
Is It or Isn't It? Property of the Estate and Exemptions in Consumer Bankruptcy Cases

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**IS IT OR ISN'T IT: PROPERTY OF
THE ESTATE AND EXEMPTIONS IN CONSUMER BANKRUPTCY CASES**

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Property of the Estate Issues

- A. Income tax refunds
- 1) Proration of current year refund
In re Meyers, 2010 WL 2990826 (7th Cir. 2010)
 - 2) Allocation of pre-petition refund between debtor and non-debtor spouse
In re Maman, 09-43339 (Bankr. ND IL, Dkt.109, May 18, 2010)
Allocate refund between filing spouse and non-filing spouse in accordance with their respective incomes.
 - 3) Election to apply pre-petition refund to post-petition tax year
 - a) Avoidable by trustee
Nichols v. Birdsell, 491 F. 3rd 987 (9th Cir. 2007)
 - b) Not avoidable by trustee
Weinman v. Graves (In re Graves) , 609 F.3d 1153 (10th Cir. 2010)
- B. Unscheduled litigation
- 1) Trustee has ability to re-open estate to administer lawsuit
Kleven v Walgreen Company (In re Christian), 378 Fed. Appx. 608, 2010 WL 1252892 (7th Cir. 2010)
 - 2) Unscheduled asset remains property of estate and only trustee is real party in interest to pursue claim. *Biesek v Soo Line R.R. Co.* 440 F.3d 410 (7th Cir.2006)
 - 3) Debtor can be judicially estopped from pursuing lawsuit. *In re Hovis* 356 F.3d 820 (7th Cir. 2004) and cases cited therein. See also *Cannon-Stokes v Potter*, 453 F.3d 446 (7th Cir. 2006) (judicial estoppel precludes debtor from pursuing claim she concealed from creditors), but see *Matthews v. Potter* 316 Fed. Appx 518, 105 Fair Empl. Prac. Cas. (BNA) 1790 (7th Cir. 2009) (debtor not judicially estopped from pursuing claims if disclosed during bankruptcy, judicial estoppel does not apply to claims for injunctive relief).

C. Legal malpractice actions

- 1) *In re Wolff*, 2010 WL 27335 (BC NDIL 2010) Malpractice claim arising during chapter 11 is property of the estate in subsequent chapter 7 case and Trustee is authorized to prosecute or settle claim.
- 2) *In re Holstein*, 321 B.R. 229 (BC ND IL 2005) Malpractice claim arising or accruing under state law after commencement of chapter 7 case is not property of estate and may be pursued by debtor.

D. Disclaimer of inheritance

- 1) Prepetition disclaimer effective and unavoidable
In re Atchison, 925 F.2d 209 (7th Cir. 1991)
- 2) Postpetition disclaimer ineffective and avoidable
In re Chenoweth, 3 F. 3d 1111 (7th Cir. 1993)

E. Prepetition transfers of property to true owner

- 1) *Lee Supply Corporation v Agnew (In re Agnew)* 818 F.2d 1284 (7th Cir. 1987)
Transfer of entireties property to wife not fraudulent transfer, did not diminish estate, property was at all times exempt from claims of creditors.

Exemption Issues

A. Lien avoidance and procedures to assert exemptions

- (1) *In re Wells*, 05-13437 (ND. Ind. Sept 3, 2008)
Judicial lien can be avoided when it impairs an exemption. Mathematical formula. When the amount due on account of the lien sought to be avoided, all other liens on the property and the amount of the debtor's exemption "exceeds the value that the debtor's interest in the property would have in the absence of any liens" the debtor's exemption is impaired. No impairment of exemption in absence of claim of exemption. *Practice pointer – claim the exemption even if liens exceed the value of the property if you intend to invoke §522(f)*
- (2) *In re Kelly*, 350 B.R. 778 (Bankr. ND IL 2006). Case reopened for the purpose of attempting to avoid judgment lien as impairing an exemption. Post-discharge, foreclosure sale resulted in surplus. Debtor sought to avoid a judgment lien so as to be able to participate in the surplus from the foreclosure sale as a part of his homestead exemption. The dispute was framed as whether Debtor could partially avoid creditor's lien in order to assert homestead exemption. Creditor had a lien against debtor's interest as well as interest of co-owner non-debtor. While debtor established a prima facie case, Judge Squires denied the motion on the ground of laches.

- (3) *In re Orr*, 304 B.R. 875 (Bankr. SD IL 2004). It is not necessary that the debtor own the property in question at the time the lien avoidance motion is brought so long as the debtor owns the property at the time the bankruptcy case was filed.
- (4) *In re Linane*, 291 B.R. 457 (Bankr. ND IL 2003). A deficiency judgment arising from a mortgage foreclosure is sufficiently different from a mortgage as to allow that deficiency judgment to be avoided under §522(f) notwithstanding §522(f)(2)(C). See also *In re Anderson*, 09 B 12312 (Bankr. ND. IL, January 25, 2010, Judge Hollis)
- (5) *In re Ehlen*, 207 BR 179 (WD WI 1997) - \$5,000 limit does not apply where Wisconsin exemptions allowed each debtor a \$7,500 tool of trade exemption which was impaired by consensual lien.
- (6) *In re Charnock*, 318 B.R. 720 (9th Cir. BAP 2004). Plain meaning of § 522(f) required avoidance of judicial lien that was senior to a consensual lien.
- (7) *In re Sheth* 225 B.R. 913 (Bankr. N.D. IL - 1998 - Judge Katz, *In re Vokac*, 273 B.R. 553 (Bankr. N.D. IL - 2003 - Judge Squires). Partial lien avoidance may be permitted.

B. Liquidation of partially exempt property

- 2) In kind exemptions
Schwab v. Reilly, 130 S.Ct. 2652 (USSC 2010)
- 3) Payment of exemption
In re Aldeir -09 CV 06932 (IL ND 4/21/2010). *Szekeley* requires payment of exemption on sale of automobile but car can be sold and exemption paid at the time of sale. However, this conclusion does not end the matter, because the Trustee filed notice of appeal before Judge Doyle could deal with the logistics of selling the Explorer and disposing of the proceeds. Because the Debtor represented to the bankruptcy court that his ex-brother-in-law has possession of the vehicle, the Bankruptcy Court must establish procedures for obtaining delivery and sale of the vehicle. For example, the Debtor could be ordered to have the Explorer delivered to a dealer or other buyer chosen by the Trustee so that the Debtor can receive payment of his exemption upon the sale.

C. Unscheduled assets

1. Unscheduled assets remain property of estate and are not deemed abandoned on closing of case. See 11 U.S.C. 544(c) and (d). *Biesek v Soo Line R.R.*, 440 F.3d 410 (7th Cir 2006).

2. Errors and omissions in schedules may be remedied by amendment, as a matter of at any time before case is closed. Bankruptcy Rule 1009(a); *In re Yonikus*, 996 F.2d 866, 872 (7th Cir. 1993); *In re Shethi*, 389 B.R. 588, 597 (Bankr. ND IL 2008); *In re Dzielak*, 2010 WL 3236770 (Bankr. ND IL 2010).
3. Amendment may be denied on a showing of bad faith or prejudice to creditors by clear and convincing evidence. *In re Yonikus*, 996 F.2d at 872; *Payne v Wood*, 775 F.2d 202, 205 (7th Cir. 1985). See also *In re Robinson*, 292 B.R. 599 (Bankr. S.D. Ohio, 2003).

D. Medical malpractice actions

1. Healing Arts Malpractice Act, ILCS 5/2-1701 et seq contains provision that benefits payable for future damages for loss of earnings are exempt from garnishment attachment execution and other process or claim to the extent that wages are exempt. Also provides that periodic installments for all future damages are exempt from garnishment, attachment execution and any other process or claim. See ILCS 5/2-1716.
2. Exemption rarely invoked and application is unclear. No reported cases applying exemption.

E. Mobile debtors and debtors' with property in other states

In re Holland, 2009WL2971087 (BC NDIL 2009)

F. Exemption planning

In re Smiley, 864 F.2d 562 (7th Cir. 1989) is the right starting point. In addition to discussing at length the essential elements of a cause of action for the denial of discharge based on a fraudulent transfer, the court also pointed out the proper standard of proof. In order to establish fraud under 11 USC §727(a)(2)(A), the plaintiff must establish that the debtor acted with actual intent, as established through the debtor's pattern of conduct. Actual intent is rarely proven by direct evidence. Rather, it is inferred through extrinsic evidence. The standard of proof is the preponderance of the evidence *Grogan v. Garner*, 498 US 279 (1991). Proof of harm to a particular creditor is not a required element. *In re Smiley*, 864 F.2d at 569. *In re Snyder*, 152 F.3d 596, 601 (7th Cir. 1998).