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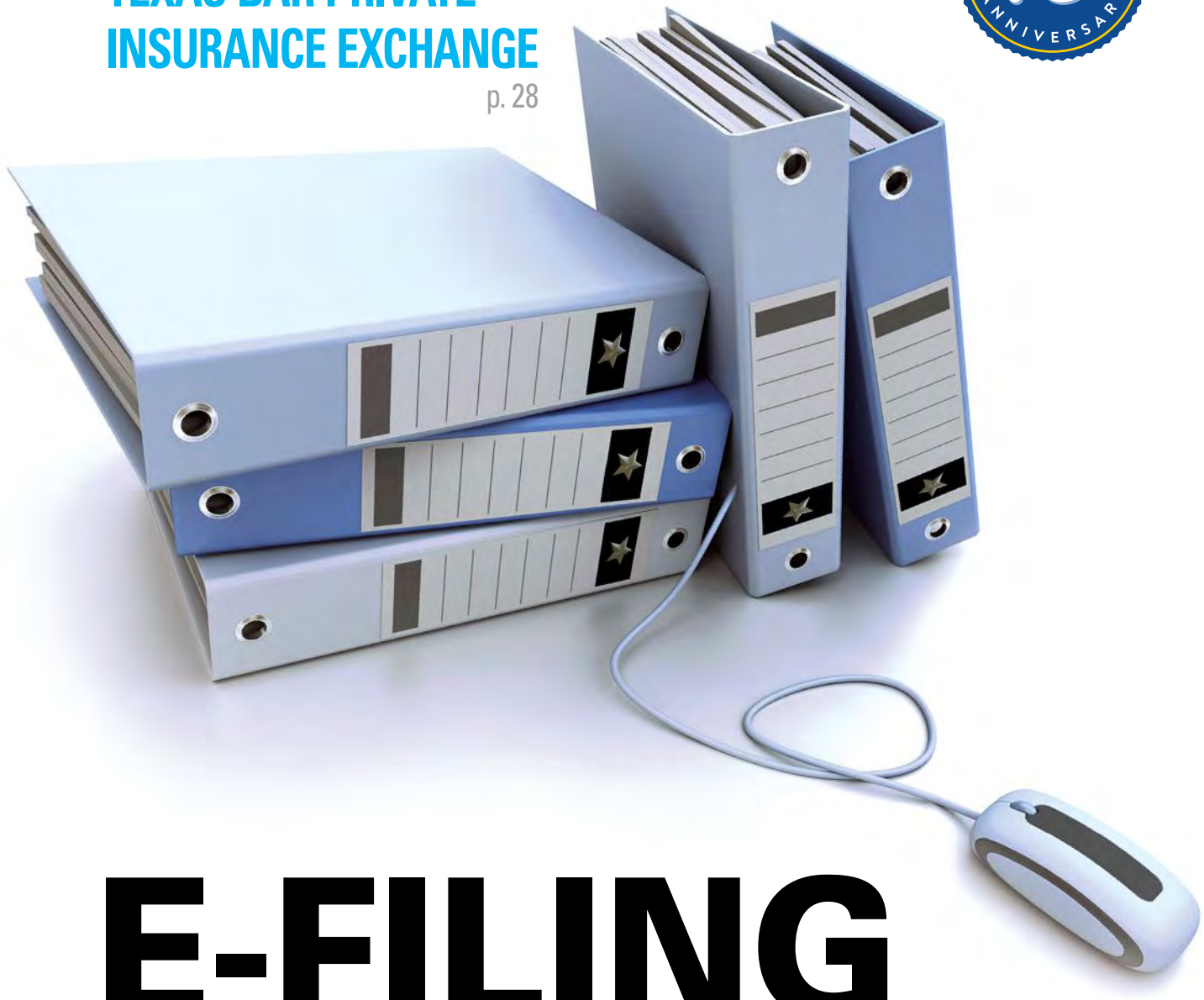

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DEPARTMENTS

IN THIS ISSUE

We examine the significant legal developments that took place during the past year, from new U.S. Supreme Court opinions on antitrust cases to legislative changes to the Texas Tax Code. **PAGE 41**

The year 2013 was riddled with ups and downs, from the announcement of a new pope and the initial public offering of Twitter on the New York Stock Exchange to the U.S. federal government shutdown and the loss of more than 5,000 lives wrought by Typhoon Haiyan. We watched Andy Murray become the first British man to win Wimbledon in 77 years and the developing story of the Boston Marathon bombing and ensuing chase of the Tsarnaev brothers. We mourned the death of South African activist and former president Nelson Mandela and welcomed the birth of a royal baby.

In Texas, the Michael Morton Act was signed into law and a filibuster made national headlines. The *Texas Bar Journal* Board of Editors has assembled a series of articles that address a sampling of the significant legal developments that took place during the past year. The articles and topics featured are not exhaustive, and the opinions reflect only the views of the authors. For information about changes enacted by the 83rd Texas Legislature, see the September 2013 issue of the *Texas Bar Journal* at texasbar.com/tbj.

14. *Id.* at *1-2.
15. *Id.* at *2-6.
16. *Id.* at *4.
17. *Id.* at *5.
18. *Id.*
19. *Id.*

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BANKRUPTCY LAW

By Mark E. Andrews and Aaron M. Kaufman

The extent of bankruptcy courts' constitutional authority remains an open issue that continues to be tested and clarified. This year, the U.S. Court of Appeals for the 5th Circuit held that, even following the U.S. Supreme Court's ruling in *Stern v. Marshall*,[1] legal malpractice counterclaims asserted by a debtor against his lawyers *may* (and *should*) be adjudicated in the bankruptcy court, because these assertions "cannot stand alone from the determination of quality the bankruptcy court made in awarding fees."[2] But, adopting the reasoning of the 6th Circuit, the 5th Circuit held that the bankruptcy court lacks constitutional authority to adjudicate "non-core" state law claims brought by a debtor, even with the parties' consent to trial in the bankruptcy court.[3] In January 2014, the Supreme Court will consider the effect of "consent" on the bankruptcy courts' constitutional authority.[4]

The only U.S. Supreme Court decision to address bankruptcy issues this year was *Bullock v. BankChampaign*,[5] where the court defined "defalcation" in the context of dischargeability of debts.[6] In *Bullock*, the court applied the canon of *noscitur a sociis* ("it is known from its associates") and held that the neighboring words of the statute (fraud, embezzlement, and larceny) implied a criminal-like degree of culpability and thus required a heightened level of culpability—not merely mistake, negligence, or objective recklessness.[7] Meanwhile, the 5th Circuit held that Section 523(a)(15) of the Bankruptcy Code "leaves it to the state court to decide whether a property right is properly addressed in divorce proceedings, or as a separate contractual claim" as a basis to declare a debt non-dischargeable.[8]

In the Chapter 11 context, the 5th Circuit affirmed a decision applying the *Till* prime-plus formula (ordinarily applicable in smaller-dollar Chapter 13 cases) to a higher-dollar commercial reorganization,[9] potentially removing some uncertainty and expense associated with Chapter 11 confirmation disputes. The 5th Circuit also rejected the concept of "artificial impairment" as a basis to deny confirmation, distinguishing from the concept of "gerrymandering," which remains prohibited.[10] In *S. White Transportation*, the 5th Circuit held that, despite giving a secured creditor adequate notice, a debtor's plan failed to extinguish a creditor's lien because that creditor did not actively participate in the bankruptcy case.[11] And, addressing post-confirmation standing, the 5th Circuit held that a liquidating trustee had standing to sue in one case[12] and that former insiders of the debtor lacked standing in another.[13] Finally, in *In re Lively*,[14] the 5th Circuit clarified that individual Chapter 11 debtors cannot keep their pre-petition property without their creditors' consent unless their plans pay non-consenting creditors in full.

The last decision of note is not a bankruptcy decision, *per se*, but warrants discussion because of its relevance to assignments of mortgages under Texas law, an issue that is frequently litigated before, during, and after all kinds of bankruptcy cases. In the wake of the recent subprime mortgage crisis, there has been a flurry of wrongful foreclosure claims. While many theories exist for the cause of the crisis and the reasons for the increased claims of wrongful foreclosure, one common thread in those lawsuits is the use of the Mortgage Electronic Registration System—an electronic "book entry system" that allows mortgages to be assigned and recorded quickly in compliance with state law and filing requirements.[15]

The two most common theories asserted in the recent trend of wrongful foreclosure claims are the "show-me-the-note" theory—in which the borrowers argue that foreclosures are invalid unless the foreclosing party presents the "wet ink" original signature on the note (a technical "gotcha" of sorts, since very few servicers are able to locate the "wet ink" original note)—and the "split-the-note" theory—in which the borrowers argue that the use of MERS "splits" the note from the deed of trust, rendering both null and preventing any mortgagee or loan servicer from holding an enforceable right to foreclose.

In 2013, the 5th Circuit held that neither theory had support under Texas law.[16] First, the Texas Supreme Court held that Texas law does not require the foreclosing party to show an original, "wet ink" note. Instead, the Court of Appeals held that, "[i]n Texas, existence of a note may be established by a photocopy of the promissory note, attached to an affidavit in which the affiant swears that the photocopy is a true and correct copy of the original note."[17] Second, the Court of Appeals concluded that the Texas Property Code expressly contemplates the use of a "book entry system," such as MERS, to allow home mortgages to be "split" from their underlying notes without nullifying the note-holder's or the servicer's rights under the note or mortgage.[18] Because the deed of trust in that case expressly included the power to foreclose and was properly assigned and recorded under applicable state law, the Court of Appeals held that the "split-the-note" theory did not apply.[19]

Notes

1. --- U.S. ---, 131 S. Ct. 2594, 180 L. Ed. 2d 475 (2011). In *Stern*, a creditor filed a proof of claim for defamation against Vickie Lynn Marshall *aka* Anna Nicole Smith in her Chapter 11 bankruptcy case. In response, Marshall asserted a counterclaim for common-law tortious interference. The U.S. Supreme Court held that the tortious-interference claim did not have to be resolved in the context of resolving the defamation claim and, thus, the bankruptcy court lacked constitutional authority to finally adjudicate the debtor's state law counterclaim.
2. *Frazin v. Haynes & Boone, L.L.P. (In re Frazin)*, 732 F.3d 313 (5th Cir. 2013) (quoting *In re Southmark Corp.*, 163 F.3d 925, 931 (5th Cir. 1999)); *see also In re Intelogic Trace, Inc.*, 200 F.3d 382 (5th Cir. 2000). The Court of Appeals reversed the portion of the bankruptcy court's judgment on the debtor's Deceptive Trade Practice Act claim, however, finding it unnecessary for the bankruptcy court to have resolved the DTPA claim in the context of the fee application. But, notwithstanding that reversal, the court held that "all factual determinations made in the course of analyzing Frazin's DTPA claim were within the [bankruptcy] court's constitutional authority because they were necessarily resolved in the process of adjudicating the fee applications." Thus, on remand, the district court was allowed to consider those findings of fact and conclusions of law, even though the bankruptcy court's judgment was not final.
3. *BP RE, L.P. v. RML Waxahachie Dodge, L.L.C. (In re BP RE, L.P.)*, 735 F.3d 279 (5th Cir. 2013).
4. *Executive Benefits Ins. Agency v. Arkison (In re Bellingham Ins. Agency, Inc.)*, 702 F.3d 553 (9th Cir. 2012), *cert. granted* 133 S. Ct. 2880, 186 L. Ed. 2d 908 (2013). To date, four circuit courts have opined on the issue. The 6th Circuit has answered in the negative, comparing "constitutional authority" to subject matter jurisdiction. *See Waldman v. Stone*, 698 F.3d 910 (6th Cir. 2012). The 9th Circuit answered in the affirmative, holding that one may consent to a court's constitutional authority, just as a party may waive his right to a jury trial. *See In re Bellingham Ins. Agency, Inc.*, 702 F.3d 553 (9th Cir. 2012). The 7th Circuit held that waiver is insufficient to confer constitutional authority where the Constitution requires an Article III court to adjudicate a private dispute. *See Wellness Int'l Network, Ltd. v. Sharif*, 727 F.3d 751, 761 (7th Cir. 2013). And the 5th Circuit agreed with the 6th and 7th circuits that consent is insufficient to authorize bankruptcy courts to adjudicate private disputes.
5. --- U.S. ---, 133 S. Ct. 1754, 185 L. Ed. 2d 922 (2013).
6. 11 U.S.C. § 523(a)(4) (emphasis added).
7. *See Bullock*, 133 S. Ct. at 1760 ("That risk must be of such a nature and degree that, considering the nature and purpose of the actor's conduct and the circumstances known to him, its disregard involves a *gross deviation* from the standard of conduct that a law-abiding person would observe in the actor's situation.") (internal quotation omitted, emphasis in the original).
8. *Kinkade v. Kinkade (In re Kinkade)*, 707 F.3d 546 (5th Cir. 2013) (holding that a debt included in a Louisiana state court divorce decree was not dischargeable under Section 523(a)(15), even though the debt arose pre-marriage from money loaned from the ex-wife's separate property).
9. *Wells Fargo Bank National Assoc. v. Texas Grand Prairie Hotel Realty, L.L.C. (In re Texas Grand Prairie Hotel Realty, L.L.C.)*, 710 F.3d 324 (5th Cir. 2013). In *Till v. SCS Credit Corp*, 541 U.S. 465, 124 S. Ct. 1951, 158 L. Ed. 2d 787 (2004), the U.S. Supreme Court held that, because there was no "efficient market" for Chapter 13 debtors to go into the market to refinance their vehicles, the bankruptcy court could calculate the "cramdown" interest rates on the vehicle lien holder by taking the present prime interest rate and adjusting the rate upward (usually one to three percentage points) based on risk factors discussed in that opinion. In the now-infamous "Footnote 14" of that decision, the Supreme Court questioned whether the same formula could extend to Chapter 11 bankruptcy cases where exit financing was easier to obtain or predict. In theory, that made sense, but not in practice. Because true exit financing has been nonexistent from Chapter 11 cases in recent years, bankruptcy courts have been more willing to apply the *Till* prime-plus formula in Chapter 11 cases. While the 5th Circuit did not endorse the *Till* or any other single formula as the only method to use in every case, it held that the *Till* prime-plus formula was an acceptable method and found no error in the bankruptcy court's application of the formula to the record below.
10. *See generally Western Real Estate Equities, L.L.C. v. Villages at Camp Bowie I, L.P. (In re Villages at Camp Bowie I, L.P.)*, 710 F.3d 239 (5th Cir. 2013). One important requirement for confirmation is that a class of "impaired" claims has accepted the plan. 11 U.S.C. § 1129(a)(10). Impairment is generally defined to mean any modification to a creditor's contractual or legal rights. *See id.* § 1124. The issue here was whether giving up $900 in post-confirmation interest constitutes "impairment." The decision distinguished from the well-known *Greystone III Joint Venture* decision, where the Court of Appeals struck down a plan that improperly "gerrymandered" creditors in order to obtain a favorable vote on a plan. *In re Greystone III Joint Venture*, 995 F.2d 1274 (5th Cir. 1991). Here, the debtor "impaired" creditors by asking them to give up $900 in interest, but otherwise proposed to pay them in-full within 90 days after the plan became effective. The secured lender and principal opponent of the plan argued that this "impairment" was "artificial" and should disqualify those creditors' votes from satisfying a confirmation requirement. In support of this argument, the secured lender compared "artificial impairment" to the kind of stacking-the-deck shenanigans prohibited by the 5th Circuit in *Greystone*. But the 5th Circuit found no materiality component in the Bankruptcy Code's definition of "impairment," and, thus, declined to read *Greystone* as a basis to "ride roughshod over affirmative language in the Bankruptcy Code to enforce some Platonic ideal of a fair voting process." 710 F.3d at 247.
11. *S. White Transportation, Inc.*, 725 F.3d 494 (5th Cir. 2013); *see also Elixir Indus., Inc. v. City Bank & Trust Co. (In re Ahern Enters., Inc.)*, 507 F.3d 817, 822 (5th Cir. 2007) (holding that, in order to extinguish a lien under a plan, four conditions must be met: (1) the plan must be confirmed; (2) the property that is subject to the lien must be dealt with by the plan; (3) the lien holder must participate in the reorganization; and (4) the plan must not preserve the lien).
12. *See Compton v. Anderson (In re MPF Holdings US LLC)*, 701 F.3d 449 (5th Cir. 2012); *see also Spicer v. Laguna Madre Oil & Gas II, L.L.C. (In re Tex. Wyo. Drilling, Inc.)*, 647 F.3d 547 (5th Cir. 2011) (refining the standards for what plan reservation language qualifies as "specific and unequivocal" as described in *Dynasty Oil & Gas, LLC v. Citizens Bank (In re United Operating, LLC)*, 540 F.3d 351, 355 (5th Cir. 2008)).
13. *See Wooley v. Haynes & Boone, L.L.P. (In re SI Restructuring Inc.)*, 714 F.3d 860 (5th Cir. 2013).
14. 717 F.3d 405 (5th Cir. 2013).
15. Under a typical loan transaction using MERS, the borrower executes a deed of trust that names MERS as the beneficiary and nominee. This allows the underlying note to be bundled and traded without requiring the deed of trust to be reassigned and re-recorded each time the note or servicing right changes hands.

16. *Martins v. BAC Home Loans Services, L.P.*, 722 F.3d 249 (5th Cir. 2013). The 5th Circuit noted that Texas courts "routinely rely on federal interpretation of Texas law," perhaps because most foreclosure cases are removed to federal courts under diversity jurisdiction. *See id.* at 253 n.2.
17. *Id.* at 254 (internal quotations omitted).
18. *See id.* at 255 (citing Tex. Prop. Code §§ 51.0025, 51.0001(1), (3) & (4)).
19. The Court of Appeals rejected the plaintiff's remaining points, including arguments of inadequate notice, promissory estoppel, and grossly inadequate sales price. On the issue of notice, the court held that an affidavit of service was sufficient evidence to demonstrate that the lender mailed notice to the correct address as required by law. On the estoppel issue, the court held that an oral promise not to foreclose was unenforceable under the statute of frauds, which applied here because the contract concerned a modification to loan for more than $50,000 secured by a lien on real property. Finally, on the alleged inadequate price, the court held that 92 percent of the last appraised value could not be considered "grossly inadequate" under the present circumstances.

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COMMERCIAL LITIGATION

By Brian P. Lauten

In 2013, the Texas and United States Supreme Courts continued to develop case law in four explosive areas: (1) arbitration agreements and a robust deference toward the enforceability of those clauses; (2) documentation of attorneys' fees; (3) new evidentiary requirements that increase the onus on plaintiffs who seek class certification; and (4) patent protection for non-naturally occurring DNA.

Arbitration Agreements Continue to be Robustly Enforceable

The underlying dispute in *Richmont Holdings, Inc. v. Superior Recharge Systems, LLC*, 392 S.W.3d 633 (Tex. 2013), involved two contracts—only one of which contained an arbitration provision. Although the movant had waited 18 months to pursue arbitration, the Texas Supreme Court found that the arbitration provision in one of the agreements was sufficient to require arbitration of all the claims, holding: "[A] Court has no discretion but to compel arbitration and stay its own proceedings when a claim falls within the scope of a valid arbitration agreement and there are no defenses to its enforcement."[1]

Similarly, in *Rachal v. Reitz*, 403 S.W.3d 840 (Tex. 2013), an arbitration provision in an inter vivos trust was found to be enforceable against the trust beneficiaries. An *en banc* Dallas Court of Appeals held that the arbitration provision was non-binding on the beneficiaries because there was no agreement to arbitrate trust disputes. The Texas Supreme Court reversed, finding the arbitration provision binding for two reasons. First, by including the restriction within the four corners of the trust, the settlor intended the restriction to be a condition on his gift. Second, the requirement of mutual assent is satisfied through the doctrine of direct benefits estoppel; in accepting the benefits of the trust and suing to enforce its terms, the beneficiary indicated acceptance of the arbitration provision.

Time Records Are Becoming an Element of Proof in Recovering Attorneys' Fees

In *City of Laredo v. Montano*, 2013 WL 5763179 *1 (Tex. Oct. 25, 2013), one of the attorneys who sought attorneys' fees under a fee-shifting statute failed to keep

STATE BAR OF TEXAS
Administrative and Public Law Section

The Administrative and Public Law Section of the State Bar of Texas sponsored the 16th Annual Mack Kidd Administrative Law Moot Court Competition in Austin on October 25 and 26, 2013. The competition focuses on administrative law and enjoys active participation from numerous Texas law schools. Judges for the competition are recruited from the private sector, agency legal staff, and the judiciary. Justices from the Third Court of Appeals judge the final round. Pictured (L to R) are second place team from Baylor University School of Law Linda Chuba and Neyma Figueroa, Justice Melissa Goodwin, Chief Justice Woodie Jones, championship team from Texas Tech University School of Law Jesse Beck, Brittney Ervin, and Richard Keeton, and Justice Jeff Rose.