at 421 (citing Rombro v. Dufrayne (*In re* Med Diversified, Inc.), 461 F.3d 251, 256 (2d Cir. 2006), Baroda Hill Inv., Ltd. v. Telegroup, Inc. (*In re* Telegroup, Inc.), 281 F.3d 133, 141–42 (3d Cir. 2002), Allen v. Geneva Steel Co. (*In re* Geneva Steel Co.), 281 F.3d 1173, 1180–81 (10th Cir. 2002), and Am. Broad. Sys., Inc. v. Nugent (*In re* Betacom of Phx., Inc.), 240 F.3d 823, 831–32 (9th Cir. 2001))).
246. *Id.* at 155.
247. *Id.*
248. *Id.*
249. *Id.*
250. *Id.* (quoting 11 U.S.C. § 101(2)(C) (2012)).
251. *Id.*

under 11 U.S.C. § 101(2).[252] Thus, any limited partnership in which AHF was the general partner (and signed the LP agreement) was clearly an affiliate.[253]

The last remaining question was whether an affiliate included a limited partnership when an AHF *subsidiary* was the general partner.[254] Several bankruptcy courts found that an affiliate did not include a limited partnership when a debtor's non-debtor subsidiary was the general partner, even if the debtor exercised actual control over the limited partner.[255] The Fifth Circuit disagreed with these rulings.[256] No one disputed that AHF actually operated all the limited partnerships, either directly or through subsidiaries.[257] Moreover, even if AHF was not a direct party to the LP agreements, AHF was a de facto party to the LP agreement because it exercised actual control over all the entities.[258] The court stated, "We see no reason why the existence of a shell conduit between a debtor and an entity—which in no way inhibits the debtor's ability to control and operate that entity—should preclude a finding of affiliate status."[259] Citing *Collier*, the panel concluded that "Congress clearly intended that claims arising from the purchase of securities of entities over which the debtor exercised sufficient control—i.e., entities which qualify as affiliates under the Bankruptcy Code—be treated no differently than claims arising from the purchase of securities of the debtor itself."[260] Thus, the panel affirmed the subordination of Templeton's claims under 11 U.S.C. § 510(b).

B. Voidable Preferences

Second, the Fifth Circuit analyzed the bankruptcy court's judgment that Templeton was liable for voidable preferences for $157,500 in interest payments he received from AHFD.[261] Templeton objected on two grounds.

First, Templeton noted that AHFD, not the debtor AHF, transferred the money to him.[262] Therefore, he asserted that the funds were not property of the estate under 11 U.S.C. § 541 and were not recoverable as voidable

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252. *Id.* at 155–56.
253. *Id.* at 156.
254. *Id.* at 156–57.
255. *See id.* at 157 (citing *In re* Wash. Mut., Inc., 462 B.R. 137, 146 (Bankr. D. Del. 2011), *In re* SemCrude, L.P., 436 B.R. 317, 321 (Bankr. D. Del. 2010), *In re* Sporting Club at Ill. Ctr., 132 B.R. 792, 797 (Bankr. N.D. Ga. 1991), and *In re* Maruki USA Co., 97 B.R. 166, 169 (Bankr. S.D.N.Y. 1988)).
256. *Id.*
257. *See id*.
258. *Id.* at 159.
259. *Id.* at 157.
260. *Id.* (citing 4 ALAN N. RESNICK & HENRY J. SOMMER, COLLIER ON BANKRUPTCY ¶ 510.04[04] (16th ed. 2014)).
261. *Id.* at 158.
262. *Id.*

preferences (which only allows recovery of estate property).[263] The panel disagreed. The panel agreed that AHF was not the legal titleholder to the AHFD account.[264] Nonetheless, citing *In re IFS Financial Corp.*, control over the account is decisive and legal title is not relevant when the debtor organization uses the subsidiary's account as a conduit.[265] The bankruptcy court found that AHF utilized the AHFD account as a conduit and that the money contained in the AHFD account properly belonged to AHF.[266] Therefore, the bankruptcy court did not err when holding the money was property of the estate.[267]

Second, Templeton claimed that he received the interest payments in the ordinary course of business and, therefore, had a defense against voidable preference claims under 11 U.S.C. § 547(c)(2).[268] AHFD made interest payments for over a year before AHF filed for bankruptcy.[269] Therefore, all the interest payments paid in the last ninety days were in the ordinary course of business.[270] The panel agreed that the bankruptcy court erred by not considering this defense.[271] The trustee argued that AHF was a Ponzi scheme and any payments from AHF could not be in the ordinary course of business under Fifth Circuit precedent.[272] The panel disagreed, stating that the record showed that AHF was not a true Ponzi scheme.[273] Unlike a traditional Ponzi scheme, AHF had legitimate business interests, and only 9% of its investments were used to pay Ponzi-like returns to others.[274] The panel declined to expand the Ponzi-scheme exception to the ordinary course of business defense to cover the transaction, noting that no other court had done so.[275]

Because the bankruptcy court failed to consider Templeton's potential ordinary course of business defense, the panel remanded the case for further factual determinations.[276]

C. Fraudulent Transfer

Finally, the Fifth Circuit considered the bankruptcy court's finding that Templeton had an affirmative defense against the recovery of fraudulent

263. *Id.*
264. *Id.* at 159.
265. *Id.* at 158–59 (citing Stettner v. Smith (*In re* IFS Fin. Corp.), 669 F.3d 255, 262 (5th Cir. 2012)).
266. *Id.* at 159.
267. *Id.*
268. *Id.* at 160.
269. *Id.*
270. *Id.*
271. *Id.* at 160–62.
272. *Id.* at 160.
273. *Id.* at 161.
274. *Id.*
275. *Id.*
276. *Id.* at 161–62.

transfers under 11 U.S.C. § 548(c).[277] The trustee objected, arguing the bankruptcy court applied the wrong legal standard.[278] The panel agreed with the trustee and remanded for further factual determinations.[279]

The bankruptcy court ruled that Templeton was protected by § 548(c), which provides an affirmative defense if the transferee "gave value to the debtor in exchange for such transfer."[280] The panel held that the bankruptcy court erred in its analysis in two ways. First, the bankruptcy court erred because it did not analyze value from the correct perspective.[281] The bankruptcy court found that Templeton gave value to the limited partnerships, but the proper question was whether Templeton had given value to the debtor (AHF).[282] Here, the record was unclear whether Templeton gave value to AHF in return for the interest payments, and the bankruptcy court made inconsistent findings as to whether Templeton gave AHF value at all.[283]

Separately, the panel found that the bankruptcy court erred when determining that Templeton acted in good faith. The bankruptcy court found that Templeton acted in good faith because his actions did not defraud other AHF creditors.[284] But that is not the test for good faith.[285] Rather, the test for determining good faith is (1) "whether the transferee had information that put it on inquiry notice that the transferor was insolvent or that the transfer might be made with a fraudulent purpose," and if so (2) whether the transferee conducted a "diligent investigation" into the transfer.[286] The bankruptcy court did not determine what information Templeton had at the time or whether he conducted a diligent investigation.[287] Thus, the bankruptcy court erred when finding that Templeton acted in good faith.[288]

Because the bankruptcy court erred in both prongs of the good faith analysis and the record did not contain sufficient facts to determine the correct ruling, the panel remanded for further factual determinations based on the proper legal test.[289]

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277. *Id.* at 162.
278. *Id.*
279. *Id.* at 164.
280. *Id.* at 162.
281. *Id.* at 163.
282. *Id.*
283. *Id.*
284. *Id.* at 164.
285. *Id.*
286. *Id.* (quoting Horton v. O'Chesky (*In re* Am. Hous. Found.), 544 F. App'x 516, 520 (5th Cir. 2013)).
287. *Id.*
288. *Id.*
289. *Id.* at 165.