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Frazin c. Haynes & Boone, L.L.P., et al. (In the Matter of Timothy Michael Frazin)

Summarized by Craig Geno, Craig M. Geno, PLLC 48 weeks 4 days ago
5th Circuit, Professional Practice Areas
Judicial Circuit: 5th Circuit
View opinion PDF | Download opinion PDF
Citation: Case No. 11-10403
Ruling: Reversed in part and Affirmed in part and remanded.
Procedural context: Appeal from the District Court which had affirmed the Bankruptcy Court's decision
Facts: Appellant, a Chapter 13 debtor, employed the Appellees' attorneys to represent him in connection with certain state law claims against Lamajak, Inc. for breach of contract, promissory estoppel and quantum meruit. The employment of the Appellees' attorneys was approved, on a contingent fee basis. After a trial and appeals, the Appellant and Lamajak reached a settlement for $3.2 million and the settlement was approved by the Bankruptcy Court. The Appellees' attorneys filed applications with the Bankruptcy Court requesting approval of their fees and the Appellant filed objections to the fee applications, asserting state-law counterclaims against the Appellees for negligence, violations of the Texas Deceptive Trade Practices Act ("DTPA") and breach of fiduciary duty. After a six-day trial, the Bankruptcy Court ruled against Appellant on the merits of his negligence and DTPA claim. The Bankruptcy Court determined that the Appellant had shown a breach of fiduciary duty, but since he failed to prove damages as a result of the breach, the Court ruled against him on his claim as well. The Bankruptcy Court overruled all of the Appellant's objections to the Appellees' fee applications and awarded the Appellees the amount requested in their fee applications. The District Court affirmed the judgment in all aspects. The Appellant appealed to the Fifth Circuit, asserting that Stern v. Marshall bars the bankruptcy court from entering a final judgment on the Appellant's state-law counterclaims. The Fifth Circuit distinguished most of those counterclaims from the counterclaims in the Stern v. Marshall case. It also held that the Appellant had not consented to the jurisdiction of the Bankruptcy Court and had not waived any objection to the contrary. The state-law malpractice claim could be heard by the Bankruptcy Court, on a final basis, because it necessarily rejected the claims of malpractice contained within the Appellant's fee objections, and the Bankruptcy Court had to rule on those objections as part of the claims-allowance process. The separate action for malpractice alleged the exact same conduct as the objections that were rejected. Similarly, the Fifth Circuit ruled that the breach of fiduciary duty claims were claims that the Bankruptcy Court must have, and did, resolve in deciding whether to grant the Appellees' fee applications and the Bankruptcy Court had jurisdiction to rule, on a final basis, on that claim. With respect to the DTPA claim, the Fifth Circuit noted that the jurisdiction of issues arising out of it were the precise problem that the Stern court found when the bankruptcy court there ruled on the counterclaims in that case. Thus, the Fifth Circuit found that because it was not necessary to decide the DTPA claim to rule on the Appellees' fee applications, the Bankruptcy Court lacked the authority to enter a final judgment as to that claim. However, the Fifth Circuit went on to hold that all facts or determinations made in the course of analyzing the Appellant's DTPA claim were within the Court's constitutional authority because they were necessarily resolved in the process of adjudicating the fee applications. As to the merits of the malpractice claim itself, the Court ruled that the Appellant had waived that issue. As to the merits of the breach of fiduciary duty claim, the Fifth Circuit found that the Bankruptcy Court's findings of fact were supported by the evidence, and the Bankruptcy Court's conclusions of law were sound.
Judge(s): Reavley, Prado and
Owen
Topics: Professional Practice Areas

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Case: 11-10403 Document: 00512392331 Page: 1 Date Filed: 10/01/2013

IN THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

United States Court of Appeals
Fifth Circuit

FILED
October 1, 2013

Lyle W. Cayce
Clerk

No. 11-10403

In the Matter of: TIMOTHY MICHAEL FRAZIN,

Debtor

TIMOTHY MICHAEL FRAZIN,

Appellant

v.

HAYNES & BOONE, L.L.P.; NINA CORTELL; WARREN DODSON; GRIFFITH & NIXON, P.C.; SCOTT GRIFFITH,

Appellees

Appeal from the United States District Court
for the Northern District of Texas

Before REAVLEY, PRADO, and OWEN, Circuit Judges.

EDWARD C. PRADO, Circuit Judge:

Timothy Frazin appeals 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 argues 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.*

Marshall, 131 S. Ct. 2594 (2011). Holding that the bankruptcy court lacked jurisdiction over Frazin's state-law counterclaim under the Texas Deceptive Trade Practices Act, we AFFIRM in part and REVERSE in part.

I. BACKGROUND

A. *Factual Background*

Frazin filed a voluntary petition under Chapter 13 of the Bankruptcy Code. While the bankruptcy proceedings were pending, Frazin filed suit in state court against Lamajak, Inc. for breach of contract, promissory estoppel, and quantum meruit. Frazin filed an application with the bankruptcy court to employ Appellee Griffith & Nixon, P.C. as special counsel to represent him in his action against Lamajak. The bankruptcy court authorized Frazin to employ Griffith & Nixon on a contingency fee basis and provided that the firm would be paid following a fee application to the court.

On April 18, 2005, the bankruptcy court entered an order discharging Frazin, but the case remained open pending the outcome of Frazin's state-court suit, as the Chapter 13 plan provided that a portion of any potential recovery would be used to satisfy unsecured claims against the bankruptcy estate.

After a two-week trial on Frazin's state-law claims against Lamajak, the jury awarded Frazin three alternative recoveries: (1) $4,000,000 for breach of contract; (2) $1,400,000 for promissory estoppel; and (3) $1,125,000 in quantum meruit. The court entered judgment on the $4,000,000 award for breach of contract, as well as attorneys' fees and interest, for a total award of $7,158,383.10 (which was later reduced to $6,360,132.40 because of an error in the interest calculation). Lamajak appealed.

Frazin filed an application with the bankruptcy court to employ Appellee Haynes & Boone, LLP as special counsel to represent him in the appeal. The bankruptcy court authorized Frazin to employ Haynes & Boone and again provided that the firm's fees would be paid upon application to and approval by

the bankruptcy court. The bankruptcy court ordered that any litigation proceeds awarded to Frazin would be paid to and held in trust by Haynes & Boone to allow the Chapter 13 trustee to determine the amount necessary to satisfy the remaining claims against the estate.

On appeal, Lamajak argued that Frazin was not entitled to recovery on any of his theories. Haynes & Boone responded to Lamajak's arguments with briefs on the merits and argued the appeal orally before the Fifth Court of Appeals of Texas. The court reversed the award for breach of contract, holding that Frazin had not presented sufficient evidence to find that a contract with definite terms had been entered into. *Lamajak, Inc. v. Frazin*, 230 S.W.3d 786, 794 (Tex. App.—Dallas 2007, no pet.). The court awarded Frazin recovery on his quantum meruit claim, *id.* at 798, that, along with attorneys' fees and interest, resulted in an award of approximately $3.4 million. Lamajak sought an extension of time to file a petition for review in the Texas Supreme Court, around which time the parties settled for $3.2 million.

Pursuant to the procedure ordered by the bankruptcy court, Lamajak wired $3.2 million to a Haynes & Boone trust account. Haynes & Boone filed a motion seeking guidance from the bankruptcy court on disbursement of the proceeds; it also filed a request for an expedited hearing on this motion. Both Haynes & Boone and Griffith & Nixon (collectively, the "Attorneys") filed applications with the bankruptcy court requesting approval of their fees. Frazin filed objections to the fee applications filed by each firm.

B. Procedural Background

In response to the Attorneys' request for fees, Frazin filed state-law counterclaims against them for negligence, violations of the Texas Deceptive Trade Practices Act ("DTPA"), and breach of fiduciary duty. The case was tried over six days before the bankruptcy court. The bankruptcy court ruled against Frazin on the merits of his negligence and DTPA claims. The bankruptcy court

determined that Frazin had shown a breach of fiduciary duty, but since he failed to prove damages as a result of the breach, the court ruled against him on this claim as well. The bankruptcy court also concluded that the Attorneys' breaches of duty were not clear and serious enough to warrant fee forfeiture. Finally, the bankruptcy court overruled Frazin's objections to the Attorneys' fee applications and awarded the Attorneys the amount requested in their original fee applications.

The district court affirmed the judgment in all respects in a brief order. Frazin timely appealed.

II. JURISDICTION AND STANDARD OF REVIEW

The district court's final judgment in this case gives us jurisdiction under 28 U.S.C. § 1291. "We review a district court's affirmance of a bankruptcy court decision by applying the same standard of review to the bankruptcy court decision that the district court applied." *Stettner v. Smith* (*In re IFS Fin. Corp.*), 669 F.3d 255, 260 (5th Cir. 2012) (citation omitted) (internal quotation marks omitted). We thus review factual findings for clear error and legal conclusions de novo. *Id.* "When the district court has affirmed the bankruptcy court's findings, [the clear error] standard is strictly applied, and reversal is appropriate only when there is a firm conviction that error has been committed." *Id.* at 260–61 (citation omitted) (alteration in original, internal quotation marks omitted).

III. DISCUSSION

A. Stern v. Marshall

Frazin argues that *Stern v. Marshall* compels the conclusion that the bankruptcy court lacked the authority to enter a final judgment on his state-law counterclaims. *Stern* involved litigation over the estate of J. Howard. 131 S. Ct. at 2601. Howard's wife at the time of his death, Vickie Marshall (also known by her stage name Anna Nicole Smith), was not included in his will, and before

Howard's death, she filed suit in Texas state probate court, arguing that Howard's son Pierce had fraudulently induced Howard to sign a living trust that did not include her. *Id.* The probate court upheld the trust and Howard's will. *Marshall v. Marshall*, 547 U.S. 293, 302 (2006). Following Howard's death, Vickie filed a petition for bankruptcy in the Central District of California. *Stern*, 131 S. Ct. at 2601. Pierce filed a complaint in the bankruptcy proceedings, contending that Vickie had defamed him through media coverage of her fraudulent inducement claim; he also filed a proof of claim for that action, seeking to recover his claimed damages from Vickie's bankrupt estate. *Id.* Vickie counterclaimed for tortious interference with the gift she had expected from Howard, a claim which was similar in substance to the fraudulent inducement claim she had earlier lost in Texas probate court. *Id.* After the bankruptcy court ruled in Vickie's favor, Pierce argued that the bankruptcy court had lacked jurisdiction over Vickie's counterclaim because it was not a "core proceeding." *Id.*

The Supreme Court held that Vickie's counterclaim was a core proceeding under the plain text of 28 U.S.C. § 157(b)(2)(C),[1] which states that

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[1] The full text of 28 U.S.C. § 157(b)(1)–(2) is as follows:
(1) Bankruptcy judges may hear and determine all cases under title 11 and all core proceedings arising under title 11, or arising in a case under title 11, referred under subsection (a) of this section, and may enter appropriate orders and judgments, subject to review under section 158 of this title.
(2) Core proceedings include, but are not limited to—

> (A) matters concerning the administration of the estate;
> (B) allowance or disallowance of claims against the estate or exemptions from property of the estate, and estimation of claims or interests for the purposes of confirming a plan under chapter 11, 12, or 13 of title 11 but not the liquidation or estimation of contingent or unliquidated personal injury tort or wrongful death claims against the estate for purposes of distribution in a case under title 11;
> (C) counterclaims by the estate against persons filing claims against the estate;
> (D) orders in respect to obtaining credit;
> (E) orders to turn over property of the estate;

"counterclaims by the estate against persons filing claims against the estate" are "core proceedings." *Id.* at 2604–05 (internal quotation marks omitted). However, the Court went on to hold that § 157(b)(2)(C) is unconstitutional insofar as it allows bankruptcy courts to enter final judgments in state-law counterclaims that would not necessarily be resolved in the process of ruling on a creditor's proof of claim. *Id.* at 2620.

Although the Court stated that its decision was "narrow," *id.*, its reasoning was sweeping. In explaining its holding, the Court discussed the importance of Article III in maintaining separation of powers among the branches of the federal government, safeguarding the independence of the judicial branch, and protecting litigants. *Id.* at 2608–09. The Court stated that "[w]hen a suit is made of the stuff of the traditional actions at common law tried by the courts at Westminster in 1789, and is brought within the bounds of federal jurisdiction, the responsibility for deciding that suit rests with Article III judges in Article III courts." *Id.* at 2609 (citation and internal quotation marks omitted). The Court concluded with a holding that was notable for its repetition throughout the opinion: bankruptcy courts "lack[] the constitutional authority to enter a final

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(F) proceedings to determine, avoid, or recover preferences;
(G) motions to terminate, annul, or modify the automatic stay;
(H) proceedings to determine, avoid, or recover fraudulent conveyances;
(I) determinations as to the dischargeability of particular debts;
(J) objections to discharges;
(K) determinations of the validity, extent, or priority of liens;
(L) confirmations of plans;
(M) orders approving the use or lease of property, including the use of cash collateral;
(N) orders approving the sale of property other than property resulting from claims brought by the estate against persons who have not filed claims against the estate;
(O) other proceedings affecting the liquidation of the assets of the estate or the adjustment of the debtor-creditor or the equity security holder relationship, except personal injury tort or wrongful death claims; and
(P) recognition of foreign proceedings and other matters under chapter 15 of title 11.

judgment on a state law counterclaim that is not resolved in the process of ruling on a creditor's proof of claim." *Id.* at 2620.

We must determine whether, and to what extent, *Stern* affects the propriety of the bankruptcy court's entry of final judgment on Frazin's claims. Frazin brought state-law counterclaims against the Attorneys, which, like the counterclaim brought by Vickie in *Stern*, are defined by § 157(b)(2)(C) as "core proceedings." A previous panel of this court has held that bankruptcy courts have the authority to enter final judgments in all proceedings defined as "core" by § 157(b). *Blackburn-Bliss Trust v. Hudson Shipbuilders, Inc.* (*In re Hudson Shipbuilders, Inc.*), 794 F.2d 1051, 1054–55 (5th Cir. 1986).

Because a previous panel has already resolved this issue, we cannot overturn its decision "absent an intervening change in the law, such as by a statutory amendment, or the Supreme Court or by our *en banc* court." *Technical Automation Servs. Corp. v. Liberty Surplus Ins. Corp.*, 673 F.3d 399, 405 (5th Cir. 2012) (internal quotation marks omitted). "[F]or a Supreme Court decision to change our Circuit's law, it 'must be more than merely illuminating with respect to the case before [the court]' and must 'unequivocally' overrule prior precedent." *Id.* (alteration in original) (quoting *Martin v. Medtronic, Inc.*, 254 F.3d 573, 577 (5th Cir. 2001)). Thus, we must decide whether *Stern* unequivocally *sub silentio* overruled *Hudson*.

Hudson's holding that bankruptcy courts can enter final judgments in *all* core proceedings is clearly inconsistent with *Stern*'s holding that bankruptcy courts cannot enter final judgments in one type of core proceeding, namely, state-law counterclaims that are not necessarily resolved in the claims-allowance process. We therefore conclude that *Stern* has unequivocally *sub silentio* overruled *Hudson* as to that type of core proceeding.

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.[2] 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.[3]

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[2] We do not decide today whether the *Stern*'s holding extends to other core proceedings under § 157(b)(2). Our holding simply applies the *Stern* test to state-law counterclaims under § 157(b)(2)(C). Future cases must determine whether *Stern* applies to other core proceedings. This court has only begun the task of interpreting the scope of *Stern*. *See In re Renaissance Hosp. Grand Prairie Inc.*, 713 F.3d 285, 294 n.12 (5th Cir. 2013)(declining to extend *Stern* to proceedings under § 157(b)(2)(K) in light of "*Stern*'s express instruction that its holding applied only in one isolated respect" (quotation marks omitted)); *Technical Automation*, 673 F.3d at 406 (interpreting *Stern* as holding that "the jurisdiction of the bankruptcy courts did not extend to most counterclaims based on common law").

[3] The Attorneys argue that Frazin consented to the jurisdiction of the bankruptcy court and waived any objection to the contrary by filing his claims there and failing to object. However, when "separation of powers] is implicated in a given case, the parties cannot by consent cure the constitutional difficulty . . . . When these Article III limitations are at issue, notions of consent and waiver cannot be dispositive because the limitations serve institutional interests that the parties cannot be expected to protect." *C.F.T.C. v. Schor*, 478 U.S. 833, 850–51 (1986). As discussed above, *Stern* makes clear that the practice of bankruptcy courts entering final judgments in certain state-law counterclaims "compromise[s] the integrity of the system of separated powers and the role of the Judiciary in that system." 131 S. Ct. at 2620. Thus, structural concerns cannot be ameliorated by Frazin's consent or waiver.

1. Malpractice

We turn first to Frazin's claim for malpractice. In his complaint in the bankruptcy court, Frazin alleged that the Attorneys were negligent in the prosecution of the underlying Lamajak trial and appeal. Frazin alleged the same acts of negligence in the objections that he filed to the Attorneys' fee applications. Notwithstanding Frazin's objections and his counterclaim, the bankruptcy court awarded the Attorneys' fees as requested.

Bankruptcy courts are permitted to award fees to professionals by 11 U.S.C. § 330. That section also contains guidelines to direct a bankruptcy court's discretion in making such fee awards. It states that a bankruptcy court may award "reasonable compensation" to a Chapter 13 debtor's attorney "based on a consideration of the benefit and necessity" of the services rendered to the debtor, as well as the "nature, the extent, and the value of such services." 11 U.S.C. § 330(a)(3), (a)(4)(B). Thus, in awarding fees, the bankruptcy court determined that the benefit and value of the Attorneys' services was sufficient to warrant payment in the amount requested. Accordingly, the bankruptcy court necessarily rejected the claims of malpractice contained within Frazin's fee objections, objections on which it had to rule as part of the claims-allowance process. The separate action for malpractice alleged the exact same conduct as the objections that were rejected. The bankruptcy court made this clear in its opinion, stating that Frazin's objections to the fee applications were overruled for the "same reasons" that the bankruptcy court ruled against Frazin on the merits of his malpractice claim.

This court has previously considered the degree to which a bankruptcy court's award of fees to a professional is interrelated with a claim of malpractice against that professional. In *Osherow v. Ernst & Young, L.L.P.* (*In re Intelogic*

Trace, Inc.), 200 F.3d 382 (5th Cir. 2000), the bankruptcy court approved the debtor's employment of Ernst & Young to provide accounting services during the bankruptcy proceedings. *Id.* at 384. Although the debtor suspected that Ernst & Young's services were deficient, it did not oppose Ernst & Young's fee application, and the bankruptcy court accordingly awarded the requested fees. *Id.* at 384–85. At a later date, the trustee filed suit against Ernst & Young in state court, alleging causes of action including negligence. *Id.* at 385. Ernst & Young removed the case to the bankruptcy court and moved for summary judgment, arguing among other things that res judicata barred the trustee's claims. *Id.* at 385–86 (citation and internal quotation marks omitted). The bulk of our opinion focused on the fourth prong of res judicata, whether the two actions were based on "the same nucleus of operative facts." *Id.* at 386–88. We held that "an award of fees for professionals . . . employed by a bankruptcy estate represents a determination of 'the nature, the extent, and the value of such services.'" *Id.* at 387 (quoting 11 U.S.C. § 330(a)(3)). We also held that "[b]y granting Ernst & Young's fee application, the bankruptcy court implied a finding of quality and value in Ernst & Young's services." *Id.* We noted that the trustee's state-law claims arose from alleged negligence in the very same services that the bankruptcy court had considered when it awarded fees. *Id.* Thus, we held that the award of professional fees and the malpractice claims arose from a common nucleus of operative fact and that the malpractice claims were barred by res judicata. *Id.* at 388–91.

The *Intelogic* court relied on a discussion of the interconnectedness of fee applications and malpractice claims in *Southmark Corp. v. Coopers & Lybrand* (*In re Southmark Corp.*), 163 F.3d 925 (5th Cir. 1999). The issue in *Southmark* was whether a state-law claim for malpractice filed by a debtor against an appointed accounting firm was a "core proceeding" under 28 U.S.C. § 157 or

merely a "related matter" from which the bankruptcy court was required to abstain under 28 U.S.C. § 1334(c)(2). *Id.* at 928–30. In holding that the claim was a core proceeding within the bankruptcy court's jurisdiction, this court discussed the relatedness of fee applications and malpractice claims as follows:

> In this case, the professional malpractice claims alleged . . . are inseparable from the bankruptcy context. A *sine qua non* in restructuring the debtor-creditor relationship is the court's ability to police the fiduciaries . . . . The bankruptcy court must be able to assure itself and the creditors who rely on the process that court-approved managers of the debtor's estate are performing their work, conscientiously and cost-effectively. . . . Award of the professionals' fees and enforcement of the appropriate standards of conduct are inseparably related functions of bankruptcy courts.
>
> Supervising the court-appointed professionals also bears directly on the distribution of the debtor's estate. If the estate is not marshaled and liquidated or reorganized expeditiously, there will be far less money available to pay creditors' claims. Excessive professional fees or fees charged for mediocre or, worse, phantom work also cause the estate and the creditors to suffer. . . . A malpractice claim like the present one inevitably involves the nature of the services performed for the debtor's estate and the fees awarded under superintendence of the bankruptcy court; it cannot stand alone.

Id. at 931.

Based on this case law, we conclude that Frazin's claim for malpractice was necessarily decided by the bankruptcy court in the process of ruling on the Attorneys' fee applications and thus fell constitutionally within the bankruptcy court's jurisdiction. As in *Intelogic,* the bankruptcy court's award of fees to the Attorneys carried with it an implicit finding of quality and value in the services provided by the Attorneys. *Southmark* makes clear that this award of fees was "inseparably related" to enforcement of the appropriate standards of conduct, and so Frazin's malpractice claim for those services "cannot stand alone" from the determination of quality the bankruptcy court made in awarding fees.

Southmark's reasoning reinforces our conclusion regarding the constitutional inquiry: the bankruptcy court, in awarding the Attorneys' fees, necessarily considered and rejected Frazin's malpractice claim as well as his objections grounded in the same allegations.

Unlike Vickie's claim in *Stern*, the malpractice claim was not "independent of the federal bankruptcy law" but was "necessarily resolvable" by a ruling on the Attorneys' fee applications. *Stern*, 131 S.Ct. at 2611. The fee application proceedings had more than "some bearing" on these claims. *Id.* at 2618. Rather, the resolution of the fee application proceedings necessarily resolved the malpractice counterclaim. Therefore, under *Stern*, the bankruptcy court had the authority to enter a final judgment rejecting Frazin's malpractice claim on its merits.

2. Breach of Fiduciary Duty

Likewise Frazin's claim that all of the Attorneys' fees be forfeited under Texas fiduciary duty law is a claim that the bankruptcy court must have and did resolve in deciding whether to grant the Attorneys' fee applications the appropriate amount of any fee award.

Frazin brought a *fee-forfeiture* action based on breach of fiduciary duty. As the Memorandum Opinion correctly observed in its discussion of Frazin's breach of fiduciary duty claim, Frazin's complaint "does not allege that the Defendants' breaches of fiduciary duty were a proximate cause of any damage to him. Rather, Frazin seeks to impose a complete fee forfeiture because, according to Frazin, of the seriousness of the Defendants' breaches of fiduciary duty." Throughout these proceedings, Frazin has consistently maintained that his breach of fiduciary duty claim was a fee-forfeiture claim, not an affirmative claim for damages. As the Texas Supreme Court held in its seminal case,

Burrow v. Acre, 997 S.W.2d 229 (Tex. 1999), even if a client suffers no actual damages, fee forfeiture in some cases is an appropriate remedy for breach of fiduciary duty by an attorney. *Id.* at 240. The fee-foreiture remedy "must fit the circumstances presented" and is limited only to "clear and serious" violations of the duty owed to a client. *Id.* at 241. Because the sole purpose of Frazin's breach of fiduciary duty action was to defeat the Attorneys' fee applications in bankruptcy court, the bankruptcy court necessarily had to resolve every aspect of his breach of fiduciary duty claim to rule on the Attorneys' fee applications.

This present claim is precisely the type of claim that the Supreme Court in *Stern* envisioned that a bankruptcy court has jurisdiction to hear and upon which the bankruptcy court is empowered to render a final judgment, Article III of the Constitution notwithstanding. While in *Stern* there was "there was never any reason to believe that the process of adjudicating [the stepson's] proof of claim would necessarily resolve [the widow/debtor's] counterclaim," in this case, the bankruptcy court could not adjudicate the Attorneys' fee application without resolving Frazin's fee-forfeiture cause of action. *See Stern*, 131 S. Ct. at 2617. The instant case is also analogous to *Katchen v. Landy*, 382 U.S. 323 (1966), which the Supreme Court cited in *Stern* as an example of a case where the bankruptcy court could reach the creditor's proof of claim without violating the Constitution. In *Katchen*, the "plenary proceeding [in an Article III court that] the creditor sought [as to whether this creditor had been preferred] could be brought into the bankruptcy court because 'the same issue [arose] as part of the process of allowance and disallowance of claims.'" *Id.* (third alteration in original) (quoting *Katchen*, 382 U.S. at 336). The same is true in the present case. Frazin's fee-forfeiture action arose as part of the Attorneys' fee application, and the bankruptcy court could not rule on the Attorneys' fee applications

without resolving Frazin's fee-forfeiture claim. Thus, the bankruptcy court had jurisdiction to resolve Frazin's fiduciary duty claim.

3. Deceptive Trade Practices Act

The other counterclaim on which the bankruptcy court entered a final judgment was for violations of the DTPA. There are three elements to a DTPA claim: "(1) the plaintiff is a consumer; (2) the defendant engaged in false, misleading, or deceptive acts; and (3) these acts constituted a producing cause of the consumer's damages." *Hugh Symons Grp., plc v. Motorola, Inc.*, 292 F.3d 466, 468 (5th Cir. 2002) (citing *Doe v. Boys Club of Greater Dall. Inc.*, 907 S.W.2d 472, 478 (Tex. 1995)) (additional citation omitted). To rule on the merits of this claim, the bankruptcy court "was required to and did make several . . . legal determinations that were not 'disposed of in passing on objections'" to the Attorneys' fee applications, which is the precise problem that the *Stern* Court found when the bankruptcy court there ruled on Vickie's counterclaim. 131 S. Ct. at 2617 (quoting *Katchen*, 382 U.S. at 323, 332 n.9). In the present case, although the bankruptcy court necessarily had to resolve most, if not all, of Frazin's *factual* allegations that supported his DTPA claims in the course of addressing claims that were otherwise within the court's jurisdiction, the bankruptcy court was not required to resolve the legal effect flowing from those factual allegations in the context of a DTPA claim.

For example, the bankruptcy court observed that under Texas law, "a plaintiff may not fracture what is essentially a negligence claim into claims for DTPA violations, breach of fiduciary duty or other claims." Similarly, the bankruptcy court recognized that "[w]here the gravamen of a plaintiff's complaint is that the lawyer inadequately represented the plaintiff in some fashion, the DTPA will not apply." The bankruptcy court then "conclude[d] that

the DTPA claims, to the extent premised upon the conduct alleged in paragraphs 7, 8, 11, 12 and 13 of the Complaint[,] are simply re-stated negligence claims which violate Texas's common law rule against the 'fracturing' of claims, and are thus not cognizable under the DTPA." The bankruptcy court was not required to decide whether a state court or an Article III court would find that the allegations were "simply re-stated negligence claims" under Texas law in order to rule on the fee applications.

By contrast, it *was* necessary for the bankruptcy court to decide whether the factual allegations were true and if so, the impact on the fee applications, regardless of whether the factual allegations could form an element of one or more state-law causes of action outside of the court's jurisdiction. The bankruptcy court carefully scrutinized each of Frazin's factual allegations and the evidence, made factual determinations, and resolved the impact on the fee applications. The analysis of the claims that Frazin alleged were DTPA violations consumes twenty-six pages of the bankruptcy court's Memorandum Opinion. The testimony and other evidence are examined in minute detail. In sum, the *factual* resolutions were part and parcel of the adjudication of the fee applications, so they must survive reversal.

Because it was not necessary to decide the DTPA claim to rule on the Attorneys' fee applications, we conclude that the bankruptcy court lacked the authority to enter a final judgment as to that claim. Nevertheless, we hold that all factual determinations made in the course of analyzing Frazin's DTPA claim were within the court's constitutional authority because they were necessarily resolved in the process of adjudicating the fee applications.

B. Merits of Malpractice & Breach of Fiduciary Duty Claims

Based on the foregoing discussion, the only claims that are properly before us are the malpractice and breach of fiduciary duty claims, over which the

bankruptcy court had authority to enter a final judgment. We now turn to the merits of this issue.

The bankruptcy court held that Frazin had failed to establish malpractice in part because he failed to show causation, which requires a showing that "but for the attorney's negligence the client would have prevailed on appeal." *Millhouse v. Wiesenthal*, 775 S.W.2d 626, 627 (Tex. 1989). In its order affirming the judgment of the bankruptcy court, the district court stated that it would have ruled against Frazin's malpractice claim on the same grounds, but that Frazin had waived this issue. We agree that Frazin has waived this issue. In his brief to the district court, Frazin mentioned the legal standard for causation, but failed to apply it by making and substantiating the argument that he would have prevailed on appeal but for the Attorneys' malpractice. He also failed to identify that issue as a proposed basis for deciding the case. In order to preserve an argument for appeal, "the litigant must press and not merely intimate the argument during the proceedings before the district court. If an argument is not raised to such a degree that the district court has an opportunity to rule on it, we will not address it on appeal." *FDIC v. Mijalis*, 15 F.3d 1314, 1327 (5th Cir. 1994).

The bankruptcy court's findings of fact as to Frazin's breach of fiduciary duty allegations are supported by the evidence, and the bankruptcy court's conclusions of law were sound. The bankruptcy court found that some of Frazin's contentions regarding breach of fiduciary duty were valid, but concluded that though there had been breaches of fiduciary duty to some extent, they did not warrant fee forfeiture. We affirm the district court's judgment affirming the bankruptcy court's judgment as to the breach of fiduciary duty claim.

IV. CONCLUSION

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 resolved 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. For this reason, the judgment of the district court affirming the bankruptcy court must be REVERSED in part and AFFIRMED in part.

Furthermore, we REMAND this case to the district court for further proceedings consistent with this opinion. We note (though we do not express an opinion) that although the bankruptcy court did not have jurisdiction to make a final judgment on the DTPA claim, the district court may have that authority. *See Stern*, 131 S. Ct. at 2619–20 (discussing district court authority under 28 U.S.C. §§ 157(c)–(d), 1334(c)); *see also Wellness Int'l Network, Ltd. v. Sharif*, No. 12-1349, 2013 WL 4441926, at *20–21 (7th Cir. Aug. 21, 2013); *Exec. Benefits Ins. Agency v. Arkinson* (*In re Bellingham Ins. Agency, Inc.*), 702 F.3d 553, 565–66 (9th Cir. 2012), *cert. granted* 133 S. Ct. 2880 (2013); *Waldman v. Stone*, 698 F.3d 910, 921–22 (6th Cir. 2012), *cert. denied* 133 S. Ct. 1604 (2013).

No. 11-10403

OWEN, Circuit Judge, concurring.

I fully join the majority opinion. I write separately only to emphasize that the Supreme Court's opinion in *Stern v. Marshall*[1] does not affect the ability of a bankruptcy court to resolve discrete issues that a core bankruptcy proceeding and a state-law cause of action share in common. The bankruptcy court properly recognized that many, if not all, of the facts Frazin alleged in support of his Texas Deceptive Trade Practices Act (DTPA) claims related to the quality, value and reasonableness of the professional services that the Appellees rendered.

Though a bankruptcy court cannot issue a final judgment disposing of certain claims in cases like the present one, this does not mean that bankruptcy courts are neutered in adjudicating core proceedings under 11 U.S.C. § 157(b)(2). A bankruptcy court should examine and resolve all challenges to a fee application, even if the challenges could or do constitute one or more elements of state-law or other causes of action that must be finally resolved by an Article III or state court. A bankruptcy court has jurisdiction to resolve discrete factual issues that necessarily must be decided in adjudicating claims for professional fees under § 330. Bankruptcy courts should not shy away from the task of resolving all issues that pertain to a fee application, even if those issues also form the basis, in whole or in part, of a potential state-law cause of action.

When a fee application is filed under § 330, a party to the bankruptcy proceedings who has standing to challenge that application must assert all grounds for denying or reducing the claim for fees. A party cannot reserve those grounds for litigation in another forum simply because the grounds also may be at issue in state-law causes of action. The fact that there are many issues common to a proceeding under § 330 and to state-law causes of action does not insulate those common grounds from the requirement that they be raised in the

[1] 131 S.Ct. 2594 (2011).

bankruptcy court. The issues necessary to adjudicate a fee application should be decided by the bankruptcy court. If and when a party who objected to the fee application files suit on state-law or other nonbankruptcy claims, the court in which that suit is filed can apply issue preclusion principles to prevent wasteful and unnecessary relitigation of factual and legal issues.[2]

[2] *See Southmark Corp. v. Coopers & Lybrand* (*In re Southmark Corp.*), 163 F.3d 925, 932 (5th Cir. 1999).

REAVLEY, Circuit Judge, concurring in part and dissenting in part.

I would affirm the judgment. We affirm the bankruptcy court's distribution of estate funds, and that is all I see before us.

The two law firms had obtained a large recovery in the lawsuit against Lamajak, Inc., enough to satisfy all creditor claims, and then the court had only to distribute what was left. The firms filed fee applications, to which the debtor Frazin objected and then filed numerous claims against them, including negligence and malpractice and even deceptive trade practice, all directed at the conduct of the lawyers related to the lawsuit against Lamajak, Inc. There was no use of the word counterclaim and no pleading meeting Rule 8 requirements, as a counterclaim must do.

I need not spell out my objections to this court's judgment because no harm is done, at least in this case, and the district court will no doubt simply dismiss whatever has been remanded. However, if it were necessary, I would hold that a bankruptcy court does not lose jurisdiction in deciding the administration of the estate when that has some collateral effect not easily avoided.

R. Galaz v. L. Galaz (In the Matter of L. Galaz)

Summarized by John Jones, J. R. Jones Law PLLC 5 days 20 hours ago
5th Circuit, 11 U.S.C. 157, 11 U.S.C. 1134, Claims, Venue/Jurisdiction, Bankruptcy Litigation
Judicial Circuit: 5th Circuit
View opinion PDF | Download opinion PDF
Citation: Case No. 13-50781 c/w 13-50783 (5th Cir. August 25, 2014)
Ruling: VACATED and REMANDED by 5th Circuit. Subject matter jurisdiction is reviewed de novo. Held that Debtor's claim was indeed "related to" the bankruptcy case because it could increase the estate but the bankruptcy court did not have the constitutional authority to enter a final judgment. In non-core proceedings, bankruptcy courts should submit findings of fact and conclusions of law to district courts or enter judgment with the parties' consent. However, when a debtor pleads a state law claim as an action that augments the estate but not necessarily resolved in the claims allowance process, the bankruptcy court is constitutionally prohibited from entering final judgment. Instead the bankruptcy court's judgment was vacated and remanded for de novo review of its decision as recommended findings and conclusions. As for the third party's judgment on his counterclaim, the bankruptcy court erred because his claims are not "related to" the bankruptcy case and will have no effect on Debtor's estate and therefore, no subject matter jurisdiction exists and the judgment must be vacated.
Procedural context: Debtor was awarded $500,000 in adversary trial against her ex-husband and a company he and his father set up for fraudulent transfer of her economic interest in a company that owned rights to Ohio Players' music catalog. Unrelated third party awarded $1,000,000 on counterclaim against ex-husband and company for fraudulent transfer of his interest also. District court affirmed judgment in both case and ex-husband and company appealed challenging bankruptcy courts' jurisdiction to enter judgment to 5th Circuit. Issue was jurisdiction to entertain Debtor and third party's claims and the district court's role in reviewing bankruptcy court's determinations.
Facts: In her pre-bankruptcy divorce, Debtor Lisa Galaz received a 25% economic interest in ARF which owned the rights to the Ohio Players' music catalog. She filed for Chapter 13 and brought suit against her ex-husband for his post-divorce fraudulent transfer of Debtor's 25% economic interest in ARF. Debtor's ex-husband also transferred the rights of Julian, the other member in ARF to an unincorporated entity that later was incorporated by the ex-husband and his father into Segundo Suenos LLC. Segundo Suenos made gross revenue of over $1,000,000. Debtor Galaz sought recovery in the adversary because her claim, if successful, would increase the size of her bankruptcy estate and was related to the bankruptcy case. Defendants filed suit against the other member of ARF and he (Julian) counterclaimed for breach of fiduciary duty and conversion of his interest in ARF which was assigned to Segundo Suenos without his consent. The Court entered judgment for Debtor and third-party against ex-husband and company and the ex-husband and company appealed.
Judge(s): Higginbotham, Jones, and Prado, Circuit Judges
Topics: Claims
Topics: Bankruptcy Litigation
Topics: Venue/Jurisdiction

Source URL: http://volo.abi.org/r-galaz-v-l-galaz-in-the-matter-of-l-galaz

IN THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

No. 13-50781
c/w 13-50783

United States Court of Appeals
Fifth Circuit
FILED
August 25, 2014
Lyle W. Cayce
Clerk

In the Matter of: LISA ANN GALAZ,

Debtor

RAUL GALAZ; SEGUNDO SUENOS, L.L.C.,

Appellants

v.

LISA ANN GALAZ; JULIAN JACKSON,

Appellees

Appeals from the United States District Court
for the Western District of Texas

Before HIGGINBOTHAM, JONES, and PRADO, Circuit Judges.

EDITH H. JONES, Circuit Judge:

Appellants Raul Galaz and Segundo Suenos, L.L.C.[1] appeal two judgments entered by the district court, acting in its appellate capacity, that affirmed the entry of final judgment and award of damages by a bankruptcy court for debtor Lisa Ann Galaz and third-party Julian Jackson. Because

[1] Although not apparent from the record, "Segundo Suenos" was most likely formed with the intention of reading "Segundo Sueños," which is Spanish for "Second Dreams." This opinion will use the spelling used by the entity itself.

rapidly evolving case law has limited bankruptcy courts' jurisdiction, we must vacate and remand with separate instructions for each judgment creditor.

BACKGROUND

Lisa filed an adversary proceeding in bankruptcy court against her ex-husband, Raul, for fraudulently transferring the assets of Artist Rights Foundation, LLC ("ARF") to a Texas limited liability company managed by Raul's father. Raul, a former California attorney,[2] founded ARF in 1998 as a California limited liability company with Julian, a music producer, in order to collect royalties for the music of the Ohio Players, a former funk band. Raul and Julian secured all rights to the Ohio Players' music catalogue and exploited those rights, but from 1998 until 2005 the rights did not generate any revenue. In May 2002, Lisa and Raul divorced and executed a divorce decree under which Raul assigned half of his 50% interest in ARF to Lisa. Because Raul transferred half of his interest to Lisa without Julian's consent, in violation of ARF's written operating agreement ("Operating Agreement"), Lisa received a 25% economic interest in ARF with no management or voting rights.

On June 3, 2005, without obtaining prior consent from either Lisa or Julian, Raul assigned all of ARF's rights to the entity Segundo Suenos. At the time of the transfer, Segundo Suenos was not organized as a business entity under the laws of any state. Three months later, Raul assisted his father, Alfredo Galaz, in filing the necessary documents to establish Segundo Suenos, L.L.C. ("Segundo Suenos") within the state of Texas. Shortly thereafter, the royalties for the Ohio Players' music began to generate a substantial amount of revenue. From the time of ARF's transfer in June 2005 until trial in February 2010, Segundo Suenos's gross revenue from the Ohio Players'

[2] Raul resigned from the California bar in 2002 after pleading guilty to mail fraud.

royalties totaled nearly one million dollars. Neither Julian nor Lisa received any share of the profits despite their interests in ARF.

In 2007, Lisa filed for Chapter 13 bankruptcy. In April 2008 she brought an adversary proceeding against Raul, Alfredo, and Segundo Suenos ("Defendants"), asserting claims under 11 U.S.C. §§ 542, 544, 548 and the Texas Uniform Fraudulent Transfer Act ("TUFTA"), and asserted that Raul, as a managing member of ARF, breached his fiduciary duties to Lisa when he transferred ARF's assets to Segundo Suenos. Defendants filed a third-party complaint against Julian, who in turn asserted seven counterclaims against Defendants, including breach of fiduciary duty and fraudulent conversion.[3] After a five-day bench trial, the bankruptcy court found that the transfer of assets from ARF to Segundo Suenos was invalid, that it constituted a fraudulent transfer under TUFTA, that Raul owed fiduciary duties to Julian and had breached those duties, and that Raul owed no fiduciary duties to Lisa. The court entered judgment for Lisa and Julian, awarding Lisa $250,000 in actual damages and $250,000 in exemplary damages, and awarding Julian $500,000 in actual damages and $500,000 in exemplary damages. Raul and Segundo Suenos appealed the judgment to the district court, which affirmed the bankruptcy court's judgment but vacated and remanded the damages awards for further consideration of Segundo Suenos's alleged expenses and for redetermination of both the actual and exemplary damages. On remand, after deducting tax liabilities that ARF incurred from 1998 to 2005, the bankruptcy

[3] Julian asserted the following counterclaims: Breach of fiduciary duty, fraudulent conversion, unfair business practices, currency in possession and received, unjust enrichment, non-disclosure of accounting, and perjury. Counterclaim Against Alfredo Galaz, Raul Galaz, Segundo Suenos, LLC, *In re Lisa Ann Galaz*, No. 08-05043 (Bankr. W.D. Tex. November 23, 2009).

court awarded Lisa $241,309.10 in actual damages and $250,000 in exemplary damages, and awarded Julian $479,216.95 in actual damages and $500,000 in exemplary damages. Appellants appealed the judgment, and the district court affirmed.[4] This timely appeal from the district court followed.[5]

STANDARD OF REVIEW

When reviewing a district court's affirmance of a bankruptcy court's judgment, this court applies "the same standard of review to the bankruptcy court decision that the district court applied." *In re Frazin*, 732 F.3d 313, 317 (5th Cir. 2013) (quoting *In re IFS Fin. Corp.*, 669 F.3d 255, 260 (5th Cir. 2012) (internal quotation marks omitted)), *cert. denied*, 134 S. Ct. 1770 (U.S. 2014). Thus, this court reviews factual findings for clear error and legal conclusions *de novo*. *Id*. *See also In re OCA, Inc.*, 551 F.3d 359, 366 (5th Cir. 2008).

DISCUSSION

A. Subject Matter Jurisdiction

The principal issues in this appeal concern the bankruptcy court's jurisdiction to entertain Lisa's and Julian's claims and the district court's role in reviewing the bankruptcy court's determinations. Appellants contend that Lisa's claims and Julian's counterclaims did not seek recovery of property taken from Lisa's estate and will not have any effect on her bankruptcy case. This court reviews the question of subject matter jurisdiction *de novo*. *In re OCA, Inc.*, 551 F.3d at 366. As will be seen, the case turns on two separate questions, the statutory and constitutional authority of the bankruptcy court. We consider each in turn.

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[4] Alfredo Galaz was not held liable.

[5] Despite being named as an appellee in this case, Julian did not participate in the proceedings before this court or the district court, even after the district court ordered Julian to file a brief during Appellants' appeal of the damages award.

No. 13-50781
Cons. w/ No. 13-50783

In *Matter of Walker*, this court explained the source of a bankruptcy court's jurisdiction:

> Jurisdiction for bankruptcy cases is rooted in the provisions of 18 U.S.C. § 1334. . . . Section 1334 provides that, with one exception, "the district court shall have original and exclusive jurisdiction of all cases under title 11." . . . Through this section, district courts, along with their bankruptcy units, are empowered to hear "cases under title 11" [i.e. the bankruptcy petition itself]. [Additionally,] § 1334(b) gives the district courts original, but not exclusive, jurisdiction over "proceedings arising under title 11"; "proceedings 'arising in' a case under title 11"; and "proceedings 'related to' a case under title 11."

51 F.3d 562, 568 (5th Cir. 1995) (internal citations omitted). Relevant to the analysis here are those cases that are at least "related to" a bankruptcy case.

> Although the Bankruptcy Code does not define "related matters," . . . we determined that a matter is related for § 1334 purposes when "'the outcome of that proceeding could *conceivably* have any effect on the estate being administered in bankruptcy.'" As we later more specifically stated, "'[a]n action is related to bankruptcy if the outcome could alter the debtor's rights, liabilities, options, or freedom of action (either positively or negatively) and which in any way impacts upon the handling and administration of the bankrupt estate.'" Conversely, "bankruptcy courts have no jurisdiction over proceedings that have no effect on the debtor."

Id. at 569 (internal citations omitted) (emphasis in original).

As the district court found, a judgment against Appellants could, at least conceivably, increase the size of Lisa's bankruptcy estate. *See In re BP RE, L.P.*, 735 F.3d 279, 282 (5th Cir. 2013) (state law claims brought by debtor against third-party non-creditors were "related to" the bankruptcy case); *Waldman v. Stone*, 698 F.3d 910, 916 (6th Cir. 2012), (bankruptcy court had subject matter jurisdiction over a debtor's state law claims in an adversary

proceeding, in part because "a damages award on [the debtor's] affirmative claims would provide assets for his other creditors"). Lisa's TUFTA claim, it must be noted, is not the paradigmatic fraudulent conveyance claim in bankruptcy, which "asserts that property that should have been part of the bankruptcy estate and therefore available for distribution to creditors pursuant to Title "was improperly removed." *Executive Benefits Ins. Agency v. Arkison*, 134 S. Ct. 2165, 2174, 189 L. Ed. 2d 83, 82 U.S.L.W. 4450 (2014). In typical bankruptcy fraudulent conveyance cases, it is the debtor who "removes" property from his estate to prevent its falling into the hands of creditors. Here, Lisa is a victim—in her status as an economic interest holder and therefore a creditor—of Raul's unauthorized transfer of ARF's assets. Her state law claim for damages and other relief is against parties who are otherwise uninvolved in the bankruptcy case and exists irrespective of the pendency of the bankruptcy case.[6]

Julian's counterclaims, in contrast, will not result in any recovery for Lisa, nor will they have any effect on her bankruptcy case. Even in light of the permissive standard for what constitutes matters "related to" bankruptcy, Julian's counterclaims as a third-party defendant fall short. *See Matter of Walker*, 51 F.3d at 569 ("As several courts have observed, 'a vast majority of cases find that "related to" jurisdiction is lacking in connection with third-party complaints.'"). Because the bankruptcy court lacked subject matter jurisdiction over Julian's unrelated third-party counterclaims, we must vacate the judgments for Julian.

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[6] As thus characterized, Lisa's claim could not arise under the Bankruptcy Code itself, 11 U.S.C. § 548, and is not a "core" claim.

Appellants also challenge the bankruptcy court's constitutional power to enter final judgment on Lisa's claims. A bankruptcy court may enter final judgment only if the court has both statutory and constitutional authority to do so. *Stern v. Marshall*, 131 S. Ct. 2594, 2608, 180 L. Ed. 2d 475, 79 U.S.L.W. 4564 (2011). A bankruptcy court's statutory authority derives from 28 U.S.C. §157(b)(1), which designates certain matters as "core proceedings" and authorizes a bankruptcy court to determine the matters and enter final judgments. *See Executive Benefits*, 134 S. Ct. at 2171. *See also Waldman*, 698 F.3d at 921-22 ("A core proceeding either invokes a substantive right created by federal bankruptcy law or one which could not exist outside of the bankruptcy." (quoting *Lowenbraun v. Canary*, 453 F.3d 314, 320 (6th Cir. 2006))), *cert denied*, 133 S. Ct. 1604 (2013). As for "non-core" proceedings, 28 U.S.C. § 157(c) authorizes a bankruptcy court either to "submit proposed findings of fact and conclusions of law to the district court," which are reviewed *de novo*, or to enter final judgment with the parties' consent. *Executive Benefits*, 134 S. Ct. at 2172.

While Section 157 gives bankruptcy courts statutory authority to enter final judgment on specific bankruptcy-related claims, "Article III of the Constitution prohibits bankruptcy courts from finally adjudicating certain of those claims." *Id*. at 2168. "Congress may not bypass Article III simply because a proceeding may have *some* bearing on a bankruptcy case; the question is whether the action at issue stems from the bankruptcy itself or would necessarily be resolved in the claims allowance process." *Stern*, 131 S. Ct. at 2618. Thus, "when a debtor pleads an action arising only under state-law, . . . or when the debtor pleads an action that would augment the bankrupt estate, but not 'necessarily be resolved in the claims allowance process[,]' then the bankruptcy court is constitutionally prohibited from

entering final judgment." *Waldman*, 698 F.3d at 919 (quoting *Sterns*, 131 S. Ct. at 2618). *Accord In re BP RE*, 735 F.3d at 285.

The district court treated Lisa's TUFTA claim as being "related to" the bankruptcy rather than a core bankruptcy claim. We agree with this characterization. The court went on, however, to hold that the bankruptcy court had authority to enter a final judgment based on the Appellants' implied consent. 28 U.S.C. § 157(c)(2); Bankr. Rule 7012; Memo Op., *Galaz v. Galaz*, No. 11-00425 (W.D. Tex April 17, 2012). This court's later decisions in *In re Frazin* and *In re BP RE* are at odds with the district court's consent rationale. Each of these cases holds that according to *Stern*, the parties' express or implied consent cannot cure the constitutional deficiency that results from circumventing, or diminishing, the Article III structural protections for the federal judiciary. *In re BP RE*, 735 F.3d at 286-87 (relying on *Waldman*, 698 F.3d at 917, 918); *In re Frazin*, 732 F.3d at 319. While the Supreme Court reserved in *Executive Benefits* the issue of the efficacy of consent to support certain final bankruptcy court judgments, *see* 134 S. Ct. at 2170 n.4, the Court has granted certiorari on a case raising that issue. *Wellness Int'l Network Ltd. v. Sharif*, 727 F.3d 751 (7th Cir. 2013), *cert. granted in part*, 134 S. Ct. 2901, 82 U.S.L.W. 3496 (2014). Until the Supreme Court decides, we are bound by controlling circuit precedent.

The failure of the consent rationale does not vitiate the lower courts' work altogether, however. As the Supreme Court recently held, claims designated for final adjudication in the bankruptcy court as a statutory matter, but prohibited from proceeding in that way as a constitutional matter, may still "proceed as non-core within the meaning of § 157(c)." *Executive Benefits*, 134 S. Ct. at 2173. Because Lisa's claim is "related to a case under title 11," 28 U.S.C. § 157(c)(1), the bankruptcy court may still hear it and "submit

proposed findings of fact and conclusions of law to the district court for *de novo* review and entry of judgment." *Executive Benefits*, 134 S. Ct. at 2173. *Id*. at 2174 (holding that the debtor's fraudulent conveyance claims "fit comfortably within the category of claims governed by § 157(c)(1)" and that the bankruptcy court would have been permitted to submit proposed findings of fact and conclusions of law on such claims). Accordingly, the district court's judgment on Lisa's TUFTA claim must be vacated and remanded for *de novo* review of the bankruptcy court's decision as recommended findings and conclusions.

B. Arbitration

Appellants contend alternatively that the bankruptcy court should have referred Lisa's claims to arbitration pursuant to an arbitration provision in the ARF Operating Agreement. "[O]nly parties to an arbitration agreement are generally bound by it," *In re Huffman*, 486 B.R. 343, 354 (Bankr. S.D. Miss. 2013). As the bankruptcy court found, Lisa was not a party to the Operating Agreement. The Operating Agreement's opening paragraph refers to "parties" as the LLC's "Members." Lisa held an only economic interest. While this circuit has recognized a limited set of circumstances in which a nonsignatory may be bound to an arbitration agreement,[7] there is no argument or evidence suggesting how Lisa, neither a Member nor a party to the LLC, is bound to the arbitration provision. As to Lisa, this argument is meritless.

C. TUFTA Claim

Appellants challenge the district court's affirmance of the bankruptcy court's judgment finding liability on Lisa's TUFTA claim. *See* Bankr. Ct. Op.,

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[7] "Six theories for binding a nonsignatory to an arbitration agreement have been recognized: (a) incorporation by reference; (b) assumption; (c) agency; (d) veil-piercing/alter ego; (e) estoppel; and (f) third-party beneficiary." *Bridas S.A.P.I.C. v. Gov't. of Turkmenistan*, 345 F.3d 347, 355-56 (5th Cir. 2003).

In re Lisa Ann Galaz, No. 08-05043 (Bankr. W.D. Tex. Nov. 12, 2010). Although the district court will ultimately review this claim *de novo* upon remand, we clarify one legal point as guidance.

TUFTA "aims to prevent debtors from fraudulently placing assets beyond the reach of creditors." *GE Capital Commercial Inc. v. Worthington Nat'l Bank*, 754 F.3d 297, 302 (5th Cir. 2014). In order to prevail on a TUFTA claim, a plaintiff must prove that (1) she is a "creditor" with a claim against a "debtor"; (2) the debtor transferred assets after, or a short time before, the plaintiff's claim arose; and (3) the debtor made the transfer with the intent to hinder, delay, or defraud the plaintiff. *Nwokedi v. Unlimited Restoration Specialists, Inc.*, 428 S.W.3d 191, 204-05 (Tex. App.—Houston [1st Dist.] 2014, pet. denied) (citing Tex. Bus. & Com. Code § 24.005(a)(1)). One issue raised here is whether Lisa qualifies as a "creditor" within the meaning of TUFTA. TUFTA defines a creditor as someone who has a "claim"—that is, a "right to payment or property, whether or not the right is reduced to judgment, liquidated, . . . fixed, contingent, matured . . . disputed, undisputed, legal, equitable, [or] secured," Tex. Bus. & Com. Code §§ 24.002(3), (4)—and defines "debtor" as "a person who is liable on a claim," *id.* at § 4.002(6).

The bankruptcy court assumed Lisa qualified as a "creditor" under TUFTA, but the district court held that Lisa had standing to assert a TUFTA claim as a creditor because she brought her claim in conjunction with other unliquidated, disputed tort claims that arose at the time ARF's assets were transferred. While we agree that Lisa qualifies as a creditor, it is more precise to say her status as a creditor turns on whether "she had a right to payment or property that existed at the time of the fraudulent transfer[] or that arose within a reasonable time afterwards." *Williams v. Performance Diesel, Inc.*, No. 14-00-00063-CV, 2002 WL 596414 at *2 (Tex. App.—Houston [14th Dist.]

Apr. 18, 2002, no pet.) (citing Tex. Bus. & Com. Code §§ 24.005(a), 24.006). Because she was an economic interest holder of ARF, which was a creature of California corporate law, she had a right to payment and was entitled to distributions from ARF before it was "dissolved" in December 2006 and Raul transferred the royalty rights. *See* Cal. Corp. Code § 17001(n) ("'Economic interest' means a person's right to share in the income, gains, losses, deductions, credit, or similar items of, and to receive distributions from, the limited liability company[.]"); *id.* at § 17300 ("[A]n economic interest in a limited liability company constitute[s] personal property of the . . . assignee.").[8] Lisa thus had standing to bring such a TUFTA claim against Appellants.[9]

Appellants raise additional arguments challenging the bankruptcy court's findings on liability, actual damages and punitive damages, but review of these factual issues is not properly before us.

Conclusion

Based on the current state of bankruptcy court jurisdiction, as interpreted by the Supreme Court and this court, we must VACATE and REMAND with instructions to DISMISS the judgment in favor of Julian Jackson, which the bankruptcy court adjudicated without jurisdiction. The

[8] Title 2.5 of the California Corporations Code, which includes all provisions applying to limited liability companies, was recently repealed, operative January 1, 2014. However, because the relevant events of this case occurred prior to the repeal, Title 2.5 of the Code applies here.

[9] Raul contends that "an economic interest holder may not bring a suit for fraudulent conveyance under California law," and relies on *PacLink Communications International v. Superior Court*, 90 Cal. App. 4th 958, 964 (Cal. App. 2d Dist. 2001), for this conclusion. However, *PacLink* does not support Raul's contention. *PacLink* focuses on the rights, or lack thereof, of shareholders to file individual suits and on the diminution of members' ownership interests in company assets. Lisa was neither a member nor a shareholder of ARF. She was an economic interest holder. Noticeably absent from *PacLink* is any discussion about the rights of economic interest holders.

bankruptcy court's judgment for Lisa Galaz must also be VACATED and REMANDED to the district court for further proceedings. *In re BP Re*, 735 F.3d at 281. The district court, in turn, may refer the case to the bankruptcy court, which may recast its judgment as proposed findings and conclusions, or may otherwise dispose of the case consistent with this opinion.

Judgment VACATED and REMANDED with instructions to DISMISS IN PART; VACATED and REMANDED for further proceedings IN PART.