29TH ANNUAL MEETING

BANKRUPTCY TOPICS AS THEY RELATE TO ARBITRATION

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WHEN SECURITIES CLAIMS COLLIDE WITH THE BANKRUPTCY CODE

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FACT PATTERN

Plaintiff's lawyer, PIABA Pete, has had a great day. The case of his career has just walked in the door. This is the case PIABA Pete has been waiting on so that he can finally retire.

Lily White, an elderly retired schoolteacher, is terrified. Her husband, a blue-collar worker, died in a terrible workplace accident a couple of years back. The Whites had always lived a frugal life, and between their savings, life insurance, the retirement accounts, and the settlement from her husband's wrongful death case, Lily White found herself with a $10,000,000.00 estate. She had no idea what to do, but as luck would have it, a financial advisor, Burt Blackheart, volunteered his services. She knew Burt from church as a long-lost friend who previously did great work for her cousin. Burt came to the funeral for Lily's husband and, after an appropriate amount of time, asked her to dinner "just to get her out of the house." At dinner, Lily confided in Burt that she did not know what to do with all the money deposited into her bank accounts.

Shortly after the dinner meeting, Lily opened an account with Burt's firm, Oakmont Financial Planners. Oakmont Financial Planners was a one-stop shop. Burt could sell her insurance, stocks, and bonds or simply give her advice. For special, high-net-worth individuals like Lily, Burt could offer guaranteed high yield investments in selective hedge funds, real estate projects, and off-shore bank CDs that all paid a guaranteed 8% a year. The best part was that Lily would not have to pay a commission. Lily, for the first time in her life, felt special.

Things appeared to go splendidly. Burt invested her money, and since all she needed was $5,000.00 a month to live like a queen, the rest of the money could compound and grow. She could make contributions to charity, send her grandchildren to college, and leave a considerable sum of money to her church. Lily received mail from Oakmont Financial Planners all the time, but Burt told her not to bother to open or worry about it as he was watching everything very carefully. Burt repeatedly told Lily she should just enjoy herself.

Suddenly, about three months ago, the monthly checks stopped. After Lily inquired, Burt came by her home and explained that there had been a problem with the accounting department. Burt assured Lily that everything was fine, and the checks would start coming again on the first of the month. The check did not come as promised, and Lily's daughter suggested that Lily needed to see a lawyer. Lily did not think so, but she did see on the news that morning something about an SEC raid on a hedge fund that sounded familiar. She remembered that she had received some mail from the Super-Mega-Uber Hedge Fund ("Super-Mega") located in Antigua.

After she broke down in tears in PIABA Pete's office, Lily signed a fee agreement. PIABA Pete had to make a difference in Lily's life. He would find her justice and get back her money.

After sorting through three years of statements, it became apparent to PIABA Pete that Burt invested all the money in illiquid partnerships and offshore bank accounts, and now Super- Mega is in a SEC receivership. There was a reference in the sales material to an E&O insurance policy. PIABA Pete suspects that Oakmont put most of its customers in Super-Mega. After some investigation, PIABA Pete also figured out that all the investments paid Oakmont Financial

Planners a 10% commission, and that Burt had purchased a $1,000,000.00 yacht to go with his newly remodeled $5,000,000.00 beachside residence and homestead located in Texas.

PIABA Pete visits with his long-time partners and considers whether to pursue involuntary bankruptcy for Super-Mega or leave it in an SEC Receivership. The decision is made not to challenge the SEC Receivership. How much difference could it make?

PIABA Pete takes the obvious path—he files a receivership claim in the Super-Mega SEC Receivership proceedings on behalf of Lily and files a FINRA arbitration against Burt and Oakmont Financial Planners. The claims made are unsuitability and breach of fiduciary duty. Blue Sky Law, '33 Act and '34 Act claims are made, but PIABA Pete doesn't think that he can identify a specific misrepresentation or omission. Good news, the receiver confirms that Oakmont Financial Planners did carry a $10,000,000.00 wasting E&O policy. Lily is going to be okay, and Pete will make a handsome, life-changing fee. When this one is over in a few months, PIABA Pete will be able to retire. At least it seems that way.

1) FEDERAL BANKRUPTCY TRUSTEES V. SEC RECEIVERS: TRUSTEES CAN'T TAKE YOUR THIRD-PARTY CLAIMS, BUT RECEIVERS CAN—IN SOME CIRCUITS, AT LEAST.

<u>Applicable statutory provision – Fed. R. Civ. P. 66:</u>

> [T]he practice in administering an estate by a receiver or a similar court-appointed officer must accord with the historical practice in federal courts or with a local rule.

<u>Applicable statutory provision – 28 U.S.C. § 959(b):</u>

> (b) Except as provided in section 1166 of title 11, a trustee, receiver or manager appointed in any cause pending in any court of the United States, including a debtor in possession, shall manage and operate the property in his possession as such trustee, receiver or manager according to the requirements of the valid laws of the State in which such property is situated, in the same manner that the owner or possessor thereof would be bound to do if in possession thereof.

<u>Applicable statutory provision – 11 U.S.C. § 1104:</u>

> (a) At any time after the commencement of the case but before confirmation of plan . . . the court shall order the appointment of a trustee—
>
> > (1) for cause, including fraud, dishonesty, incompetence, or gross mismanagement of the affairs of the debtor by current management, either before or after the commencement of the case, or similar cause, but not including the number of holders of securities of the debtor or the amount of assets or liabilities of debtor;
> >
> > (2) if such appointment is in the interest of creditors[.]

Analysis

There are several key distinctions between a SEC receiver and a bankruptcy trustee. An SEC Receiver is appointed on a case-by-case basis often to preserve status quo or prevent diversion and waste of assets. *SEC v. Current Financial Services Inc*., 783 F.Supp. 1441, 1443 (D.C. 1992). Unlike a bankruptcy trustee, an SEC receiver is not bound by the bankruptcy code. Unlike an SEC receiver, a chapter 11 trustee has the same duties as a debtor-in-possession, and payment to creditors must comply with the absolute priority rule. Therefore, victims of securities fraud may obtain higher priority in a receivership case than they would under bankruptcy.

Although receivers typically do not have the same caliber of experience in liquidating a company as a bankruptcy trustee, claims by creditors against third party defendants are not property of the bankruptcy estate and therefore cannot be pursued by the trustee. *In re S.I. Acquisition, Inc.* 817 F.2d 1142, 1150 (5th Cir. 1987). Specifically, a bankruptcy trustee may only bring forth derivative claims for causes of action such as alter-ego, fraudulent conveyances, and breach of contract. Courts are divided on whether a receiver can bring forth and settle claims made by creditors of the receivership estate.

Within the Fifth and Tenth circuits, a receiver may pursue and settle creditor claims with third-party defendants because the creditor claims are related to the estate and ultimately increase the liability of the receivership estate. *Zacarias v. Stanford Int'l Bank, Ltd.*, 945 F.3d 883 (5th Cir. 2019); *Sec. & Exch. Comm'n v. Stanford Int'l Bank, Ltd.,* 927 F.3d 830 (5th Cir. 2019); *SEC v. DeYoung*, 850 F.3d 1172 (10th Cir. 2017). The First, Second, Seventh, and Eleventh circuits, on the other hand, hold that a receiver does not have standing to bring claims against third party defendants. *Isaiah v. JPMorgan Chase Bank, N.A.*, 960 F.3d 1296 (11th Cir. 2020); *Fleming v. Lind-Waldock & Co.*, 922 F.2d 20, 25 (1st Cir. 1990) ("Since 1935 it has been well settled that 'the plaintiff in his capacity of receiver has no greater rights or powers than the corporation itself would have.'") (*quoting McCandless v. Furlaud*, 296 U.S. 140, 148 (1935)); *Eberhard v. Marcu*, 530 F.3d 122, 132 (2d Cir. 2008) ("A receiver may commence lawsuits, but 'stands in the shoes of the corporation and can assert only those claims which the corporation could have asserted.'") (*quoting Lank v. N.Y. Stock Exch*., 548 F.2d 61, 67 (2d Cir.1977)); *See Jarrett v. Kassel*, 972 F.2d 1415, 1426 (6th Cir. 1992) (holding that a receiver "had authority to sue on behalf of the receivership itself but had no authority to bring a cause of action on behalf of the individual customers"). "[l]ike a trustee in bankruptcy or for that matter the plaintiff in a derivative suit, an equity receiver may sue only to redress injuries to the entity in receivership, corresponding to the debtor in bankruptcy and the corporation of which the plaintiffs are shareholders in the derivative suit." *Scholes v. Lehmann*, 56 F.3d 750, 753 (7th Cir. 1995).

A Petition for Certioari regarding the circuit split is before the Supreme Court of the United States for review. *See Barry L. Rupert, et al. v. Ralph Janvey, et al., case no.* 19-1411 in the Supreme Court of the United States; *Antonio Jubis Zacarias, et al. v. Ralph S. Janvey, et al*., case no. 19-1402 in the Supreme Court of the United States. Thank you to PIABA Amicus Committee, Royal B. Lea, in particular, for drafting and filing an amicus brief on the issue.

Outcome: PIABA Pete spends eleven long years litigating with the Receiver over who owns the securities fraud claims against Burt, the partnerships, and the offshore banks. This litigation prompts Burt to relocate to Florida. PIABA Pete is questioning his judgment to proceed with an SEC receiver as opposed to proceeding with a bankruptcy plan.

2) DON'T VOTE FOR THAT CHAPTER 11 PLAN-YOU MAY BE RELEASING CLAIMS AGAINST THIRD-PARTIES.

Change in facts: PIABA Pete files an involuntary bankruptcy petition against Super-Mega and a chapter 11 trustee is appointed. The trustee files a plan of reorganization and tries to recover the limits of the Oakmont Financial Planners' E&O policy on behalf of the bankruptcy estate. Within the trustee's plan of reorganization, all creditors voluntarily (but likely unknowingly) give up claims against third parties. The Devil is always in the details. The following provisions are buried within the fifty-page plan:[1]

- Defined Terms
  - Contributed Claims
    - All Causes of Action . . . against any Person that is not a Released Party and that are related in any way to the Debtors . . . including . . . (b) all Cause of Action for unlawful dividend, fraudulent conveyance, fraudulent transfer, voidable transaction, or other avoidance claims under state or federal law; (c) all Causes of Action based on, arising out of, or related to the misrepresentation of any of the Debtors' financial information, business operation, or related internal controls . . . .

- Liquidating Trust
  - Contribution of Contributed Claims
    - [A]ll Contributed Claims will be irrevocably contributed to the Liquidation Trust and shall thereafter be Liquidation Trust Actions for all purposes.
  - Pursuit and Resolution of Liquidation Trust Actions

    The Liquidating Trust . . . will have the exclusive right, power, and interest on behalf of itself, the Debtors, the Estates, and the Contributing Claimants to institute, commence, file, pursue, prosecute, enforce, abandon, settle, compromise, release, waive, dismiss or withdraw any and all Liquidation Trust Actions or Assets[.]

Applicable statutory provision – 11 U.S.C. § 1126(c):

> (c) A class of claims has accepted a plan if such plan has been accepted by creditors, other than any entity designated under subsection € of this section, that hold at least two-thirds in amount and more than one-half in number of the allowed claims of such class held by creditors, other than any entity designated under subsection € of this section, that have accepted or rejected such plan.

Applicable statutory provision – 11 U.S.C. § § 1129(a)(8); (b):

> (a) The court shall confirm a plan only if all of the following requirements are met:

[1] Provisions from the *Joint Chapter 11 Plan of Liquidation of Woodbridge Group of Companies, LLC and its affiliated Debtors*, Case No. 17-12560, filed in the United States Bankruptcy Court District of Delaware [ECF No. 2138].

(7) With respect to each impaired class of claims or interests—
(A) Such class has accepted the plan; or
(B) Such class is not impaired under the plan.

> (b)[I]f all of the applicable requirements of subsection (a) of this section other than paragraph (8) are met with respect to a plan, the court, on request of the proponent of the plan, shall confirm the plan notwithstanding the requirements of such paragraph if the plan does not discriminate unfairly, and is fair in equitable, with respect to each class or claims of interests that is impaired under, and has not accepted the plan.

Analysis:

For a plan to be confirmed one of the following must occur: 1) each class must be non- impaired; 2) each impaired class must vote to approve the plan; or 3) the requirements of "cramdown" contained in 11 U.S.C. § 1129(b) must be met. An impaired class accepts a plan if at least one-half of the class' claimants containing two-thirds of the aggregate dollar amount for the class' claims vote to approve the plan. 11 U.S.C. § 1126(c).

Although courts are divided, the majority of courts hold that a non-voting class is not deemed to have accepted the plan. *In re Vita Corp.*, 380 B.R. 525, 527 (C.D. Ill. 20008) (*citing In re Eagle-Picher Indus*., 203 B.R. 256 (S.D. Ohio 1996); *In re Westwood Plaza Apartments, Ltd.*, 192 B.R. 693 (E.D. Tex. 1996); *In re M. Long Arabians*, 103 B.R. 211 (9th Cir. 1989); *In re Smith*, 2006 Bankr. LEXIS 3196, 2006 WL 3627298 (Bankr. M.D. N.C. 2006); *In re Jim Beck, Inc.,* 207 B.R. 2010 (Bankr. W.D. Va. 1997); *In re Higgins Slacks Co.,* 178 B.R. 853 (Bankr. N.D. Ala. 1995); *In re 7th Street & Beardsley P'ship*, 181 B.R. 426 (Bankr. D.Ariz. 1994); *In re Adkisson Vill. Apts. of Bradley County, Ltd*., 133 B.R. 923 (Bankr. S.D. Ohio 1991); *In re Friese*, 103 B.R. 90 (Bankr. S.D. N.Y. 1989); *In re Townco Realty, Inc*., 81 B.R. 707 (Bankr. S.D. Fla. 1987)). Within the Southern District of Texas, a bankruptcy court ruled that a plan is not confirmable where no creditors vote on a plan, holding that each impaired class must affirmatively accept the plan. *In re Castaneda*, 09-50101, 2009 WL 3756569, at *1 (Bankr. S.D. Tex. Nov. 2, 2009). On the other hand, the Tenth Circuit Court of Appeals held that a creditor who is the sole member of a class is deemed to have accepted a plan of reorganization if it does not vote or object to the plan. *Heins v. Ruti—Sweetwater, Inc., (In re Ruti-Sweetwater, Inc.)*, 836 F.2d 1263, 1267-68 (10th Cir. 1988).

Once a plan with a litigation trust is confirmed, a trustee will proceed in pursuing the claims in order to provide payout to the class. It is important to note that a litigation trust's standing to pursue a claim post-confirmation must be expressly provided for in the debtor's plan. *See Dynasty Oil & Gas, LLC v. Citizens Bank et al. (in re United Operating, LLC)*, 540 F.3d. 351, 355 (5th Cir. 2009). While some D&O carriers may have several exclusions in a policy, it is important to evaluate the exceptions to the exclusion. Several courts have concluded that the insured vs. insured exclusion is not trigged by a lawsuit brought by a successor-in-interest against former directors for breach of fiduciary duty. *In re Palmaz Scientific, Inc.*, 2018 WL 3343597, *13 (Bankr. W.D. Tex. 2018).

Outcome: Lily votes for the plan so that she can at least receive the 10% distribution proposed. PIABA Pete continues with the FINRA arbitration against Burt Blackheart, but failed to get the automatic stay lifted. Although PIABA Pete was happy to hear the plan was confirmed, Judge King holds PIABA Pete in contempt for violating the discharge injunction in the plan. PIABA Pete has a BAD day.

3) WE DON'T NEED TO FIGHT ANY MORE AFTER THE FINRA PANEL HAS RULED. DEBTS ARISING FROM SECURITIES VIOLATIONS (EVEN THE UNSUITABLE ONES) ARE NOT DISCHARGEABLE.

Change in facts: Burt is sued by several clients for the same investments, and the wasting E&O Policy is now exhausted or frozen by the courts. Burt receives poor legal advice and files for bankruptcy to stop Lily's FINRA Arbitration. Burt Blackheart's bankruptcy case gets assigned to Judge Gargotta. PIABA Pete proceeds to lift the automatic stay and receives a FINRA Arbitration Award. The award comes down for $10,000.00 for unsuitable investment advice. There is no specific award for Blue Sky, '33 Act or '34 Act claims. Burt is not concerned because he thinks the Arbitration Award will be discharged by the bankruptcy court. Maybe not so fast.

Applicable statutory provision – 11 U.S.C. § 523(a)(19)

(a) A discharge under section 717, 1141, 1192,[2] 1228(a), 1228(b), or 1328(b) of this title does not discharge an individual debtor from any debt—

…

(19) that—

(A) is for—

(i) the violation of any of the Federal securities laws, … any of the State securities laws or any regulation or order issued under such Federal or State securities laws; or

(ii) common law fraud, deceit, or manipulation in connection with the sale of any security; and

(B) results, before, on or after the date on which the petition was filed, from—

(i) any judgment, order, consent order, or decree entered in by any Federal or State judicial or administrative proceeding;

[2] Small Business Reorganization Act, Pub. L. 116-54 effective February 19, 2020.

> (ii) any settlement agreement entered into by the debtor; or
>
> (iii) any court or administrative order for any damages, fine penalty, citation, restitutionary payment, disgorgement payment, attorney fee, cost, or other payment owed by the debtor.

Analysis:

The creditor carries the burden to show a debt is nondischargeable under any discharge exception within 11 U.S.C. § 523. *Grogan v. Garner,* 498 U.S. 279, 283 (1991). It is in the bankruptcy court's authority to determine if a debt is nondischargeable. *Dennis v. Dennis (In re Dennis)*, 25 F.3d 274, 277 (5th Cir. 1994) (citing *In re Shuler*, 722 F.2d 1253, 1265 (5th Cir. 1984), *cert. denied*, 469 U.S. 817 (1984). If a "'tribunal other than the bankruptcy court [determines]. . . whether a federal or state securities violation or some type of related fraud has occurred,' the [bankruptcy c]ourt should not disturb or attempt to relitigate those findings." *See Jenkins v. Jones (In re Jones)*, 600 B.R. 561, 569 (Bankr. W.D. Tex. 2019) (quoting *Wright v. Minardi (In re Minardi)*, 536 B.R. 171, 192 (Bankr. E.D. Tex. 2015). However, the bankruptcy court may inquire into the true nature of the underlying debt litigated in state court or in arbitration if necessary. *Dennis*, 25 F.3d at 277 (citing *Brown v. Felsen*, 442 U.S. 127, 138 (1979).

For a debt to be excepted from discharge due to a violation of securities law under § 523(a)(19), a creditor must prove that "(1) the debt is for violation of securities law or for common law fraud in connection with the sale of a security; and (2) the debt must be memorialized in a judicial or administrative order, or in a settlement agreement." *Wright v. Minardi (In re Minardi)*, 536 B.R. 171, 191 (Bankr. E.D. Tex. 2015) (citing *McGraw & Pfeifer Sutter Fam. LLC v. Collier (In re Collier)*, 497 B.R. 877, 903 (Bankr. E.D. Ark. 2013).

A FINRA award memorialized by a judicial order provides a bankruptcy court sufficient evidence to except a debt from discharge. *Jones*, 600 B.R. at 569. Even if a FINRA award does not specifically issue findings of specific violations of securities laws, fraud, or breach of fiduciary duty, the award may be nondischargeable if "the FINRA [a]ward arose, at least in part, in connection with [debtor's] violation of [state] securities laws." *Id.*

Some courts have addressed nuances in excepting a debt from discharge. For example, the Tenth Circuit Court of Appeals affirmed a ruling discharging judgments for unjust enrichment in connection with a Ponzi scheme. *Oklahoma Dept. of Securities, ex. Rel. Fought v. Wilcox*, 691 F.3d 1171, 1177 (10th Cir. 2012). In *Wilcox,* creditors sued debtors in state court for unjust enrichment but did not pursue any actions for securities law violations. *Id*. at 1176-77. Creditors successfully obtained judgments, and the bankruptcy court excepted the judgments from discharge.

Id. at 1174. The Tenth Circuit reversed the bankruptcy court based on a strict interpretation of § 523(a)(19), stating that a judgment only for unjust enrichment was not a judgment "for a violation" of securities law. *Id.* at 1174-75. The appellate court clarified that the ruling may have been different if the creditor prosecuted debtors for securities law violations in state court. *Id.* at 1176-77.

The Eleventh Circuit Court of Appeals determined that liability arising from a third party's violation of securities laws may be excepted from discharge. *Lunsford v. Process Techs. Servs. (In re Lunsford)*, 848 F.3d 963 (11th Cir. 2017). Within *Lunsford*, a creditor sued the debtor and the company in which the debtor served as president and obtained an arbitration award. *Id.* at 965. The award detailed the securities law violations and stated explicitly that the award's findings would include the debtor unless only the company was referenced. *Id.* at 967. The state court confirmed the award and entered a joint and several judgment against the company and debtor. *Id.* at 965. The debtor asserted that the debt was dischargeable because he was merely a third party to the violations of securities laws. *Id*. at 969. The bankruptcy court determined the debt was excepted from discharge because the debtor was a party to the legal action in which a judgment was entered for securities laws violations against the company. *Id.* The appellate court affirmed the bankruptcy court and acknowledged that the ruling may be inconsistent with *Wilcox*, and nevertheless stated "[t]he whole text establishes section 523(a)(19) precludes discharge regardless of whether the debtor violated securities laws as long as the securities violation caused the debt." *Id.* at 968. A critical difference between *Lunsford* and *Wilcox* is that in *Lunsford*, the debtor was jointly and severally liable for the securities laws violations, whereas in *Wilcox*, the debtor was not charged with any securities law violations.

Outcome: The debt owed to Lily is excepted from discharge. PIABA Pete now moves forward in attempting to collect the debt. Burt's entire net worth is tied up in his newly remodeled home and yacht, both of which he has claimed as exempt under the Texas Property Code.

4) HAND OVER YOUR HOMESTEAD, OR AT LEAST ALL VALUE ABOVE $170,350.00, A LA CLYDE JONES

Change in facts: Burt claimed the full value of $5,000,000.00 as exempt as a homestead under Texas law. Burt also attempted to claim the yacht as exempt, but subsequently amended his schedules without requiring PIABA Pete or the trustee to file an objection. Trustee and PIABA Pete proceed to file an objection to Burt's claimed homestead exemption. Burt filed a reply, asserting that the Texas homestead protects his residence's full value, or in the alternative, the newly remodeled home is necessary to support him and his spouse. As an exhibit in support of the reply, Burt attaches a doctor's note saying it is necessary for Burt's health to swim in his resort-styled pool and play tennis at his private tennis court three times a week.

Applicable statutory provision - 11 U.S.C. § 522(q)(1)(B):

(q)(1) As a result of electing under subsection (b)(3)(A) to exempt property under State or local law, a debtor may not exempt any amount of an interest in property described in subparagraphs (A), (B), (C), and (D) of subsection (p)(1) which exceeds in the aggregate $170,350[3] if--

(A) the court determines, after notice and a hearing, that the debtor has been convicted of a felony (as defined in section 3156 of title 18), which under the circumstances, demonstrates that the filing of the case was an abuse of the provisions of this title; or

(B) the debtor owes a debt arising from--

(i) any violation of the Federal securities laws (as defined in section 3(a)(47) of the Securities Exchange Act of 1934), any State securities laws, or any regulation or order issued under Federal securities laws or State securities laws;

(ii) fraud, deceit, or manipulation in a fiduciary capacity or in connection with the purchase or sale of any security registered under section 12 or 15(d) of the Securities Exchange Act of 1934 or under section 6 of the Securities Act of 1933;

(iii) any civil remedy under section 1964 of title 18; or

(iv) any criminal act, intentional tort, or willful or reckless misconduct that caused serious physical injury or death to another individual in the preceding 5 years.

(2) Paragraph (1) shall not apply to the extent the amount of an interest in property described in subparagraphs (A), (B), (C), and (D) of subsection (p)(1) is reasonably necessary for the support of the debtor and any dependent of the debtor.

[3] As adjusted under section 104, effective April 1, 2019. To be readjusted effective April 1, 2022.

Analysis:

The objecting party carries the burden in establishing a debtor's claimed exemption is improper. *In re Presto*, 376 B.R. 554, 563 (Bankr. S.D. Tex. 2007). The burden of proof is by a preponderance of the evidence. *Id.;* Fed. R. Bankr. P. 4003(c).

Bankruptcy courts can make findings or adopt rulings from other courts or arbitration panels to limit a debtor's homestead under § 522. To satisfy the requirements under § 522(q)(1)(B)(ii), a debtor must owe a debt arising from the act of fraud, deceit, or manipulation while acting in a fiduciary capacity or in connection with the purchase or sale of a registered security. *Presto*, 376 B.R. at 592. The Bankruptcy Code defines "debt" as "liability on a claim[.]" 11 U.S.C. § 101(12). Congress intended to adopt the broadest definition of the term "claim." *Johnson v. Home State Bank*, 501 U.S. 78, 83 (1991). Within the Bankruptcy Code, "claim" is defined as a "right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured or unsecured." 11 U.S.C. § 101(5).

If a party requests a debtor's homestead exemption to be capped under 11 U.S.C. § 522(q), a bankruptcy court may permit a debtor to retain the full value of a claimed homestead exemption if the homestead is reasonably necessary for the support of the debtor and debtor's dependents. *See In re Bounds*, 491 B.R. 440, 452-53 (W.D. Tex. 2013). The following factors are considered under the reasonably necessary standard: " (1) the debtor's present and anticipated living expenses, (2) the health of the debtor and his/her dependents, (3) debtor's job skills and education, (4) debtor's other assets, (5) debtor's ability to save for retirement, (6) the special needs of the debtor and his or her dependents, and (7) debtor's continuing financial obligations such as alimony or child support." *Id*. (citing *In re Jackson*, 376 B.R. 75, 80 (Bankr. D. Conn. 2007) *aff'd, Jackson v. Novak*, 593 F.3d 171 (2nd Cir.2010)).

Bankruptcy courts look at these factors strictly and tend to favor restricting the homestead. Within *Bounds*, the bankruptcy court granted an objection to a debtors' claimed homestead under § 522(q) because the home was more than reasonably necessary for the debtors' needs. *Id*. at 553. Specifically, the home consisted of 4,200 square feet of living space and had a tennis court, barn, a gated driveway, and a private pond. Since the debtors were soon to have no children living at home, had the ability to secure employment, and the capability to downsize to a smaller home, the court determined the homestead exemption should be limited. *Id.* at 453. The court further addressed how one debtor was convicted of fraud and theft in the amount of $500,000.00 against the objecting party, and that the objecting party would not obtain payment from the bankruptcy case if the debtors were entitled to keep the claimed homestead. *Id.* at 454.

Additionally, within *Presto,* the bankruptcy court determined that it was not reasonably necessary for a debtor with substantial income and future earning capacity to live in a two-story 3,400 square foot home with a custom pool in a gated community with a country club, especially when his children only stay during the summer. *Presto*, 376 B.R. at 599. The debtor argued that his pool, which also included a slide and a hot tub, was medically necessary. *Id.* The court clarified the analysis for a medically necessary pool: "The only question this condition would raise is whether the Debtor had sufficient income and other assets to afford *any* house, not this specific house, that can provide a pool." *Id.* The court also included a footnote expressing doubt about the accuracy of the debtor's medical need for a pool, as debtor's application to build the pool simply requested expedited approval for his children and did not mention the medical necessity. ("If I didn't have my beautiful children to please, I would not be asking for accelerated approval, but please understand (like all good Daddy's [sic]), I want to put a big smile on my children all summer.") *Id.* at FN 51.

Outcome: The Homestead is sold for $2,000,000 because oil prices collapsed, and no one is buying these kinds of homes during a pandemic. After all of the closing costs and expenses are paid, Mr. Blackheart receives $170,350 and Lily and PIABA Pete receive a check for $1.5 million. Lily is paid her $1,000,000. PIABA Pete makes a nice fee that just covers the actual time his has put in the case over the last five years. PIABA Pete goes back to work the next day.