Bankruptcy Creditor Attorney Panel

Attorney's Fees; Compensation

A bankruptcy court may consider only section 330(a)(3) factors in awarding attorney's fees: *In re Market Center E. Retail Prop., Inc., Market Center E. Retail Prop., Inc. v. Lurie*, 750 F.3d 1239 (10th Cir. 2013).

Before bankruptcy, an attorney agreed to represent the debtor for half the attorney's normal hourly rate and 15% of the recovery to pursue a risky claim against a third party. After bankruptcy, the court authorized the debtor in possession to employ the attorney with fees to be determined by the court under section 330. The attorney spent only 43 hours and produced a settlement with a recovery to the estate of at least $2.25 million more than could have been expected before the commencement of litigation, based on the attorney's creative strategy. Creditors were paid in full, and the debtor received a surplus. The bankruptcy court awarded a fee based on the prepetition agreement, based in part on the big risk the attorney took and the big reward.

Section 330(a)(3) permits the court to award a fee based on (A) the time spent, (B), the rates charged, (C) necessity or benefit, (D) whether the services were performed within a reasonable time, (E) the attorney's skill and experience in bankruptcy, and (F) reasonableness, based on customary compensation. The Tenth Circuit applies the adjusted lodestar approach, which takes into account the factors under section 330(a)(3) and the 12 factors set forth in *Johnson v. Ga. Highway Express, Inc.*, 488 F.2d 714 (5th Cir. 1974), including time and labor, novelty and difficulty, required skill, customary fee, whether the fee is contingent, amount involved, results obtained and awards in similar cases.

The lodestar subsumes four Johnson factors (novelty and complexity, counsel's skill, quality of the representation and results), so the court may make an adjustment based on results only in a rare and exceptional case.

In *Perdue v. Kenny A. ex rel. Winn*, 130 S. Ct. 1662 (2010), the Supreme Court rejected use of the Johnson factors in cases involving fee shifting statutes and limited consideration to the lodestar. The Court of Appeals determines that standards in bankruptcy cases differ from those in feeshifting cases and so does not apply *Perdue*. The bankruptcy courts remain bound by section 330(a)(3) and relevant *Johnson* factors. Further, the bankruptcy courts must consider all the section 330(a) factors and no other factors, other than relevant *Johnson* factors. They may not consider "big risk/big reward" or the attorney's prepetition compensation arrangement. Within those limitations, they have substantial discretion. But the fee here was based on impermissible factors, so the court of appeals reverses and remands for further consideration.

Section 329(b)'s remedy is limited to attorney compensation and does not encompass other transfers: *In re Whitley, Baker v. Cage*, 737 F.3d 981 (5th Cir. 2013).

The debtor filed a chapter 13 petition, which the court dismissed. The court then dismissed the debtor's second chapter 13 petition three months later. The debtor's attorney received an $1,800 fee for the first case and disclosed that he had received $12,000 in the second case. Three months after the court dismissed the second case, the court reopened the case and converted it to chapter 7. Between dismissal and reopening, the debtor was sentenced to life for a criminal conviction and transferred to his attorney real property that was subject to a lien. The attorney did not disclose the real property transfer to the court in a Rule 2016 statement. He later bought the property for $99,000 in cash at the lienor's foreclosure sale. On the trustee's motion, the bankruptcy court ordered return of the cash and real property compensation under section 329, without regard to the amount the attorney had paid to the lienor at the foreclosure sale. Section 329(a) requires an attorney to disclose compensation received in contemplation or in connection with the case. Section 329(b) permits the court to order a return of any compensation "to the extent excessive." To do so, the court must determine the value of the services and, if the court imposes sanctions, must determine and justify the amount of the sanctions. By disregarding the amount the attorney paid to acquire the real property, the court effectively ordered the attorney to pay $99,000 to the estate. To justify such an order, the court had to evaluate the attorney's conduct and state a reason for sanctions and for the amount of the sanctions. The court could not properly make a blanket "return" order without such an analysis.

Bankruptcy court improperly relied on provision for regulating attorney compensation to address claim of excessive compensation by ordering debtor's attorney to return properties to estate outright that debtor previously had owned: *In re Whitley*, 737 F.3d 980 (5th Cir. 2013)

James Whitley, "who was facing serious criminal charges, filed a pro se petition for Chapter 13 bankruptcy to stop the imminent foreclosure on certain of his income producing properties" (according to the district court's opinion). He hired a bankruptcy lawyer Reese Baker, to whom he paid a retainer ($1,800) that Baker did not disclose to the bankruptcy court. The bankruptcy was dismissed without prejudice in March 2009.

After the dismissal, Baker disclosed the $1,800 retainer and requested additional compensation of about $16K. While the fee motion was still pending, Whitley hired Baker to file another Chapter 13 petition in April 2009, and paid him $10,000 for services in the first case, and $274 for the anticipated filing fee in the second case. When Baker later disclosed the $10,000 payment in the second bankruptcy, he did so without stating its purpose.

Meanwhile, in the first bankruptcy, the trustee objected to the motion for additional compensation of about $16,000, and Baker withdrew it in June 2009.

In July 2009, the bankruptcy court dismissed the second bankruptcy with prejudice. Baker moved for fees and costs of about $10,000, to which the trustee again objected.

While the fee motion was pending, two things happened: the prosecution of Whitley ended with a conviction and sentence of life imprisonment, and Whitley transferred to Baker's wholly-owned LLC two properties "as compensation for fees owed to Baker" for the second bankruptcy case. Within days after the transfer, the properties' secured creditors foreclosed and Baker bought them in the ensuing sale for about $99,000. Baker then amended his pending fee motion to request about $22,000; the motion explained (for the first time) the fee nature of the $10,000 he received in connection with the first bankruptcy, but disclosed nothing about the two properties he received, then lost, then bought out of foreclosure.

The trustee again objected, and Baker moved to withdraw the fee motion. The property transactions came to light anyway and, in October 2009, were discussed at a hearing after which the bankruptcy court vacated its dismissal of the second case and converted it into a Chapter 7 case. The Chapter 7 trustee then filed this adversary claim against Baker, claiming that he received avoidable transfers (under 11 U.S.C. §§ 548-50) of money and property, and moved for summary judgment.

The judge ordered Baker to show cause why his compensation "'should not be disgorged to the extent in excess of the reasonable value of ... services pursuant to ... § 329(b).'" After a hearing, the bankruptcy court ordered Baker to disgorge $12,074 plus the two properties, regardless of what he paid to buy them free of Whitley's creditors' liens or what he paid to maintain and improve them later. The district court affirmed.

The Fifth Circuit reversed and remanded. Baker did not appeal "the bankruptcy court's finding that his services were not worth any reasonable value" that justified either of his withdrawn fee motions, or its order that he disgorge the $12,074, but "only the bankruptcy court's order obliging him to return the two properties outright." One problem with the order was that § 329(b) allows a court to recover excess compensation, but "the bankruptcy court ... did not value the property at the time Whitley transferred it to Baker, nor did it value the property at the time it ordered Baker to return it to the estate. Accordingly, the § 329(b) remedy ... was not indexed to the compensation Whitley actually paid to Baker." Also, the remedy took away not just the compensation, but Baker's personal investments in the properties.

An additional issue was the bankruptcy court's alternative reliance on § 329(a) to order disgorgement as a disciplinary sanction for Baker's failure to disclose what Whitley paid or him agreed to pay him. "Although a $98,775 sanction may have been appropriate considering Baker's conduct as adverted to in these proceedings," the record was inadequate because the bankruptcy court "did not address Baker's $98,775 foreclosure purchase in its order, did not value the properties at the time that Whitley transferred

them to Baker, and did not value the properties at the time it ordered Baker to return them to the estate." Thus, it did not properly "assess the extent of the disciplinary sanction it imposed, nor assess that amount in connection with Baker's conduct in the case."

Automatic Stay

Application to Non-debtor: *In re Residential Capital*, LLC, 529 Fed.Appx. 69 (2d Cir. 2013).

The debtor in possession moved for an order that the automatic stay applied to a creditor's action against the debtor's parent and affiliates. The court denied the motion as a matter of law, without factual findings on the proceeding's effect on the estate. The automatic stay applies to "the commencement or continuation … of a judicial … proceeding against the debtor" and to any "act to obtain possession of property from the estate or to exercise control over property of the estate." It therefore normally does not apply to a proceeding against a nondebtor. However, the stay may apply to a proceeding against a nondebtor if the claim asserted in the proceeding will have an immediate adverse economic consequence for the estate. The Court of Appeals therefore remanded to the district court to determine the proceeding's effect.

Trial Subpoena: *In re Kenoyer, Kenoyer v. Cardinale*, 489 B.R. 103 (Bankr. N.D. Cal.
2013).

Automatic stay does not prevent enforcement of trial subpoena against the debtor. The debtor was a co-defendant in state court litigation. Before bankruptcy, the plaintiff served a trial subpoena on him. When the debtor filed his bankruptcy petition, the plaintiff severed him from the state court case but still insisted that he testify. Section 362(a)(1) stays "the commencement or continuation, including the issuance or employment of process … to recover a claim against the debtor …." Enforcement of a trial subpoena against a debtor who has been severed from the action runs the risk of requiring the debtor to employ counsel to represent him to ensure that the testimony does not adversely affect him in a later proceeding, for example, to determine dischargeability. However, where the plaintiff seeks the debtor's testimony to pursue the case against the other defendants and not primarily to build a case against the debtor, the automatic stay does not by its terms apply. A bankruptcy court may enjoin enforcement of a subpoena, but the burden rests on the debtor to seek an injunction, not on the other party to seek stay relief to enforce the subpoena.

Avoiding Powers

Fraudulent Transfers: *In re Northlake Foods, Inc., Crumpton v. Stephens*, 715 F.3d 1251 (11th Cir. 2013).

Subchapter S corporation's dividend is not a fraudulent transfer. The debtor corporation agreed with a shareholder in 1991 that if the shareholder became liable for the corporation's taxes, the corporation would declare a dividend in the amount of the shareholder's resulting tax liability. In 2005, the debtor made a Subchapter S election and in 2006 issued a dividend to the shareholder in the amount of his resulting tax liability. The debtor was insolvent at the time and filed bankruptcy within two years. The trustee may avoid a transfer made while the debtor was insolvent within two years before bankruptcy if the debtor did not receive reasonably equivalent value in exchange. The shareholder's agreement to pay the corporation's taxes provided reasonably equivalent value to the debtor. Therefore, the dividend was not an avoidable transfer.

Preferences

The filing of a lis pendens is not a transfer: *In re Ute Mesa Lot 1, LLC, Ute Mesa Lot 1, LLC v. First-Citizens Bank & Trust Co.*, 736 F.3d 947 (10th Cir. 2013)

The creditor sued the debtor to reform a mortgage on the debtor’s property that mistakenly named the debtor’s principal as the mortgagor. Within 90 days, the debtor filed bankruptcy. It sought to avoid the lis pendens as a preference.

A preference requires a transfer of an interest in property of the debtor. Section 101(54) defines “transfer” as each mode of disposing or of parting with property or an interest in property. Federal law thus defines what constitutes a transfer, but state law defines property and interests in property.

Under applicable state law, a lis pendens provides only notice to the world of the plaintiff’s claimed interest in the property and permits the plaintiff’s ultimate judgment, once obtained, to rank ahead of all intervening interest holders, but grants no interests in the property to the plaintiff. Therefore, the filing of the lis pendens is not a preferential transfer.

A debt is incurred in the ordinary course if the transaction is ordinary, whether or not common: *In re C.W. Mining Co., Rushton v. SMC Electrical Prods., Inc.*, 500 B.R. 635 (10th Cir. B.A.P. 2013).

A coal mining debtor purchased on account a longwall electric system to construct a longwall mining operation, which differed from the continuous mining operation that the debtor had previously conducted, from a supplier who regularly sells such systems. The trustee sought to avoid the debtor’s payment to the supplier as a preference.

Section 547(c)(2) provides an avoidance defense "to the extent that the transfer was in payment of a debt incurred in by the debtor in the ordinary course of business or financial affairs of the debtor and the transferee" and the payment was in the ordinary course. A debt is incurred in the ordinary course if the transaction is an arm's-length, commercial transaction that occurred in the marketplace, rather than, for example, an insider transaction. Whether the debtor has incurred similar debt or debt for a similar purpose is not relevant. "The transaction need not have been common; it need only be ordinary." Therefore, this debt was incurred in the ordinary course of the debtor's business.

Posting loan proceeds to secured letter of credit to secure new contract is not a preference: *In re ESA Enviro. Specialists, Inc., Campbell v. The Hanover Ins. Co.*, 709 F.3d 389 (4th Cir. 2013).

As a government contractor, the debtor needed to post surety bonds to secure its performance obligations. Its surety refused an additional bond the debtor needed for a new contract unless it received collateral for the new bond and for the debtor's contingent obligations under the existing bonds. The debtor obtained a letter of credit in favor of the surety and borrowed cash to cash collateralize the letter of credit. Once the debtor posted the letter of credit, the surety issued the bond and the debtor received the new contract. The debtor filed bankruptcy within 90 days.

The trustee may avoid as a preference a transfer of property of the debtor for or on account of an antecedent debt, made within 90 days before bankruptcy, that enables the creditor to a greater percentage than if the transfer had not been made. However, under the "earmarking doctrine," if the property passes from a new creditor to the transferee creditor, whether or not through the debtor's hands first, the transfer is not a preference. The theory is that the property never became property of the debtor but was used by the new creditor to "buy" the old creditor's claim, although the court said the transfer was not avoidable because it "does not diminish the estate." In this case, the cash went from the new lender, through the debtor, to the surety, but not to satisfy an antecedent debt owing to the surety. Therefore, the earmarking defense does not apply.

Instead, the court looked to the contemporaneous exchange defense (which the court referred to as the "new value" defense). Under section 547(c)(1), the trustee may not avoid a transfer to the extent it was intended to be a contemporaneous exchange for new value given to the debtor and in fact was a substantially contemporaneous exchange. "New value" means "money or money's worth in goods, services, or new credit, or release … of property previously transferred …." The defense applies even where a third party provides the debtor the new value, as long as it offsets the loss in value to the estate resulting from the transfer of property of the debtor.

The debtor received the new government contract, which the court valued as worth at least as much as the transferred property. Therefore, the defense applies. A dissent argued that a contract confers only the right to receive money in the future and therefore should not count as new value, as that term is defined. The majority ruled that the contract is an asset that has inherent value.

Chapter 11 Plans

The absolute priority rule applies in individual chapter 11 cases: *In re Lively*, 717 F.3d 406 (5th Cir. 2013).

A question of first impression in the Fifth Circuit: Whether Chapter 11's absolute priority rule, 11 U.S.C. § 1129(b)(2)(B), as amended by the BAPCPA FN1, applies in such individual debtor cases?

Debtor Philip Lively's Chapter 13 case was converted to Chapter 11 after a creditor filed a claim that caused his scheduled debts to exceed the debt ceiling for Chapter 13 cases. Proceeding in Chapter 11, Lively proposed a reorganization plan that, inter alia, allowed him to retain all of his property, including the net value of a mortgage and net lease income from nine railroad tank cars, while paying unsecured creditors a small dividend that exceeded the liquidation value of his assets. No competing plans were filed; no objections to confirmation were filed by any creditor. Although the unsecured claims class voted overwhelmingly in dollar amount to approve the plan, the majority of that class voted by number of claims to reject it.

The court wrote:

> To answer Lively's question, we use standard tools of statutory interpretation, which focus on the language of the statute taken in the context of the Bankruptcy Code of which it is a part. *RadLAX Gateway Hotel, LLC v. Amalgamated Bank*, --- U.S. ----, 132 S.Ct. 2065, 2070-71, 182 L.Ed.2d 967 (2012). So doing, we are inclined to agree with the bankruptcy court in this case that the "narrow" interpretation is unambiguous and correct, and the exception to the absolute priority rule plainly covers only the individual debtor's post-petition earnings and post-petition acquired property. But even if the statutory language is ambiguous, then the "narrow view" must prevail, because the opposite interpretation leads to a repeal by implication of the absolute priority rule for individual debtors. . . .

Section 1129(a)(3) does not bar confirmation of a plan that contains provisions prohibited by law: *In re Irving Tanning Co., Irving Tanning Co. v. Maine Superint. of Ins.*, 496 B.R. 644 (1st Cir. B.A.P. 2013).

Before bankruptcy, the debtor self-insured its workers compensation liability. Applicable state law required the debtor to post cash, a letter of credit or a surety bond to assure claim payments. The debtor did all three. After bankruptcy, the state agency and the surety drew the letters of credit and with the cash the debtor had posted, created a fund for payment of claims. State law permitted turnover of such a claim fund to the debtor only after all claims had been resolved and paid.

The debtor's plan provided for immediate turnover of the claim fund to the estate to create a workers compensation claims escrow in an amount equal to the amounts of all undisputed claims plus the amount of the bankruptcy court's estimation of disputed claim; state court adjudication of disputed claims, which would be paid in full from the escrow; prompt transfer of the excess of the claim fund over the escrow amount to the estate for distribution to creditors; and an injunction that channeled all workers compensation claims to the escrow.

Section 1123(a)(5) requires a plan to provide adequate means for its implementation, notwithstanding any otherwise applicable bankruptcy law. Section 1129(a)(3) denies confirmation to a plan unless it is "proposed in good faith and not by any means forbidden by law."

Section 1129(a)(3) does not undo section 1123(a)(5)'s preemption authorization. It applies to only the means by which the plan is proposed and does not require that the plan comply with law that another Bankruptcy Code provision preempts. Therefore, section 1129(a)(3) does not prevent confirmation of a plan that relies on section 1123(a)(5) preemption of state law prohibiting an action the plan requires.

However, courts construe section 1123(a)(5) preemption carefully, subject to three limitations. The plan provision must be adequate for the plan's implementation, necessary, and nothing more. A law protecting public health, safety and welfare is not preempted. For both statutory and constitutional reasons, a law defining and protecting property rights is not preempted.

In this case, the turnover of the claims fund was not necessary to a liquidating plan, workers compensation laws protect public health and safety, and turnover would have violated the property rights of the claim fund owners. Therefore, the plan turnover provision did not preempt state law, and the court denied confirmation.

Back-up liquidation provision in a plan does not establish feasibility: *In re Renegade Holdings, Inc.*, 2013 WL 2353940 (Bankr. M.D.N.C. May 29, 2013).

The debtor's plan provided that if it did not make payments that the plan required, it would be liquidated to make distributions to creditors. The debtor's recent operating history suggested that the debtor would not be able to make the payments. Section 1129(a)(11) requires as a condition to confirmation that confirmation "is not likely to be followed by the liquidation or need for further financial reorganization … unless such liquidation or reorganization is proposed in the plan." This section applies only where the plan is a liquidating plan or the proposed liquidation is likely to yield the payments provided for in the plan; a mere "drop dead" provision, without more, is not adequate to meet the section's requirement. Therefore, the court denied confirmation.

Best interest test applies only to creditors with filed claims: *In re Marshall*, 721 F.3d 1032 (9th Cir. 2013)

The individual debtor had suffered a substantial fraud judgment that precipitated the bankruptcy. The creditor did not file a claim by the claims bar date. The debtor proposed a plan that did not provide for any recovery on the fraud claim.

Section 1129(a)(7), the best interest test, requires that a plan provide for a recovery by a creditor that is not less than the amount the creditor would receive in a hypothetical chapter 7 case. Even though the fraud creditor would have had an opportunity to file a proof of claim after the chapter 11 claims bar date if the case converted to chapter 7, the best interest test applies only to actual creditors with allowed claims in the chapter 11 case. If it applied to all creditors who might conceivably file proofs of claim in a converted chapter 7 case but who did not file them in the chapter 11 case, the test would become unmanageable. Therefore, the plan met the best interest test and could be confirmed.

Claims

A silent secured creditor's lien rides through chapter 11 case: *In re S. White Transp., Inc., Acceptance Loan Co., Inc. v. S. White Trans., Inc.*, 725 F.3d 494 (5th Cir. 2013).

The chapter 11 debtor scheduled the secured creditor's claim and lien as disputed and gave the creditor notice of the case filing and plan confirmation. The plan provided that the lien was discharged. The creditor did not file a proof of claim, appear in the case or object to confirmation.

Section 1141(c) provides that after confirmation, "the property dealt with by the plan is free and clear of all claims and interests of creditors." The courts have conditioned this section's application on the lien holder's participation in the case, on the ground, based in part on section 506(d), that a secured creditor who is satisfied to rely on the collateral

alone may ignore the bankruptcy case and preserve the lien securing the claim. Participation means active participation. Receipt of notice does not constitute participation, such as appearing or filing a claim or objecting. Here, the secured creditor took no action at all. Therefore, section 1141(c) did not affect this lien, which was preserved.

Section 502(d) disallowance applies to a purchased claim: *In re KB Toys, Inc.*, 736 F.3d 247 (3d Cir. 2013).

A trade creditor sold its claim. The debtor's statement of affairs listed the trade creditor as having received a preference. The trustee objected to the claim under section 502(d) on the ground that the creditor had received a preference and had not returned it. Section 502(d) requires the court to disallow "any claim of any entity from which property is recoverable" under the avoiding powers unless "such entity has paid the amount … for which such entity or transferee is liable." By its terms, the statute focuses on the claim, not the claimant, and requires disallowance no matter who holds the claim. That result is consistent with the bankruptcy policies of equal treatment, augmenting the estate and ensuring compliance with bankruptcy court orders and prevents the creditor from "washing" the claim through a sale. The purchaser is a volunteer in the bankruptcy process who can mitigate this risk through the purchase terms and therefore deserves no special protection.

Bankruptcy court may recharacterize a claim as an equity interest: *In re Fitness Holdings Int'l, Inc., Official Committee of Unsecured Creditors v. Hancock Park Capital II, L.P.*, 714 F.3d 1141 (9th Cir. 2013).

The debtor's shareholders made a series of loans to the debtor, which the debtor repaid while insolvent within two years before bankruptcy. The trustee sought to recharacterize the loans as equity investments in the debtor and then to avoid the repayment as a fraudulent transfer. The trustee may avoid a transfer that the debtor made while insolvent within two years before bankruptcy if the debtor did not receive reasonably equivalent value. "Value" includes satisfaction of an antecedent debt, although it does not include a return of an equity investment. A debt is a liability on a claim. A claim is a right to payment. Applicable nonbankruptcy law determines whether there is a right to payment or only an equity investment. Therefore, the court must examine the transaction and apply nonbankruptcy law to determine whether the shareholders' loans gave rise to a right to payment, that is, whether to recharacterize what purported to be loans as equity investments. Recharacterization, which determines a loan's character, thus differs from equitable subordination, which determines whether an acknowledged loan or other claim should be subordinated to other claims.

Bankruptcy Code preempts state law anti-deficiency statute: *In re Rader, Pierce v. Carson*, 488 B.R. 406 (9th Cir. B.A.P. 2013).

The secured creditor filed a proof of claim that bifurcated the claim into secured and unsecured portions and then stipulated with the trustee for stay relief to permit foreclosure. At the foreclosure sale, the creditor bid the amount of the secured claim. The debtor received a discharge about 30 days later. Later, the trustee objected to the creditor's unsecured claim on the basis of a state statute that bars a post-foreclosure deficiency claim against a debtor if the creditor does not commence an action for the deficiency against the person liable on the claim within 90 days after the foreclosure. Federal law preempts state law when the federal law so thoroughly occupies a field as to imply that Congress left no room for state legislation in the field (field preemption) or when the state law poses an obstacle to the accomplishment of the federal law's purposes (conflict preemption). Here, requiring the creditor to proceed in state court would be inconsistent with the Congressional purpose that claims in a bankruptcy case be addressed in the case in the bankruptcy court. In addition, the automatic stay that was in effect at the time of the foreclosure and the discharge injunction that took effect later prevented the creditor from complying with the state law, creating a conflict between state and federal law. Therefore, the Bankruptcy Code preempts the state law, so the court allows the creditor's unsecured deficiency claim without the creditor's compliance with the state law anti-deficiency statute's procedure.

Court subordinates LLC interest buy-back claim: *In re Tristar Esperanza Props., LLC, O'Donnell v. Tristar Esperanza Props., LLC*, 488 B.R. 394 (9th Cir. B.A.P. 2013).

The LLC member withdrew from the LLC under the LLC's operating agreement, which entitled her to payment of the appraised amount of her interest. After the LLC refused to pay, she obtained a judgment against the LLC for the amount owed. The LLC then filed bankruptcy. Section 510(b) subordinates a claim "for damages arising from the purchase or sale of" a security of the debtor. The non-limiting definition of "security" includes equity interests similar to LLC interests, so an LLC interest is a security. Section 510(b) does not contain any limitation on the nature of "damages" to which it applies; the term includes loss from breach of contract as well as from fraud or another tort. Similarly, courts construe "purchase or sale" in section 510(b) broadly to encompass 9 the underlying principle that an equity investor takes the risks and rewards of an enterprise and should not be able to elevate an equity interest to a priority that competes with creditors who have only fixed claims. Here, the investor's claim was for purchase of her interests and so comes within section 510(b)'s mandatory subordination rule.

Contempt sanctions for postpetition environmental violations are entitled to administrative expense priority: *Munce's Superior Petroleum Prods., Inc. v. N.H. Dept. of Enviro. Servs.*, 736 F.3d 567 (1st Cir. 2013).

Before bankruptcy, the state obtained a state court injunction requiring the debtor to bring facilities into compliance with environmental laws. The state brought a contempt motion in the state court, claiming the debtor had not complied with the injunction. While the contempt motion was pending, the debtor filed a chapter 11 case and continued operations. The state court stayed proceedings, but the bankruptcy court ruled that the automatic stay did not apply. The state court then issued a contempt citation and imposed a daily fine pending compliance. The debtor in possession did not comply, and the state requested assessment of the penalties, which the state court granted. Section 503(b) grants administrative expense priority to the actual and necessary costs and expenses of preserving the estate. Reading Co. v. Brown, 391 U.S. 471 (1968), granted administrative expense priority to a tort claim resulting from the estate's business operation. Here, although state court issued the initial compliance order before bankruptcy, it imposed contempt sanctions for postpetition noncompliance. Therefore, the sanctions qualified as an administrative expense, whether compensatory or punitive, as long as they were incurred in the postpetition business operation.

Commencement of Case

Involuntary: *In re Green Hills Development Co., L.L.C.*, 741 F.3d 651 (5th Cir. 2014)

Green Hills Development Company, L.L.C. ("Green Hills") entered into a construction loan agreement with Credit Union Liquidity Services, L.L.C. ("CULS") as part of a plan to develop approximately 403 acres of land in Brandon, Mississippi (the property). Under that agreement, Green Hills executed a promissory note (the Note) for $14.5 million as well as a related security agreement and Deed of Trust on the property. At closing, CULS dispersed $8,250,000 to enable Green Hills to acquire the property and reserved $5,500,000 for construction advances. Separately, in order to provide additional funding for the development, Green Hills also formed the Stonebridge Public Improvement District (the "PID") pursuant to Mississippi law. The PID entered into a trust indenture, with the Bank of the Ozarks as trustee, through which the PID issued bonds, using the proceeds to improve the property.

Green Hills requested and received from CULS six disbursements from the construction reserve totaling $4,455,566.92. Request for a seventh draw was made, but CULS did not provide the funds. Green Hills made some of the payments required under the Note, ultimately repaying approximately $5,921,930.36 of the loan's principal, although its payments were not always timely. Toward the end of 2008, the relationship between Green Hills and CULS soured, and Green Hills did not repay the outstanding balance of

$8,074,348.57 when the Note matured on November 3, 2008. Green Hills also fell behind in its bond obligations to the PID.

Green Hills filed suit against CULS in Texas state court (the Texas Litigation), seeking damages estimated to exceed $20 million, an injunction preventing CULS from collecting its debt under the Note, and other relief. Green Hills asserted a wide variety of claims and theories to invalidate the loan agreement and offset its debt, including fraud, promissory estoppel, breach of contract, breach of fiduciary duty, equitable estoppel, unconscionability, duress, reformation, equitable subordination, and various statutory claims. CULS answered and filed a counterclaim for $8,315,065.09, the amount it claimed was then owed under the loan agreement. CULS also filed a motion for summary judgment on all of Green Hills's claims and its own counterclaims. The state court held a hearing on that motion, among others, at which it partially granted and partially denied summary judgment in favor of CULS. The Texas court did not issue a written order, but the record includes a pro-posed order that CULS prepared and filed with the Texas court after the hearing. That proposed order would have granted summary judgment to CULS only on Green Hills's claims under the Texas Deceptive Trade Practices Act.

CULS filed a petition for involuntary bankruptcy against Green Hills in the Bankruptcy Court for the Southern District of Mississippi. Green Hills filed a motion to dismiss the petition, arguing that involuntary bankruptcy was an improper vehicle to resolve what was essentially a two-party dispute and that CULS lacked standing because its claim against Green Hills was subject to a bona fide dispute as to liability or amount.

The court held that CULS had failed to offer sufficient evidence that Green Hills was generally not paying its debts as they came due, and that, pursuant to § 303(h)(1), relief was not appropriate. The bankruptcy court held in the alternative that relief under § 303(h)(1) was improper because Green Hills's debt to CULS was subject to a bona fide dispute. The court reached this conclusion despite holding that CULS's claim was not subject to a bona fide dispute for the purposes of standing to file the petition under § 303(b).

Under § 303(b), an involuntary petition may be brought only by the "holder of a claim ... that is not ... the subject of a bona fide dispute as to liability or amount." In *Subway Equipment Leasing Corp. v. Sims (In re Sims*), the Fifth Circuit had stated that, in considering whether a claim is subject to a bona fide dispute, "the bankruptcy court must determine whether there is an objective basis for either a factual or a legal dispute...." Under this objective standard, the petitioning creditor has the burden to establish a prima facie case that no bona fide dispute exists, after which the debtor must present evidence sufficient to rebut the prima facie case.

The court ruled that CULS's claim was subject to a bona fide dispute and affirmed the dismissal of the petition on the ground that CULS lacked standing under § 303(b).

Discharge

The debtor's publication of a notice in a newspaper of national circulation satisfied Due Process requirements for discharge: *In re Placid Oil Co.*, 753 F.3d 151, 154-158 (5th Cir. 2014).

Mr. Williams and his children (“Williamses”) brought tort claims against Placid Oil Company (“Placid”) in connection with the allegedly asbestos-related illness and death of his wife. Placid, a Texas company, owned and operated a large natural gas production and processing facility near Black Lake, Louisiana. The company filed for bankruptcy in 1986. The bankruptcy court set January 31, 1987, as the bar date by which potential creditors were required to file claims. On three occasions in January 1987, Placid published a Notice of Bar Date in the Wall Street Journal, a newspaper of national circulation available in Louisiana. The notice informed creditors of the existence of the bankruptcy case, their opportunity to file proofs of claim, relevant deadlines, consequences of not filing a proof of claim, and how proofs of claim should be filed. On September 30, 1988, Placid confirmed its Fourth Amended Plan of Reorganization (“Plan”). The court order provided that all claims against Placid that arose on or before this confirmation date were forever discharged except for Placid's obligations under the Plan, which did not address potential future asbestos liability.

Mr. Williams worked at the Black Lake facility from 1966 to 1995. For the purposes of this proceeding, the parties agreed that Mr. Williams was occupationally exposed to insulation containing asbestos, that Mrs. Williams was exposed to asbestos dust and fibers when laundering Mr. Williams's clothing, and that the insulation was in Placid's care, custody, and control prior to the sale of the facility in 1988. In 2003, Mrs. Williams's health suddenly deteriorated. She was diagnosed with the asbestos-related lung cancer mes-othelioma and passed away on August 9, 2003. In March 2004, in Louisiana state court, the Williamses brought a tort action against Placid, alleging that its negligence caused Mrs. Williams's death and attendant damages. In November 2008, Placid filed a motion to reopen its bankruptcy case, and in September 2009, Placid filed a complaint asking the bankruptcy court to determine whether the Williamses' claims were discharged.

Prior to the Plan's confirmation, no asbestos-related claims had ever been filed against Placid, and the Williamses did not file any proof of claim. After confirmation, other plaintiffs commenced asbestos-related suits against Placid, but Placid has neither been found liable in nor settled any such case.

The bankruptcy court granted Placid's motion for summary judgment and denied the Williamses' cross-motion. The court found that the Williamses had pre-confirmation claims and that the claims were discharged by Placid's constructive notice.

The court explained:

> The level of notice required by the Due Process Clause depends on whether a creditor is "known" or "unknown." A debtor must provide actual notice to all "known creditors" in order to discharge their claims. *City of New York v. New York, N.H. & H.R. Co.*, 344 U.S. 293, 295–97, 73 S.Ct. 299, 97 L.Ed. 333 (1953). Known creditors include both claimants actually known to the debtor and those whose identities are "reasonably ascertainable." *Tulsa Prof'l Collection Servs., Inc. v. Pope*, 485 U.S. 478, 489–490, 108 S.Ct. 1340, 99 L.Ed.2d 565 (1988). A claimant is "reasonably ascertainable" if he can be discovered through "reasonably diligent efforts." *Id.* at 490, 108 S.Ct. 1340 (citation omitted). "[I]n order for a claim to be reasonably ascertainable, the debtor must have in his possession, at the very least, some specific information that reasonably suggests both the claim for which the debtor may be liable and the entity to whom he would be liable." *In re Crystal Oil*, 158 F.3d 291, 297 (5th Cir.1998).FN2 By contrast, the debtor need only provide "unknown creditors" with constructive notice by publication. *Id.* at 295, 298. Publication in a national newspaper such as the Wall Street Journal is sufficient. *Id* at 295, 297–98.
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> Here, we clarify this Circuit's understanding of the rule of *Crystal Oil*. At one extreme, the law does not require that a creditor serve upon the debtor a formal complaint in order to make himself "reasonably ascertainable" or "known." However, at a minimum, the debtor must possess "specific information" about a manifested injury, to make the claim more than merely foreseeable.
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> Applying the above principles, we hold that the bankruptcy court did not err in finding that the Williamses were unknown creditors under the undisputed facts presented here. Although Placid knew of the dangers of asbestos and Mr. Williams's exposure, such information suggesting only a risk to the Williamses does not make the Williamses known creditors. Here, Placid had no specific knowledge of any actual injury to the Williamses prior to its bankruptcy plan's confirmation.
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> We hold that because a bar date notice need not inform unknown claimants of the nature of their potential claims, Placid's notices were substantively sufficient to satisfy due process. Placid's notice informed

> claimants of the existence of the bankruptcy case, the opportunity to file proofs of claim, relevant deadlines, consequences of not filing a proof of claim, and how proofs of claim should be filed.FN8 We decline to articulate a new rule that would require more specific notice for unknown, potential asbestos claimants.

Exemptions

Homestead exemption can be lost post-petition: *In re Frost*, 744 F.3d 384 (5th Cir. 2014).

Under Texas law, a debtor's homestead is permanently exempted from the bankruptcy estate, whereas proceeds from the sale of a homestead are only exempted for six months. When Frost filed his bankruptcy petition, his homestead in Cibolo, Texas, was exempted from the bankruptcy estate under Texas Property Code section 41.001(a). Subsequently, he sold the property and used some of the funds for non-bankruptcy expenses. Under Texas law, property owners who sell their homesteads must reinvest the proceeds in another homestead within six months. The Bankruptcy Court determined that, because Frost did not reinvest the proceeds in a new homestead, he had recharacterized the proceeds as nonexempt property; accordingly, the Bankruptcy Court ordered that the proceeds be distributed in part to Frost's creditors and that a small amount of the remaining funds, approximately $18,000, be held in trust for Frost's future use to purchase a new homestead.

Compare: **Louisiana Revised Statutes 20:1. Declaration of homestead; exemption from seizure and sale; debts excluded from exemption; waiver; certain proceeds from property insurance exempted**

> A.(1) The bona fide homestead consists of a residence occupied by the owner and the land on which the residence is located, including any building and appurtenances located thereon, and any contiguous tracts up to a total of five acres if the residence is within a municipality, or up to a total of two hundred acres of land if the residence is not located in a municipality.
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> (2) The homestead is exempt from seizure and sale under any writ, mandate, or process whatsoever, except as provided by Subsections C and D of this Section. This exemption extends to thirty-five thousand dollars in value of the homestead, except in the case of obligations arising directly as a result of a catastrophic or terminal illness or injury, in which case the exemption shall apply to the full value of the homestead based upon its value one year before such seizure. This homestead exemption from seizure and sale shall extend automatically to the proceeds from any property insurance policy received as a result of damage caused by a gubernatorially declared disaster to a homestead and that are held

separately in an escrow account identified as insurance proceeds paid from the damage of a homestead for its repair or replacement.

(3) For the purposes of this Section, "catastrophic or terminal illness or injury" shall mean an illness or injury which creates uninsured obligations to health care providers of more than ten thousand dollars and which are greater than fifty percent of the annual adjusted gross income of the debtor, as established by an average of federal income tax returns for the three preceding years.

B. The exemption provided in Subsection A shall extend to the surviving spouse or minor children of a deceased owner and shall apply when the homestead is occupied as such and title to it is in either the husband or wife but not to more than one homestead owned by the husband or the wife. The exemption shall continue to apply to a homestead otherwise eligible while owned in indivision by the spouses, and occupied by either of them, when the community property regime of which the homestead is a part is dissolved by judgment which so provides, pursuant to R.S. 9:381 et seq., or Article 159 or 2375 of the Louisiana Civil Code. If either spouse becomes the sole owner and continues to occupy the homestead as such, the exemption as to that spouse shall be deemed to have continued uninterrupted.

C. This exemption shall not apply to any of the following debts:

(1) For the purchase price of property or any part of such purchase price.

(2) For labor, money, and material furnished for building, repairing, or improving the homestead.

(3) For liabilities incurred by any public officer, or fiduciary, or any attorney at law, for money collected or received on deposits.

(4) For taxes or assessments.

(5) For rent which bears a privilege upon said property.

(6) For the amount which may be due a homestead or building and loan association for a loan made by it on the security of the property; provided, that if at the time of making such loan the borrower be married, and not separated from bed and board from the other spouse, the latter shall have consented thereto.

(7) For the amount which may be due for money advanced on the security of a mortgage on said property; provided, that if at the time of granting such mortgage the mortgagor be married, and not separated from bed and board from the other spouse, the latter shall have consented thereto.

(8) For any obligation arising from the conviction of a felony or misdemeanor which has the possibility of imprisonment of at least six months.

D. The right to sell voluntarily any property that is exempt as a homestead shall be preserved, but no sale shall destroy or impair any rights of creditors thereon. Any person entitled to a homestead may waive same, in whole or in part, by signing a written waiver thereof; a copy of such waiver shall be provided to the homeowner; however, if the person is married, and not separated from bed and board from the other spouse, then the waiver shall not be effective unless signed by the latter, and all such waivers shall be recorded in the mortgage records of the parish where the homestead is situated. However, if the homestead is the separate property of one of the spouses, the homestead exemption may be waived by that spouse alone in any mortgage granted on the homestead, without the necessity of obtaining a waiver from the non-owning spouse. The waiver may be either general or special and shall have effect from the time of recording. The waiver shall not be required or permitted for the rendering of medical treatment, medical services, or hospitalization. Notwithstanding any other provision of law to the contrary, a waiver of exemption from seizure as to an exempted homestead shall automatically include insurance for that property to the extent subject to the creditor's mortgage or security interest.

Jurisdiction

A bankruptcy judge may not constitutionally determine non-core proceeding even with litigants' consent: *In re BP RE, L.P., BP RE, L.P. v. RML Waxahachie Dodge, L.L.C.*, 735 F.3d 279 (5th Cir. 2013).

The debtor in possession sued a defendant in the bankruptcy court on state law non-core contract and tort claims, consenting to the bankruptcy court's issuing final judgment. After unsuccessfully attempting to withdraw the consent and then losing the litigation in the bankruptcy court, the debtor in possession appealed, arguing that the bankruptcy court lacked constitutional authority to issue final judgment. Article III vests judicial power in judges whose tenure is during good behavior and whose salaries may not be reduced. Article III protects litigants' personal interests in an independent judiciary but also, importantly, protects structural interests in the separation of powers. Bankruptcy judges are not Article III judges. Therefore, even though section 157(c)(2)

permits a litigant to consent to a bankruptcy judge's issuing a final judgment in a non-core proceeding, Article III's structural protections prevent the court from constitutionally permitting it. However, because section 157(c)(2) expressly permits a bankruptcy judge to issue proposed findings and conclusions in a non-core proceeding.

Bankruptcy courts cannot enter final judgments in one type of core proceeding--state-law counterclaims that are not necessarily resolved in the claims-allowance process: *In re Frazin*, 732 F.3d 313, 319-20, 324 (5th Cir. 2013).

Timothy Frazin appealed the judgment of the district court affirming the final judgment entered by the bankruptcy court on certain state-law counterclaims that Frazin filed against the Appellees, attorneys who were authorized by the bankruptcy court to represent Frazin in a separate lawsuit. Frazin argued that the bankruptcy court lacked the authority to enter a final judgment on these claims in light of the Supreme Court's decision in *Stern v. Marsha*ll, ––– U.S. ––––, 131 S.Ct. 2594, 180 L.Ed.2d 475 (2011). The court wrote:

> The final issue we need to decide is whether the claims brought by Frazin fall within the scope of the *Stern* opinion. Despite the narrowing language at the end of the Court's opinion, *Stern* clearly grounded its reasoning in principles that are broad in scope. The Court's concern for separation of powers and the independence of the judiciary is equally as sharp with respect to the state-law counterclaims brought by Frazin as it was with the counterclaim brought by Vickie in *Stern*. Based on the reasoning in the opinion, we see no basis for treating Frazin's state-law counterclaims for malpractice, breach of fiduciary duty, and violations of the DTPA any differently than the Court treated Vickie's counterclaim for tortious interference with a gift. Thus, we must apply the test from Stern to determine whether any of these counterclaims would necessarily have been resolved in the claims-allowance process.
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> We conclude that the bankruptcy court was within its authority to enter a final judgment on Frazin's state-law counterclaims for malpractice and breach of fiduciary duty, as these claims were necessarily re-solved in the course of ruling on the Attorneys' fee applications. We also agree with the bankruptcy court that these claims fail on their merits. Most of all, we uphold the final judgment on the fee applications. However, we hold that the bankruptcy court erred in entering a final judgment on Frazin's DTPA state-law counterclaim because it was not necessary to resolve it in the course of ruling on the Attorneys' fee applications.

The court held that the bankruptcy court lacked jurisdiction over Frazin's state-law counterclaim under the Texas Deceptive Trade Practices Act.

Bankruptcy Rule 8002(a) is jurisdictional: *Smith v. Gartley*, (5th Cir. 13-50154 2013)(*per curiam*).

If an appeal is not taken within the time limit set forth in the rule, the court will lack jurisdiction over the appeal.

Property of the Estate

A right to appeal a judgment defensively is property of the estate: *In re Croft, Croft v. Lowry*, 737 F.3d 372 (5th Cir. 2013).

A creditor obtained a sanctions judgment against the debtor before bankruptcy. The debtor appealed and later filed bankruptcy. The trustee proposed to sell the debtor's right to appeal as property of the estate. Section 541(a) looks first to state law to determine what is property, then to federal law to determine if it is property of the estate. State law here defines property as every species of valuable right and interest. The right to request a higher court to review a lower court's judgment and reduce claims against the debtor and its property is a valuable right that could be used to reduce a claim against the estate. Therefore, it is property of the estate that the trustee may sell.

Property of the estate includes payments for postpetition violation of a prepetition employment contract: *Longaker v. Boston Scientific Corp.*, 715 F.3d 658 (8th Cir. 2013).

The debtor entered into a three-year employment contract, which guaranteed his compensation for the entire period. One year later, he filed bankruptcy. The next day, his employer terminated his employment. He sued to recover the remaining two years' compensation.

Property of the estate includes all interests of the debtor in property as of the commencement of the case, including a contingent interest under a prepetition contract. However, it does not include earnings for services that the debtor actually performs postpetition.

Here, the debtor did not perform any postpetition services; rather, his right to compensation existed as of the commencement of the case, independent of whether he performed services. Rather, the claim against the employer vests in the estate, which has the sole standing to assert it. A dissent argues that the employer prevented the debtor from performing the services, thereby injuring the debtor and giving him standing to assert the claim.

Provisional credit funds on an uncollected check are property of the debtor: *In re Dayton Title Agency, Inc., The White Families Cos. v. Slone*, 724 F.3d 675 (6th Cir. 2013).

The debtor title company received a check for its client trust account from a fraudulent borrower to pay a loan. The debtor deposited the check with its bank, which issued a provisional credit to the debtor. The debtor issued payment to the lender based on the provisional credit. The check bounced, and the bank charged back the debtor's trust bank account. The chargeback depleted all the debtor's funds, rendering it insolvent, and resulting in its bankruptcy. The trust account had other funds at the time of the chargeback, which remained at the time of bankruptcy.

The funds included other clients' trust funds and fees owed to the debtor. The estate sued the lender to recover the entire payment as a fraudulent transfer. The estate may avoid and recover a transfer of property of the debtor made without receiving reasonably equivalent value in exchange if the transfer left the debtor with unreasonably small capital. The transfer here clearly left the debtor with unreasonably small capital, and the debtor did not receive reasonably equivalent value by payment of the lender's claim, because only the borrower, not the debtor, had an obligation to the lender. The trust account portion representing fees owed to the debtor was property of the debtor, and the other clients' trust funds were held in trust and not property of the debtor.

A trust is created upon an express declaration of trust and conveyance of and vesting of title to property in the trustee. Because the check bounced, the borrower never conveyed property to the debtor, and the bank did not intend to create a trust. So the debtor did not hold the provisional credit funds in trust. Under U.C.C. § 4-210, the bank has a security interest in the check (an item) and its proceeds. The check self-liquidated upon collection of the check.

Proceeds includes whatever is acquired upon sale or other disposition of collateral. The bank's provisional credit to the debtor was not proceeds of the check. Therefore, the bank did not have a security interest in the provisional credit funds in the trust account, and the funds were unencumbered property of the debtor. As a result, the debtor's transfer to the lender was a fraudulent transfer that the estate could avoid and recover.

Nondisclosure of an unenforceable option may violate 18 U.S.C. § 152: *U.S. v. Kurlemann*, 708 F.3d 722 (6th Cir. 2013).

The debtor was a defendant in state court litigation. Because he needed cash, he sold a vacant lot to a friend for its full market value of $220,000, with an oral agreement that the friend would sell it back to the debtor in a year. The debtor lost the state court litigation and filed a chapter 7 case. The debtor did not disclose the oral repurchase agreement in his statement of affairs or at the 341 meeting. Shortly after the 341 meeting, the debtor caused an affiliate to purchase the lot from the friend for $235,000. Section 521 requires disclosure of all assets. Under 18 U.S.C. § 152, concealing an

asset or making a false oath in a bankruptcy case is a felony. The oral repurchase agreement was unenforceable under the statute of frauds, so the asset may have been worthless. But section 521 requires disclosure of all assets, no matter what the debtor's opinion of value. Moreover, the statute of frauds is an affirmative defense; it does not render the agreement invalid. Therefore, the debtor's failure to disclose the agreement was a crime.

Judicial Estoppel.

The Chapter 13 is not estopped from pursuing a personal injury cause of action that was not disclosed by the debtor during the pendency of her case: *In re Flugence*, 738 F.3d 126 (5th Cir. 2013).

After the debtor's chapter 13 plan had been confirmed, she was injured in an accident and hired an attorney to prosecute the claim. The debtor did not disclosure the action in her bankruptcy court and received a discharge. The personal injury sought to have Flugence judiciallyestopped from pursuing the undisclosed claim. The bankruptcy court declaredthat although Flugence was estopped from pursuing the claim on her own behalf,her bankruptcy trustee was not similarly estopped and could pursue the claimfor the benefit of Flugence's creditors in accordance with *Reed v. City of Arlington*,650 F.3d 571 (5th Cir. 2011) (en banc). *Reed*, 650 F.3d at 573, holds generally that, where a debtor is individually estopped from pursuing an undisclosed claim, absent unusual circumstances, an innocent trustee can pursue the claim for the benefit of creditors.

We agree with the personal-injury defendants that there is a continuingduty to disclose in a Chapter 13 proceeding and that Flugence has met all theelements of judicial estoppel. Therefore, the bankruptcy court did not abuse itsdiscretion by finding her estopped. We disagree with the personal-injury defendants'reading of Reed, however, because nothing there requires that recoverybe limited strictly to the amount owed creditors. We therefore reverse the portionof the district court's judgment that reversed the judgment of the bankruptcycourt, and we render judgment reinstating the bankruptcy court's judgmentin full.

The court wrote: "Accordingly, where a debtor is judicially estopped from pursuing a claimhe failed to disclose to the bankruptcy court, the trustee, consistent with Reed,may pursue the claim without any limitation not otherwise imposed by law. Thejudgment of the district court is REVERSED, and judgment is RENDEREDreinstating the judgment of the bankruptcy court."

The court also wrote: ""Reed sensibly requires only that, after a claimis prosecuted and the creditors and fees have been paid, any remaining recovery must be returnedto the personal-injury defendants."