Southwest Bankruptcy Conference

Judicial Round-and-Round

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ABI Southwest Judicial Roundtable Discussion
Issues around the BAPCPA limitations of homestead exemptions

Issue

What are some potential issues that may arise related to the federal limitations on state homestead exemptions?

Summary

In 2005, Congress enacted Subsections (o), (p), and (q) of section 522 to curb perceived abuses of state homestead exemptions. These subsections impose a federal cap on the amount a debtor can exempt under state law if the debtor converted nonexempt property into exempt property with fraudulent intent; acquired an interest in the homestead within 1,215 days before filing the petition; or committed certain bad acts. If these provisions apply, a state homestead exemption is limited to $189,050 for cases filed after April 1, 2022.[1]

Although these limitations have been around since 2005, changes to state homestead statutes, increased scrutiny by trustees, and increases in equity may trigger cases involving these limitations in jurisdictions where they were virtually unknown before. For example, Washington recently amended its homestead exemption to allow debtors to exempt an amount of equity, which currently ranges from $229,200 to $887,500.[2] With the recent rises in home price, debtors in states like Washington are starting to trigger the conditions required to impose these federal limitations on their state law exemptions.

A. Issues with Section 522(p)

Section 522(p) is concerned with an "interest" that was acquired within 1215-days of filing the petition. This provision provides:

> (1) Except as provided in paragraph (2) of this subsection and sections 544 and 548, 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 interest that was acquired by the debtor during the 1215-day period preceding the date of the filing of the petition that exceeds in the aggregate $189,050 in value in—
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> (A) real or personal property that the debtor or a dependent of the debtor uses as a residence;
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> (B) a cooperative that owns property that the debtor or a dependent of the debtor uses as a residence;
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> (C) a burial plot for the debtor or a dependent of the debtor; or
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> (D) real or personal property that the debtor or dependent of the debtor claims as a homestead.

One issue is what is considered an "interest" in property? Does this include equity in the property, or only title to the property? Does "interest acquired" include equity that accrues on the homestead within 1,215 days of filling the petition?

[1] Pursuant to 11 U.S.C. § 104, the amount is adjusted every three years to account for changes in the cost of living. For cases commenced in the three-year period before April 1, 2022, the amount is $170,350.

[2] The Washington homestead exemption amount is based on the county's median sale price for a single-family home in the preceding calendar year. *See* RCW 6.13.030.

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Some courts have found that "interest" refers to equity in homestead property, rather than title or ownership interest. *See*, *e.g., In re Meguerditchian*, 566 B.R. 102 (Bankr. D. Mass. 2017) (finding that the word "interest" appears in subsections (p)(1) and (p)(2)(B), and while not expressly defined in § 522, § 541(a)(1) makes clear that the "interests of the debtor in property" of the bankruptcy estate can be "solely equitable in nature."); *Parks v. Anderson*, 406 B.R. 79 (D. Kan. 2009); *Venn v. Reinhard (In re Reinhard),* 377 B.R. 315, 320 (Bankr. N.D. Fla. 2007) (deciding that "interest" refers to equity and not ownership under § 522(p)); *In re Rasmussen,* 349 B.R. 747, 756 (Bankr. M.D. Fla. 2006) (interpreting "interest" to mean acquisition of equity under § 522(p)).

Other courts interpreted "interest" to mean title to property. *See, e.g.*, *In re Greene*, 583 F.3d 614, 624 (9th Cir. 2009) (concluding that filing a homestead claim for an underlying property interest does not fall within § 522(p) because a homestead claim is not an ownership interest); *In re Aroesty*, 385 B.R. 1, 7 (1st Cir. BAP 2008) (holding that a debtor who previously held a beneficial interest in real property held in trust acquired an "interest" under § 522(p) when record title was received to the trust); *In re Sainlar*, 344 B.R. 669, 673 (Bankr. M.D. Fla.2006) (concluding that the term "interest" in § 522(p) means title interest because the phrase "interest that was acquired" implies actively acquiring title to property); *In re Blair*, 334 B.R. 374, 376–77 (Bankr. N.D. Tex. 2005) (concluding that the plain meaning of "interest" in real property under § 522 is the title to a home because "one does not actually 'acquire equity in a home'").

<u>Courts have applied the § 522(p) limitation where:</u>

- The debtor lived in the home for more than ten years before filing the petition but only acquired legal title within 1,215 days of filing. *In re Aroesty*, 385 B.R. 1 (1st Cir. BAP 2008).
- The debtor partitioned community property with fraudulent intent to avoid the § 522(p) cap, resulting in the non-debtor spouse being limited to what she could recover under the debtor's capped homestead. *Matter of Wiggains*, 848 F.3d 655 (5th Cir. 2017).
- The debtor acquired the property more than 1,215 days before filing the petition, but within three months of filing the petition converted nonexempt assets of $240,000 to pay the mortgagee thereby significantly increasing the equity in the residence. *Parks v. Anderson*, 406 B.R. 79 (D. Kan. 2009).
- Spouses resided in the property for more than 1,215 days but transferred homestead property between themselves within 1,215 days. *In re Gentile*, 483 B.R. 50 (Bankr. D. Mass. 2012).
- The debtor acquired the interest in his residence, within 1,215 days of filing the petition when he conveyed the property to a trust of which he was the trustee. *In re Stella*, 470 B.R. 1 (Bankr. D. Mass. 2012).

<u>Courts have declined to apply the § 522(p) limitation where:</u>

- Debtor inherited the property more than 1,215 days before filing the petition but began occupying the property as a homestead within 1,215 days of filing. *In re Rogers*, 513 F.3d 212 (5th Cir. 2008).
- The trustee failed to prove that the debtor acquired equity in the homestead exceeding the § 522(p) cap. *In re Schreiber*, 466 B.R. 903 (Bankr. S.D. Tex. 2012).
- The debtor acquired the property more than 1,215 days before filing the petition but did not establish residency by moving a recreational vehicle and tent onto the property until within 1,215 days of filing. *In re Greene*, 583 F.3d 614, 624 (9th Cir. 2009).

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Another issue raised by § 522(p) is whether "interest acquired" includes equity that accrues on the homestead within the 1,215 days.

Some courts have distinguished "equity" from "interest" and held that § 522(p) does not apply to the increased equity within the 1,215-day period as a result of appreciation. *See In re Blair*, 334 B.R. 374 (Bankr. N.D. Tex. 2005) (Holding that debtors' increased equity in the homestead as result of mortgage payments made within the 1,215-day period before filing the petition was not an "interest acquired" within 1,215 days of filing sufficient to trigger the § 522(p) cap); *In re Sainlar*, 344 B.R. 669, 673 (Bankr. M.D. Fla. 2006) (holding that "interest" means an ownership interest, not the accumulation of equity gained after ownership was acquired.).

Other courts have drawn a distinction between active and passive acquisition of equity have held that the term "interest" encompasses the active, but not passive, acquisition of equity during the 1,215-day period. *See In re Rasmussen,* 349 B.R. 747 (Bankr. M.D. Fla. 2006).[3] The *Rasmussen* court drew a distinction between an "active" and a "passive" acquisition of interest. Focusing on the term "acquired by the debtor," the court concluded that the statute applies to an active acquisition of interest such as purchase, making a down payment, or paying down a mortgage, but not a "passive" acquisition such as appreciation of equity by mere increase in market value.

B. Issues with Section 522(q)

This section applies to debtors who have been convicted of a felony that demonstrates that the filing of the case is an abuse of the Code. Section 522(q)(1)(A) states:

> (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 $189,050 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.

This provision raises four discrete questions of law: (1) Has the debtor elected to exempt property under state law?; (2) Has the debtor claimed a state homestead exemption in excess of the cap?; (3) Has the debtor been convicted of a felony as defined in 18 U.S.C. § 3156?; and (4) Does the felony conviction demonstrate that the filing of the case was an abuse of the Code?

The first question is whether the debtor has elected an exemption under state law.[4] There is some disagreement on whether debtors in opt out states can "elect" an exemption under state law. *Compare In re McNabb*, 326 B.R. 785 (Bankr. D. Ariz. 2005) (holding that debtors in opt out states do not have a choice between state and federal exemptions and therefore cannot "elect" an exemption under state law), *with In re Wayrynen*, 332 B.R. 479 (Bankr. S.D. Fla. 2005) (holding that the exemption cap applies in all states, including opt out states), *and In re Rasmussen*, 349 B.R. 747 (Bankr. M.D. Fla. 2006) (same).

[3] *See also In re Chouinard*, 358 B.R. 814 (Bankr. M.D. Fla. 2006); *In re Fehmel*, 372 F. App'x 507 (5th Cir. 2010).
[4] This question applies to both subsections (p) and (q).

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The second question concerns whether the debtor has claimed an exemption exceeding the statutory cap. This question requires a fact-specific analysis and is likely determinative on the applicable state's property and exemption law. However, this question may become more complicated if the property is jointly owned by a felon debtor and a non-felon debtor.

Judge Heston addressed the third and fourth questions in *In re Cotton*. *See In re Cotton,* No. 21-40847, 2022 WL 1132215 at *1 (Bankr. W.D. Wash. Apr. 15, 2022); Order Granting Partial Summary Judgment at 9–11, *In re Cotton*, No. 21-40847 (Bankr. W.D. Wash. Nov. 16, 2021), ECF No. 35.

In *Cotton*, a debtor was previously convicted of sexual abuse of a minor, who later obtained a judgment lien against the debtor for damages that resulted from the abuse. The court had to determine whether a felony conviction under state law meets the definition required for § 522(q) and whether the felony conviction demonstrated an abusive filing.

The court first determined that a felony under state law falls within the definition of the statute. Next, the court found that the language "demonstrates that the filing of the case was an abuse" modifies the felony conviction, which suggests that—at a minimum—there must be some nexus between the felony conviction and the filing of the case. The court noted that one way a debtor's felony conviction can demonstrate an abuse of the Code is if the felony arises from bankruptcy fraud or perjury within a bankruptcy proceeding.[5] Another way a felony conviction can demonstrate an abusive filing is by "showing that the debtor is 'attempting to discharge civil liability owing to victims of the crime, or that the bankruptcy filing may in some manner impede the debtor's obligation to pay restitution related to the felony conviction.'"[6]

That court found that the debtor filed the petition in an attempt to avoid the judgment lien of his abuse victim which would likely preclude any meaningful recovery by the victim. Accordingly, the court concluded that the nexus between the felony conviction and the filing of the petition demonstrated an abuse of the code and the § 522(q)(1)(A) cap applied.

C. Issues with Section 522(m)

If the exemption caps of § 522(o), (p), or (q) apply, subsection (m) may allow joint debtors to double the cap applied to their homestead. Section 522(m) provides: "Subject to the limitation in subsection (b), this section shall apply separately with respect to each debtor in a joint case." In effect, this provision may allow joint debtors to increase the applied cap from $189,050 to $378,100.[7] This "doubling" applies to joint debtors in all states because the cap is purely a concept of federal law and § 522(m) applies that cap separately to each debtor.[8]

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[5] Citing *In re Prince, No. 09-43627*, 2011 Bankr. LEXIS 5511 (Bankr. E.D. Tex. July 25, 2011).
[6] Quoting Collier on Bankruptcy ¶ 522.13 (Richard Levin & Henry J. Sommer eds., 16th ed.).
[7] *See, e.g.*, *In re Nestlen*, 441 B.R. 135 (10th Cir. BAP 2010); *In re Gentile*, 483 B.R. 50 (Bankr. D. Mass. 2012) (holding that Massachusetts homestead exemption was capped by § 522(p)(1) but joint debtors may "stack" the capped exemption under § 522(m)); *In re Limperis*, 370 B.R. 859 (Bankr. S.D. Fla. 2007) (holding that where the homestead exemption was limited by § 522(p), joint debtors could double the limitation under § 522(m)); *In re Davis*, No. 22-40279-MJH, 2022 WL 2500331 (Bankr. W.D. Wash. July 6, 2022) (holding that § 522(m) allows joint debtors to stack the § 522(p) exemption cap).
[8] *See In re Nestlen*, 441 B.R. 135 (10th Cir. BAP 2010)*; In re Davis*, No. 22-40279-MJH, 2022 WL 2500331 (Bankr. W.D. Wash. July 6, 2022).

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Judge Heston recently held in *In re Davis*, that the plain language of § 522(m) requires the cap imposed by § 522(p) to be applied separately to joint debtors, effectively doubling the $170,350 cap when each debtor has an ownership interest. *In re Davis*, No. 22-40279-MJH, 2022 WL 2500331 (Bankr. W.D. Wash. July 6, 2022). In *Davis*, the debtors moved to compel the chapter 7 Trustee to abandon real property that was acquired within 1215 days of filing the petition. The Trustee argued that if the debtor's exemption was capped at $170,350, the property had value to estate, but if § 522(m) allows joint debtors to double the exemption cap imposed by § 522(p), the property was inconsequential to the estate and could be abandoned.

Judge Heston concluded that § 522(m) applies requires courts to apply the exemption cap separately to each joint debtor, reasoning that subsection (m) does not authorize joint debtors to each claim a separate state homestead exemption, but instead, applies the federal cap to each Debtor, meaning that each Debtor's share of the homestead is value-capped at $170,350. Effectively allowing debtors to double the amount of the cap. Debtors 'aggregate homestead exemption is capped at $340,700.

Possible Discussion Points

(1) Do you think the title definition or the equity definition of "interest" in § 522(p) is more persuasive? Why?
(2) Does "interest acquired" include equity that accrues on the homestead within 1,215 days of filling the petition?
(3) Do you agree with the distinction between an interest acquired "actively" and "passively"?
(4) Do you find ambiguity in § 522(m), (p), or (q)?
(5) Can debtors in opt out state's "elect" an exemption under state law?

Secondary Sources Used

WILLIAM HOUSTON BROWN ET AL., HOMESTEAD CAPS—SECTION 522(O), (P), AND (Q), BANKR. EXEMPTION MANUAL § 4:8 (June 2022).

Bankr. Exemption Manual § 4:8

Bankruptcy Exemption Manual | June 2022 Update
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Chapter 4. State Opt Out and Limitations on State Exemptions (Section 522(b))

§ 4:8. Homestead caps—Section 522(o), (p), and (q)

West's Key Number Digest

- West's Key Number Digest, Bankruptcy 2774
- West's Key Number Digest, Bankruptcy 2797.1
- West's Key Number Digest, Bankruptcy 2798

Legal Encyclopedias

- C.J.S., Bankruptcy § 172
- C.J.S., Bankruptcy §§ 176 to 177
- C.J.S., Bankruptcy § 182

Subsections (o), (p), and (q) of section 522 curb perceived abuses of the homestead exemption. These subsections apply to the debtor's homestead exemption even if the debtor's homestead choice is controlled by an opt-out state, thus significantly limiting the opt out. The court in In re Rensin, 600 B.R. 870, 889 (Bankr. S.D. Fla. 2019), concluded that the sections are "intended to work together." The debtor argued that when section 522(p) applied to property purchased within the 1,215 days preceding bankruptcy that section 522(o) was not applicable, but the court disagreed, holding that both sections 522(o) and (p) could apply. "Section 522(p) automatically limits the value of a homestead exemption where the home was acquired during the 1,215 days prior to the bankruptcy. Section 522(o) provides for a reduction in the homestead value claimed, including the capped homestead value when section 522(o) applies, where it is shown that the debtor used non-exempt assets to obtain value in a homestead with the intent to stymie creditors." Although the Florida home was acquired within the 1,215 days, the *Rensin* Court found that the debtor was not entitled to any Florida homestead exemption because of the application of section 522(o).

10-year look-back for fraudulent transfers—Section 522(o)

Subsection (o) enables the trustee to reduce the amount of an exemption by the amount that it might have increased as a result of efforts to defraud a creditor any time in the 10 years prior to the filing of the petition. 11 U.S.C.A. § 522(o) provides that:

> (o) For purposes of subsection (b)(3)(A), and notwithstanding subsection (a), the value of an interest in—
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> (1) real or personal property that the debtor or a dependent of the debtor uses as a residence;
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> (2) a cooperative that owns property that the debtor or a dependent of the debtor uses as a residence;
>
> (3) a burial plot for the debtor or a dependent of the debtor; or
>
> (4) real or personal property that the debtor or a dependent of the debtor claims as a homestead;
>
> shall be reduced to the extent that such value is attributable to any portion of any property that the debtor disposed of in the 10-year period ending on the date of the filing of the petition with the intent to hinder, delay, or defraud a creditor and that the debtor could not exempt, or that portion that the debtor could not exempt, under subsection (b), if on such date the debtor had held the property so disposed of.

Under section 522(o), prebankruptcy conversion of nonexempt assets to exempt assets is permissible as long as there was no intent to hinder, delay or defraud a creditor. See, for example, In re Wrobel, 508 B.R. 271 (Bankr. W.D. N.Y. 2014) (construing § 522(o), mere pre-bankruptcy conversion of non-exempt to exempt property is not sufficient for limitation of state homestead). Contrast In re Smither, 542 B.R. 39 (Bankr. D. Mass. 2015) (property was subject to reduction under section 522(o) to extent attributable to fraudulent conversion from nonexempt to exempt). See also § 8:2 for discussion of prebankruptcy conversion of assets.

The subsection is applied to limit a homestead only where there is actual intent to hinder, delay, or defraud. The Court in In re Shaw, 622 B.R. 569 (Bankr. D. Conn. 2020), examined the triggering elements under section 522(o) and found that the section did not limit a Chapter 7 debtor's homestead notwithstanding pre-bankruptcy transfers between the debtor and her mother. The parties had exchanged quit-claim deeds within the 10-year period, but there was no evidence of any value exchanged or any proceeds received by the debtor for the deed to her mother. When the mother transferred an undivided interest back to the debtor, section 522(o) did not apply because it was not a transfer from the debtor, and there was no evidence of fraudulent intent by the debtor in any transfer. The *Shaw* Court allowed the debtor's claimed homestead exemption in the jointly-owned property and avoided an impairing judgment lien under section 522(f). See chapter 6 for lien avoidance.

For other examples of lack of fraudulent intent, see In re Roberts, 527 B.R. 461 (Bankr. N.D. Fla. 2015); In re Corbett, 478 B.R. 62 (Bankr. D. Mass. 2012); In re Presto, 376 B.R. 554, 52 A.L.R. Fed. 2d 689 (Bankr. S.D. Tex. 2007). The trustee or objecting creditor bears the burden of proving the fraudulent intent. In re Coppaken, 572 B.R. 284 (Bankr. D. Kan. 2017) (judgment creditor satisfied burden of showing debtor's conversion of assets with requisite fraudulent intent); In re Osejo, 447 B.R. 352 (Bankr. S.D. Fla. 2011) (trustee carried burden of showing intent to hinder, delay, or defraud creditors); In re Agnew, 355 B.R. 276 (Bankr. D. Kan. 2006); see also In re Sissom, 366 B.R. 677 (Bankr. S.D. Tex. 2007) (discussing elements of proof on actual intent). The burden of proof is preponderance of evidence. Wolters v. Lakey, 456 B.R. 687 (D. Kan. 2011); In re Cook, 460 B.R. 911 (Bankr. N.D. Fla. 2011). Construing section 522(o), the court in In re Maronde, 332 B.R. 593, 55 Collier Bankr. Cas. 2d (MB) 51, Bankr. L. Rep. (CCH) P 80394 (Bankr. D. Minn. 2005), stated some of the badges of fraud that the court may consider in passing on the debtor's intent to defraud a creditor:

1. the transfer or obligation was to an insider;

2. the debtor retained possession or control of the property transferred after the transfer;
3. the transfer or obligation was disclosed or concealed;
4. before the transfer was made or obligation was incurred, the debtor had been sued or threatened with suit;
5. the transfer was of substantially all of the debtor's assets;
6. the debtor absconded;
7. the debtor removed or concealed assets;
8. the value of the consideration received by the debtor was not reasonably equivalent to the value of the asset transferred or the amount of the obligation incurred;
9. the debtor was insolvent or became insolvent shortly after the transfer was made or the obligation was incurred;
10. the transfer occurred shortly before or shortly after a substantial debt was incurred; and
11. the debtor transferred the essential assets of the business to a lienor was transferred the assets to an insider of the debtor.

Maronde, 332 B.R. at 600 (citing In re Northgate Computer Systems, Inc., 240 B.R. 328, 360–61 (Bankr. D. Minn. 1999)). The *Maronde* court reduced the debtor's homestead but also used the finding of fraudulent intent as a basis to find lack of good faith and denial of the Chapter 13 debtor's confirmation. See also In re Addison, 368 B.R. 791, Bankr. L. Rep. (CCH) P 80889 (B.A.P. 8th Cir. 2007), aff'd in part, rev'd on other grounds in part, 540 F.3d 805, 60 Collier Bankr. Cas. 2d (MB) 299, Bankr. L. Rep. (CCH) P 81298, 48 A.L.R. Fed. 2d 829 (8th Cir. 2008) (to determine whether debtor's eve of bankruptcy conversion of assets was effected with intent to hinder, delay, or defraud creditors, bankruptcy court appropriately used badge-of-fraud approach but erred in finding debtor's intent was such as to warrant the limitation of his exemption rights); In re Wilmoth, 397 B.R. 915, 61 Collier Bankr. Cas. 2d (MB) 463, Bankr. L. Rep. (CCH) P 81373 (B.A.P. 8th Cir. 2008) (section 522(o) did not change prior standard of determining fraudulent conversion of asset; it merely added 10-year look back); In re Lacounte, 342 B.R. 809, Bankr. L. Rep. (CCH) P 80653 (Bankr. D. Mont. 2005).

In In re Booth, 417 B.R. 820 (Bankr. M.D. Fla. 2009), the court held that the debtor did not commit any acts with the intent to hinder, delay, or defraud her creditors, therefore the Florida homestead exemption was allowed. The court stated:

> None of the traditional badges of fraud are present. She fully and credibly explained her actions.
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> The Debtor lives a modest lifestyle and had no financial problems until her daughter defaulted on the line of credit payments. She has no priority unsecured debts and she is current with her car payments. Her credit card debt is modest. Her credit card billing statements and Schedules reflect a history of responsible credit card use. She did not purchase luxury goods or take cash advances. She consistently paid her credit card bills. The balance of her Chase credit card was $351.56 when she incurred the home repair charges.
>
> Even though the Debtor's income was decreasing in early 2009, her expenses were manageable. She was able to cover the first mortgage, her car and credit card payments, and living expenses. Her financial world collapsed with her daughter's disclosure of the line of credit default. The default was the tipping point, turning the Debtor's manageable financial situation to unmanageable. The Palmetto Road debt spiraled out of control. The economic crash made her situation desperate. Her business dwindled and Palmetto Road depreciated. The Debtor panicked. She made the best decisions she could under tremendous financial stress and without the benefit of comprehensive professional advice.

In re Booth, 417 B.R. 820, 825 (Bankr. M.D. Fla. 2009).

The Tenth Circuit Bankruptcy Appellate Panel in In re Willcut, 472 B.R. 88, 67 Collier Bankr. Cas. 2d (MB) 1636, Bankr. L. Rep. (CCH) P 82272 (B.A.P. 10th Cir. 2012), interpreted the statute's phrase "value of an interest in … real property" to refer to "the measure of the increase in monetary value of the economic interest in real property claimed as a homestead due to a fraudulent transfer of non-exempt funds into the property, rather than a title interpretation of the word 'interest.'" In re Willcut, 472 B.R. 88, 67 Collier Bankr. Cas. 2d (MB) 1636, Bankr. L. Rep. (CCH) P 82272 (B.A.P. 10th Cir. 2012). The BAP found no indication that Congress intended to change the view that "mere conversion of nonexempt property into exempt property, without fraudulent intent, does not deprive the debtor of exemption rights in the converted property, … [with] the purpose of adding § 522(o) and § 522(p) in 2005 … to address the pre-BAPCPA 'mansion loophole' and to limit the value of homestead exemptions when there is fraud. This leads to our interpretation of § 522(o)—that the statute was enacted to prevent the fraudulent attempt to build up equity in a homestead." In re Willcut, 472 B.R. 88, 67 Collier Bankr. Cas. 2d (MB) 1636, Bankr. L. Rep. (CCH) P 82272 (B.A.P. 10th Cir. 2012). When there is no equity in the homestead property, "there is no value subject to reduction." In re Willcut, 472 B.R. 88, 67 Collier Bankr. Cas. 2d (MB) 1636, Bankr. L. Rep. (CCH) P 82272 (B.A.P. 10th Cir. 2012). The BAP affirmed the bankruptcy court's finding of no equity and overruling the trustee's objection to homestead exemption.

The Eighth Circuit Bankruptcy Appellate Panel stressed the importance of the word "attributable" in the statute, holding that where a debtor's alleged fraudulent conversion of non-exempt assets was used to make improvements to the otherwise exempt homestead, the homestead is not automatically reduced by the full amount spent on the improvements; rather, section 522(o) requires a showing of the extent to which the improvements actually increased the value of the homestead attributable to the conversion. In re Crabtree, 562 B.R. 749, Bankr. L. Rep. (CCH) P 83058 (B.A.P. 8th Cir. 2017). To prove this reduction, the Court stated:

> Where a debtor fraudulently converts nonexempt assets to make improvements to his homestead, a bankruptcy court must therefore determine both the value of the debtor's interest in the homestead with those improvements and the value of the debtor's interest in the homestead without those improvements. In most such cases, the difference will be the value of the debtor's interest in the homestead that is "attributable" to the improvements and thus the amount by which the value of the debtor's interest in the homestead must be reduced. The amount the debtor spent on the improvements is relevant only to the extent an appraiser might take it into account in valuing the homestead with the improvements.

In re Crabtree, 562 B.R. at 753–754.

Assuming a reduction in homestead is established for purposes of section 522(o), the question then becomes how a trustee realizes recovery of the reduction. The debtor may still have an exemption, but it is reduced under the statute to the extent attributable to fraudulent disposition. However, if all proceeds attributable to property disposed of in the 10-year period were tainted with fraudulent intent, the entire homestead exemption may be denied. See, e.g., In re Rensin, 600 B.R. 870 (Bankr. S.D. Fla. 2019). The court in In re Colliau, 552 B.R. 158 (Bankr. W.D. Tex. 2016), agreed with another decision from its district, holding that it would be appropriate to impose an equitable lien on the property, permitting the trustee to sell the property to recover the amount of the reduced homestead exemption. The *Colliau* debtors had claimed exemption in 100% of the fair market value, but that value was reduced by $11,156 under section 522(o), and the trustee would be allowed to sell the property to recover $11,156, and the court concluded that it had authority to issue an equitable lien under section 105(a). The court gave the debtors 90 days to satisfy the lien before the trustee could sell the property. See also In re Sissom, 366 B.R. 677 (Bankr. S.D. Tex. 2007) (applying an equitable lien under section 522(o)).

Section 522(o) applies only to exemptions claimed under subsection (b)(3)(A) and not to those allowable under (b)(3)(B), meaning that entirety or joint interests that are protected under state law are not subject to section 522(o)'s restrictions. In re McCallan, 629 B.R. 491 (Bankr. M.D. Ala. 2021); In re Hinton, 378 B.R. 371 (Bankr. M.D. Fla. 2007).

Although Florida had traditionally taken a liberal stance as to allowing its homestead exemption, courts in that state have held that to the extent the Florida homestead conflicts with section 522(o), "by virtue of the Supremacy Clause, 11 U.S.C.A. § 522(o) preempts Florida's constitutional homestead exemption." In re Garcia, 2010 WL 2697020 (Bankr. S.D. Fla. 2010). Accord In re Osejo, 447 B.R. 352 (Bankr. S.D. Fla. 2011).

$189,050 cap on increase in homestead value acquired within 1,215 days of petition—Section 522(p)

Subsection (p) limits the amount of the homestead that was acquired within 1,215 days of filing the bankruptcy petition. The amount in the statute is subject to automatic adjustment every three years, under 11 U.S.C.A. § 104, and the most recent adjustment took effect April 1, 2022. As will be discussed later, some controversy results from the language used in this subsection, referring to "electing" state or local exemptions, a distinction from prior subsection (o), which simply refers to any homestead exemption "for purposes" of section 522(b)(3)(A). Section 522(p) provides:

> (p)(1) Except as provided in paragraph (2) of this subsection and sections 544 and 548, 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 interest that was acquired by the debtor during the 1215-day period preceding the date of the filing of the petition that exceeds in the aggregate $189,050 in value in—
>
> (A) real or personal property that the debtor or a dependent of the debtor uses as a residence;
>
> (B) a cooperative that owns property that the debtor or a dependent of the debtor uses as a residence;
>
> (C) a burial plot for the debtor or a dependent of the debtor; or
>
> (D) real or personal property that the debtor or dependent of the debtor claims as a homestead.
>
> (2)(A) The limitation under paragraph (1) shall not apply to an exemption claimed under subsection (b)(3)(A) by a family farmer for the principal residence of such farmer.
>
> (B) For purposes of paragraph (1), any amount of such interest does not include any interest transferred from a debtor's previous principal residence (which was acquired prior to the beginning of such 1215-day period) into the debtor's current principal residence, if the debtor's previous and current residences are located in the same State.

Section 522(p) is concerned with an "interest" acquired by the debtor during the 1,215-day period preceding the filing of the petition. The term "interest" has been interpreted to refer to equity in the homestead property, rather than title or ownership interests. In re Meguerditchian, 566 B.R. 102 (Bankr. D. Mass. 2017); Parks v. Anderson, 406 B.R. 79, Bankr. L. Rep. (CCH) P 81492 (D. Kan. 2009); see also In re Willcut, 472 B.R. 88, 67 Collier Bankr. Cas. 2d (MB) 1636, Bankr. L. Rep. (CCH) P 82272 (B.A.P. 10th Cir. 2012), agreeing with the *Parks* interpretation of "interest" and applying it in section 522(o). The *Meguerditchian* Court found that the word "interest" appears in subsections (p)(1) and (p)(2)(B), and while not "expressly defined" in the statute, in section 541(a)(1) it is clear that the "interests of the debtor in property" of the bankruptcy estate

can be "solely equitable in nature." In re Meguerditchian, 566 B.R. at 109. That Court further concluded that section 522(p)(1)'s reference to "interest" is in the context of "something quantifiable," with a focus of economic value, "and there is nothing unusual about speaking of an 'amount of' equity." In contrast, "it would be strange to speak of someone having an 'amount of' title, so title sits uneasily with subsection (p)(1) in this respect." In re Meguerditchian, 566 B.R. at 110. Going further, that Court found subsection (p)(2)(B)'s reference to transfer of an "interest" from one residence to another to "rule out any definition of 'amount of interest' that reduces it to title." Equity in one residence can be transferred to another, but title in one residence cannot be transferred into another residence. *In re Meguerditchian,* 566 B.R. at 110. That court also found that "the majority position is by far the more persuasive, that 'interest' in § 522(p) is plain in meaning and can only mean equity." *In re Meguerditchian,* 566 B.R. at 110.

Other courts have adopted a "title" interpretation of "interest." See cases cited in In re Willcut, 472 B.R. 88, 67 Collier Bankr. Cas. 2d (MB) 1636, Bankr. L. Rep. (CCH) P 82272 (B.A.P. 10th Cir. 2012), and see discussion below of interpretations of acquisition of the "interest."

If the debtor acquired the interest prior to the 1,215-day period, subsection (p) does not apply. While it may appear straightforward, application of the statute depends upon the facts and underlying state law. For example, the term "acquired" was interpreted by one court applying Minnesota law to mean that delivery of a deed and the debtor's acquisition of the property occurred when the conveying father instructed his attorney to record the deed, not at the time of the father's execution of the deed. Since the deed was recorded within the 1215-day period, section 522(p) applied. In re Bruess, 539 B.R. 560 (B.A.P. 8th Cir. 2015).

Section 522(p) was applied to limit the debtor's homestead where:

- The debtor partitioned community property with fraudulent intent to avoid the cap of section 522(p), resulting in the non-debtor spouse being limited to what she could recover under the debtor's capped homestead. Matter of Wiggains, 848 F.3d 655, 77 Collier Bankr. Cas. 2d (MB) 511 (5th Cir. 2017).
- The debtor had lived in the home for more than a decade prior to the petition date but only acquired legal title within 1,215 days of the petition date. In re Aroesty, 385 B.R. 1, Bankr. L. Rep. (CCH) P 81216 (B.A.P. 1st Cir. 2008). But compare In re Peake, 480 B.R. 367 (Bankr. D. Kan. 2012)(distinguishing Aroesty).
- The debtor acquired the property more than 1,215 days prior to commencement of the bankruptcy case, but, less than three months before filing for bankruptcy, converted nonexempt assets of $240,000 to pay the mortgagee significantly increasing the equity in the residence. Parks v. Anderson, 406 B.R. 79, Bankr. L. Rep. (CCH) P 81492 (D. Kan. 2009).
- The debtor acquired the interest in his residence, within section 522(p)'s meaning, when he conveyed the property to a trust of which he was the trustee. In re Stella, 470 B.R. 1 (Bankr. D. Mass. 2012).
- The debtor acquired the property more than 1,215 days prepetition but only began to use it as a homestead within the 1,215 days. However, on appeal, the court reversed, holding that debtor's acquisition of ownership interest outside of 1,215-day period protected his homestead exemption from monetary cap. In re Greene, 346 B.R. 835, 56 Collier Bankr. Cas. 2d (MB) 627, Bankr. L. Rep. (CCH) P 80798 (Bankr. D. Nev. 2006), subsequently aff'd in part, rev'd on other grounds in part, 583 F.3d 614, 62 Collier Bankr. Cas. 2d (MB) 829, Bankr. L. Rep. (CCH) P 81596 (9th Cir. 2009).
- The spouses transferred homestead property between themselves within 1,215 days, with fact that they continually resided there not overcoming effect of transfer. In re Gentile, 483 B.R. 50 (Bankr. D. Mass. 2012).
- The debtors acquired the property within section 522(p)'s coverage when the prior conveyance was in fraud of creditors, and re-conveyance was within statutory time period. In re Dickey, 517 B.R. 5 (Bankr. D. Mass. 2014).

Section 522(p) was not applied to limit the debtor's homestead where:

- Under Nevada law, the debtor had sufficient beneficial and equitable interest in the property as homestead prior to transfer of legal title within the 1215 days from a limited liability company, so that section 522(p)(1) did not apply. In re Caldwell, 545 B.R. 605, Bankr. L. Rep. (CCH) P 82932 (B.A.P. 9th Cir. 2016).
- Section 522(p) was a limitation on the debtor's homestead exemption but did not convert a pre-bankruptcy unenforceable judgment lien, under Texas law, into an enforceable lien against the homestead. In re McCombs, 659 F.3d 503, 66 Collier Bankr. Cas. 2d (MB) 873, Bankr. L. Rep. (CCH) P 82086 (5th Cir. 2011).
- The debtor had inherited the property more than 1,215 days prepetition, although she had begun to occupy the property as a homestead within the 1,215-day period. In re Rogers, 513 F.3d 212, Bankr. L. Rep. (CCH) P 81081 (5th Cir. 2008).
- Sections 522(o) and (p) limitations did not apply to tenancy by entirety exemption under section 522(b)(3)(B). In re McCallan, 629 B.R. 491 (Bankr. M.D. Ala. 2021).
- The objecting creditor failed to prove that the debtor acquired an interest in the homestead within 1,215 days before filing bankruptcy. In re Migell, 569 B.R. 918 (Bankr. M.D. Fla. 2017).
- The trustee failed to prove that the debtor acquired equity in the homestead in excess of section 522(p)'s cap. In re Schreiber, 466 B.R. 903 (Bankr. S.D. Tex. 2012).
- The debtor acquired the property more than 1,215 days prior to commencement of the bankruptcy case, although the debtor did not designate the property as a homestead until within the 1,215-day look-back period. In re Reinhard, 377 B.R. 315 (Bankr. N.D. Fla. 2007).
- The debtor acquired the property more than 1,215 days prior to commencement of the bankruptcy case, although the debtor did not establish residency by moving a recreational vehicle and tent onto the property until within 1,215-day period. In re Greene, 583 F.3d 614, 62 Collier Bankr. Cas. 2d (MB) 829, Bankr. L. Rep. (CCH) P 81596 (9th Cir. 2009).
- The debtor moved from a larger to a smaller home the debtor already owned. In re Jones, 397 B.R. 765 (Bankr. D. S.C. 2008).
- Under Kansas law, debtor may claim residential exemption in equitable interest in land, and transfer of legal title to self-settled trust and subsequent transfer back to debtor within 1,215 days did not trigger section 522(p). In re Peake, 480 B.R. 367 (Bankr. D. Kan. 2012) (distinguishing In re Aroesty, 385 B.R. 1, Bankr. L. Rep. (CCH) P 81216 (B.A.P. 1st Cir. 2008), based on difference in Massachusetts and Kansas law).

Another question under section 522(p) is whether the term "interest acquired" includes equity that accrues on the homestead within the 1,215 days. In re Blair, 334 B.R. 374, Bankr. L. Rep. (CCH) P 80415 (Bankr. N.D. Tex. 2005), considered this, distinguished "equity" from "interest," and held that subsection 522(p) does not apply to equity gained as a result of appreciation within the 1,215-day period; see also In re Sainlar, 344 B.R. 669, Bankr. L. Rep. (CCH) P 80712 (Bankr. M.D. Fla. 2006) (same). In Blair, the Chapter 7 debtors also continued to make mortgage payments while the case was pending, improving the equity value. These courts essentially found "interest" to mean an ownership interest, not the accumulation of equity gained after ownership was acquired; since the ownership was acquired outside the 1,215-day period, section 522(p) was not triggered. In what may foretell more case authority on this subject, another court concluded that the statute's term "interest" did encompass equity acquired during the 1,215-day period. In re Rasmussen, 349 B.R. 747 (Bankr. M.D. Fla. 2006). In *Rasmussen*, the court's analysis focused on the term "acquired by the debtor," concluding that what the statute contemplated was the debtor's acquisition of an interest by active means, including purchase, making a down payment, or paying down a mortgage. In contrast to these "active" acquisitions, accumulating equity is, according to that court, a "passive" acquisition, and the court held that appreciation of equity by mere increase in market value was not an acquisition "by the debtor." While this is a thoughtful distinction, in an appropriate cases, it could be argued that a debtor acquired equity by knowingly, "actively" purchasing property, albeit outside that 1,215-day period, that the debtor knew would increase substantially in value, including during the 1,215 days. To find a debtor's "active" role in gaining equity may not be that difficult in the right case, and it is predictable that the *Rasmussen* rationale will be seen in new attacks by trustees on homesteads with equity issues.

See In re Chouinard, 358 B.R. 814 (Bankr. M.D. Fla. 2006) (following *Rasmussen*'s passive market increase approach). The Fifth Circuit avoided adoption of a strict "title" or "equity" approach to section 522(p), holding that the debtor's Texas homestead exemption was limited by that statute when proof established that appreciation in value to the property within the 1,215 days pre-bankruptcy was attributed to actual improvements to the property, constituting "actively acquired home equity." In re Fehmel, 372 Fed. Appx. 507 (5th Cir. 2010).

In the *Meguerditchian* case, discussed above in the context of "equity," a trustee argued that section 522(p)'s cap should apply when it was alleged that the debtor acquired "equity" within the 1,215 days by rolling over the proceeds from sale of a previous residence to pay down a mortgage on the present homestead. The court concluded that section 522(p)(2)(B) protected this type of acquisition of equity, excluding from the statutory cap such amount of interest "transferred from a debtor's previous principal residence into the debtor's current principal residence. Notably, this subsection requires only a transfer 'into the debtor's current principal residence'; it does not require that the transfer have funded the acquisition of the current form of title of the current principle residence." *In re Meguerditchian,* 566 B.R. at 116. That court found the only other case directly addressing the issue to be In re Welch, 486 B.R. 1 (Bankr. D. Mass. 2013), and the *Meguerditchian* Court concluded that *Welch* "stands for the proposition that a simple change in the form of title to equity that a debtor already owns is not an acquisition of interest within the meaning of subsection (p)(1)." *In re Meguerditchian,* 566 B.R. at 117. Although the issue was raised on appeal in In re Khan, 375 B.R. 5, Bankr. L. Rep. (CCH) P 81024 (B.A.P. 1st Cir. 2007), the *Meguerditchian* Court found that it was not decided. In re Meguerditchian, 566 B.R. at 117.

The same court that had decided *Welch* applied section 522(p)'s cap when a debtor actively acquired his entire equity ownership within the 1,215 look-back period. In re Zakarian, 570 B.R. 680 (Bankr. D. Mass. 2017). In that case, the Chapter 7 debtor had been the trustee of a trust of which his wife was beneficiary, with the debtor having no beneficial interest in the property under that trust, but the trust conveyed the property to the spouses as tenants by entirety within the 1,215 days before the husband filed bankruptcy. The court concluded that the debtor actively acquired his equity interest and his homestead exemption was capped.

It has been held that the trustee may not keep the case open to wait for the value of the homestead to appreciate in value so that the trustee could potentially recover value above section 522(p)'s statutory cap. In re Colliau, 552 B.R. 158 (Bankr. W.D. Tex. 2016). That court held that the "snapshot rule," which had been reaffirmed by the Fifth Circuit in In re Brown, 807 F.3d 701 (5th Cir. 2015), required that "exemptions are determined by the law and facts as they exist on the petition date and that they do not change due to subsequent events." *Colliau,* 552 B.R. at n. 24 (citing cases on "snapshot rule").

Since some states have opted out of the federal exemption scheme and mandate the debtor's use of state law exemptions, while other states permit the debtor to elect whether to claim exemptions under federal or state law, the question has arisen as to whether subsections (p) and (q), which both use the term "electing," apply both in opt-out states and in non-opt-out states. Most courts agree that the cap on homesteads fixed by section 522(p) applies in every state, whether or not the state has opted out of the federal exemptions. In In re Wayrynen, 332 B.R. 479, Bankr. L. Rep. (CCH) P 80391 (Bankr. S.D. Fla. 2005), the court held that the phrase in subsection (p), "as a result of electing under subsection (b)(3)(A) to exempt property under State or local law," could not be interpreted to make the provision applicable only to debtors in states where a debtor may elect between federal and state schemes but not in states where the debtor has no choice other than the state scheme. "The gravamen of § 522(p)(1) is to limit the ability of individuals desiring to take advantage of the lenient exemption provisions of 'debtor-friendly' states by relocating to such states." *Wayrynen*, 332 B.R. at 486. Again, in In re Virissimo, 332 B.R. 201 (Bankr. D. Nev. 2005), the court held the provision to apply in both opt-out and non-opt-out states. Agreeing that the caps applied in opt-out states, another court, in In re Summers, 344 B.R. 108 (Bankr. D. Ariz. 2006), held that the caps did not permit debtors to increase the effective state-law homestead. See also In re Kaplan, 331 B.R. 483, 54 Collier Bankr. Cas. 2d (MB) 1676 (Bankr. S.D. Fla. 2005); In re Landahl, 338 B.R. 920, Bankr. L. Rep. (CCH) P 80514 (Bankr. M.D. Fla. 2006); In re Kane, 336 B.R. 477, 55 Collier Bankr. Cas. 2d (MB) 1148, Bankr. L. Rep. (CCH) P 80492 (Bankr. D. Nev. 2006); In re Greene, 346 B.R. 835, 56 Collier Bankr. Cas. 2d (MB) 627, Bankr. L. Rep. (CCH) P 80798 (Bankr. D. Nev. 2006), subsequently aff'd

in part, rev'd on other grounds in part, 583 F.3d 614, 62 Collier Bankr. Cas. 2d (MB) 829, Bankr. L. Rep. (CCH) P 81596 (9th Cir. 2009); In re Rasmussen, 349 B.R. 747 (Bankr. M.D. Fla. 2006).

So far, in only one reported case has the court held that section 522(p)'s cap does not apply to debtors in opt-out states. In re McNabb, 326 B.R. 785, 54 Collier Bankr. Cas. 2d (MB) 750, Bankr. L. Rep. (CCH) P 80333 (Bankr. D. Ariz. 2005) (rejected by, In re Rasmussen, 349 B.R. 747 (Bankr. M.D. Fla. 2006)). In this case, the court held that the Code's homestead cap applies only in non-opt-out states. The court rather reluctantly found the statute's "plain meaning" of the phrase in subsection (p), "as a result of electing under subsection (b)(3)(A) to exempt property under State or local law," to compel the application of the statute only to debtors who may choose between federal and state exemptions, not to debtors in states allowing only state exemptions. In its criticism of the *McNabb* holding, the court in In re Kaplan, 331 B.R. 483, 54 Collier Bankr. Cas. 2d (MB) 1676 (Bankr. S.D. Fla. 2005), noted that "[m]ore than two-thirds of the states have opted out of the federal exemptions and, if *McNabb* is followed, these new caps would only apply in Texas and Minnesota, not in states like Arizona or Florida, in which debtors must utilize state exemptions." *Kaplan*, 331 B.R. at 484.

In view of the specific language "electing," it is somewhat surprising that only the *McNabb* court reached this result. At this point, no appellate court has spoken on the issue, which future editions of this manual will continue to follow. For further examination of the new sections 522(o), (p), and (q), see Howard, Exemptions Under the 2005 Bankruptcy Amendments: A Tale of Opportunity Lost, 79 Am. Bankr. L.J. 397, 402 (2005) (available on Westlaw).

The meaning of section 522(b)(1)'s "election" was an issue in In re Connor, 419 B.R. 304 (Bankr. E.D. N.C. 2009), discussed previously in §§ 3:9 and 4:6. In *Connor*, the court held that when one joint debtor was not eligible for a state-law exemption, but the other joint debtor was, the noneligible debtor was forced to use section 522(d) exemptions under section 522(b)(3)'s domiciliary requirements; therefore, no "election" was made by that debtor, resulting in the husband and wife using different exemption schemes. The *Connor* court did not discuss the *McNabb* or other court's discussion of election in the context of section 522(p).

Since joint debtors are each entitled to their exemptions, joint debtors may stack their capped homestead exemptions. See In re Nestlen, 441 B.R. 135, Bankr. L. Rep. (CCH) P 81915 (B.A.P. 10th Cir. 2010) (statutory cap of section 522(p) was doubled in joint case filed by spouses); In re Limperis, 370 B.R. 859 (Bankr. S.D. Fla. 2007) (where the homestead exemption was unlimited as to value under Florida law but was limited by the section 522(p) cap to $125,000 (now $189,050) as to each debtor for residential property acquired during the 1,215-day period, joint Chapter 13 debtors' were entitled to stack their Florida homestead exemptions in the maximum amount of $250,000).

$189,050 cap on homestead value where fraud or crime involved—Section 522(q)

Like subsection (p)'s reference to "electing" state or local exemptions, subsection (q) limits the amount of the homestead to $189,050 if fraud or criminal activity was involved in its acquisition. The amount in the statute is subject to automatic adjustment every three years, under 11 U.S.C.A. § 104, and the most recent adjustment took effect April 1, 2019. 11 U.S.C.A. § 522(q) provides:

> (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 $189,050 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 five 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.

One court has interpreted this subsection in the context of what is required to meet the "criminal act" element of section 522(q)(1)(B)(iv). In re Larson, 340 B.R. 444, Bankr. L. Rep. (CCH) P 80511 (Bankr. D. Mass. 2006), opinion aff'd, Bankr. L. Rep. (CCH) P 80951, 2007 WL 1444093 (D. Mass. 2007), aff'd, 513 F.3d 325, 59 Collier Bankr. Cas. 2d (MB) 90, Bankr. L. Rep. (CCH) P 81109 (1st Cir. 2008). In Larson, the debtor had not been "convicted" in the sense of going to trial and having a jury verdict of guilty; rather, the debtor had been involved in an automobile accident resulting in death of another driver. She was charged with vehicular homicide, and she entered into a pretrial diversion under which she was placed on probation. The state judge had, however, made findings sufficient to establish guilt of the vehicular homicide, for which a civil judgment had also been entered in the amount of $1 million. The bankruptcy court determined that the state court findings were sufficient to constitute a "criminal act" under section 522(q). A further hearing was required, however, to determine the extent to which the debtor might need the claimed homestead in excess of the cap for her "reasonably necessary support." 11 U.S.C.A. § 522(q)(2). For interpretation of "reckless misconduct" see In re Burns, 395 B.R. 756 (Bankr. M.D. Fla. 2008). See also In re Bounds, 491 B.R. 440 (Bankr. W.D. Tex. 2013), concluding that proof of an increased amount reasonably necessary must be by preponderance of evidence and finding that the debtor failed that burden.

The combination of the look-back period, the issues raised by extraterritorial use of state exemptions, and the possible applications of subsections 522(o), (p), or (q) raise an unknown number of possible scenarios. To illustrate the difficulty of determining the applicable law and the effect of these subsections, here is just an example of one of endless potential fact variations:

> A Tennessee businessman left his business partnership after a conflict with his former partners. This conflict resulted in extensive litigation and the risk of a judgment in the amount of $5 million. The businessman liquidated his real estate and other liquid assets in Tennessee where his homestead exemption would be $5,000 (or $7,500 in a joint filing). The assets were liquidated after first transferring them to his wife's name. They moved on January 1, 2005, to the state of Florida where they acquired a home with $500,000 equity.

Assuming that the former business partners succeed in obtaining an overwhelming judgment, the debtor has several difficult choices:

- If he files within two years (730 days) after moving his domicile to Florida, his homestead exemption will be capped at the amount of the Tennessee limit ($5,000/$25,000). If Tennessee, like some states, prohibits nonresidents from using its rules, he may be governed by the federal exemption scheme, with its $25,150 homestead. 11 U.S.C.A. § 522(d)(1).
- If he files more than two years but less than three years and four months (1,215 days) after acquiring the Florida home, the (otherwise unlimited) Florida exemption will be capped at $189,050. 11 U.S.C.A. § 522(p).
- If he files more than 1,215 days after acquiring the house but within 10 years and if the value in the house can be found to be attributable to the disposition of property with intent to hinder, delay, or defraud a creditor, all or such attributable part of the homestead exemption may be set aside. 11 U.S.C.A. § 522(o).

Footnotes

a0 United States Bankruptcy Judge, Western District of Tennessee

a1 of the Tennessee Bar

a2 of the Tennessee Bar

Entered on Docket November 16, 2021 **Below is the Order of the Court.**

Mary Jo Heston
U.S. Bankruptcy Judge
(Dated as of Entered on Docket date above)

UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT OF WASHINGTON AT TACOMA

In re: ROBERT DANIEL COTTON, JR. TINA MARIE COTTON, Debtors.	Case No. 21-40847-MJH **Order Granting Partial Summary Judgment on Debtors' Motion to Avoid Lien**

This matter came before the Court on October 12, 2021 on Robert Daniel Cotton and Tina Marie Cotton's ("Debtors") motion to avoid the judicial lien held by Suzanne Moore against Debtors' residence located at 4128 South J Street, Tacoma, Washington (the "Real Property"). Ms. Moore objected to the motion. The Court considered the parties' arguments and took the matter under advisement. On November 4, 2021, the Court held a status conference, at which time the Court identified for the parties four discrete issues raised by Debtors' motion.[1] At the status conference, the parties requested the Court bifurcate and enter partial summary judgment on the following issues: (1) whether the Real Property is the type of property described in subparagraph (A), (B), (C), or (D) of 11 U.S.C. § 522(p)(1);[2] and, (2) whether Mr.

[1] *See* discussion *infra* Section II.B.1.

[2] Unless otherwise indicated, all chapter, section and rule references are to the Federal Bankruptcy Code, 11 U.S.C. §§ 101-1532, and to the Federal Rules of Bankruptcy Procedure, Rules 1001-9037.

Cotton has been convicted of a felony as defined in 18 U.S.C. § 3156. Based on the pleadings in the record and the arguments of counsel, the order of the Court is as follows.

I. BACKGROUND

The facts relied upon for the purpose of this order are undisputed. In 1997 and 1998, Debtor Robert Daniel Cotton ("Mr. Cotton") sexually abused Ms. Moore when she was ten and eleven years old. In 1999, Mr. Cotton was convicted of two counts of child molestation in the first degree under RCW 9A.44.083, a class A felony. In 2016, Debtors purchased the Real Property for $160,000 and have resided there at all times since its purchase.[3] On October 13, 2019, Ms. Moore commenced an action against Mr. Cotton in Pierce County Superior Court for damages caused by the sexual abuse. On October 12, 2020, Ms. Moore obtained a civil judgment against Mr. Cotton in the amount of $358,775 (the "Judgment"). Ms. Moore recorded the Judgment against Mr. Cotton's interest in the community property on November 19, 2020.

On May 12, 2021, amendments to the Homestead Act became effective, increasing the maximum allowed homestead exemption from $125,000 to "the greater of: (a) $125,000; [or] (b) The county median sale price of a single-family home in the preceding calendar year." RCW 6.13.030. On May 17, 2021, five days after the increased homestead exemption became effective, Debtors filed their Chapter 7 bankruptcy case.

Debtors' schedules reflect that the Real Property had a value of $400,614 as of the petition date. Schedule A, ECF No. 1. At the time of the petition, the Real Property was encumbered by a deed of trust in the amount of $145,831.40. Debtors claimed a homestead exemption in the Real Property in the amount of $254,782.60. Schedule C, ECF No. 1. On June 15, 2021, a meeting of the creditors was held under § 341. On June 30, 2021, Ms. Moore timely filed a proof of claim asserting that, as of the petition date, she was owed $389,442.89. At the time of filing the claim, Ms. Moore indicated that the claim was not secured by a lien on property. On

[3] The Real Property is community property.

August 16, 2021, Debtors moved under § 522(f) to avoid Ms. Moore's judicial lien. On the same day, Ms. Moore amended her claim, increasing the total amount claimed to $395,104.65 and indicating that the claim is secured by a lien on the Real Property.

On October 6, 2021 Ms. Moore responded to Debtors' motion to avoid the judicial lien, arguing that § 522(q)(1)(A) does not permit Debtors to exempt an interest in the Real Property exceeding $170,350.[4] Ms. Moore did not concede that the Real Property has a fair market value of $400,614 but failed to provide any evidence contradicting Debtors' valuation. On October 12, 2021, the Court held a hearing and the parties presented arguments on the applicability of § 522(q)(1) to Debtors' claimed exemption.

II. DISCUSSION

To avoid a lien under § 522(f), Debtors must prove the following: "(1) there was a fixing of a lien on an interest of the debtor in property; (2) such lien impairs an exemption to which the debtor would have been entitled; and (3) such lien is a judicial lien." *Culver, LLC v. Chiu (In re Chiu)*, 304 F.3d 905, 908 (9th Cir. 2002). Neither party disputes that the lien securing the Judgment was fixed on Debtors' property or that such lien is a judicial lien, therefore, these questions need not be addressed. Thus, to avoid Ms. Moore's judicial lien, Debtors must prove that it impairs their homestead exemption.

Judicial liens impair an exemption to the extent that the sum of all liens on the property, together with the value that the debtor could claim as exempt in the absence of the liens, exceed the value of the debtor's interest in the property if it were totally unencumbered. *See Owen v. Owen*, 500 U.S. 305 (1991).

In this case, the parties dispute the amount that the Debtors can claim as exempt. Both parties agree that RCW 6.13.030 allows Debtors to claim a maximum homestead exemption

[4] In her objection, Ms. Moore argued that the homestead exemption should be capped at $125,000 under § 522(q)(1)(A). However, the amount of the cap in § 522(q)(1) was adjusted under 11 U.S.C. § 104, effective April 1, 2019, to $170,350. Accordingly, the Court applies the current statutory cap amount to this order.

of $424,300.[5] Debtors argue that they may exempt their claimed equity of $254,782.60. Ms. Moore argues that Debtors' exemption must be capped at $170,350 under § 522(q)(1)(A). If Debtors are correct, Ms. Moore's judicial lien would impair their homestead exemption and therefore could be avoided. If Ms. Moore is correct, the lien may only be partially avoided to the extent that it impairs the applicable exemption.

A. Procedure

As an initial matter, the Court addresses the procedural appropriateness of Ms. Moore's objection.

1. Ms. Moore's objection is timely and proper under Rule 4003.

Exemptions are governed by Rule 4003. This rule provides that "[a]n objection to a claim of exemption based on § 522(q) shall be filed before the closing of the case." Fed. R. Bankr. P. 4003(b)(3). Ms. Moore objected to Debtors' exemption under § 522(q)(1)(A) before the close of the case. Thus, her objection is timely.

Unlike some other bankruptcy rules, Rule 4003(b) prescribes no particular form for objections to exemption claims. However, the lack of entitlement to an exemption may be raised as a defense to a lien avoidance action, even if no timely objection was made. *See* Fed. R. Bankr. P. 4003(d); *Heintz v. Carey* (*In re Heintz)*, 198 B.R. 581 (9th Cir. BAP 1996). Although Ms. Moore did not raise an independent objection to Debtors' claim of exemption, she has raised her objection as a defense to Debtors' lien avoidance action. As such, Ms. Moore's objection is proper under Rule 4003(d).

2. Ms. Moore has the burden of proof.

Generally, a debtor's claimed exemption is presumptively valid, and the party objecting to a debtor's exemption has the burden of proving that the exemption is improper. *Carter v.*

[5] Ms. Moore does not contest that the median sale price of a single-family home in Pierce County in 2020 was $424,300.

Anderson (In re Carter), 182 F.3d 1027, 1029 n.3 (9th Cir.1999); Fed. R. Bankr. P. 4003(c). If the objecting party can produce evidence sufficient to rebut the presumption of validity, then the burden shifts to the debtor to provide unequivocal evidence to demonstrate that the exemption is proper. *Carter*, 182 F.3d at 1029 n.3. Accordingly, Ms. Moore has the burden of establishing by a preponderance of the evidence that Debtors' claimed exemption of $254,782.60 is improper.

B. Arguments

1. *Introduction and Background*

Ms. Moore challenges the validity of Debtors' claimed exemption under § 522(q)(1)(A) arguing that Debtors' exemption cannot exceed $170,350. In relevant part, § 522(q) provides:

> (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 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[.] 11 U.S.C. § 522(q).

To meet her burden, Ms. Moore must establish by a preponderance of the evidence that:

> (1) The Real Property is the type of property described in subparagraph (A), (B), (C), or (D) of subsection (p)(1);
>
> (2) Mr. Cotton exempted an interest in the Real Property which exceeds in the aggregate $170,350;
>
> (3) Mr. Cotton has been convicted of a felony as defined in Section 3156 of Title 18; and,
>
> (4) The felony conviction demonstrates that the filing of the case was an abuse of the Bankruptcy Code.

At the November 4, 2021 status conference, the Court noted that: (1) the facts surrounding the first and third issues are undisputed, and the Court could decide these issues as a matter

of law; and (2) the second[6] and fourth[7] issues require further factual development in the record for final resolution. At the status conference, the parties requested that the Court decide the two legal issues under partial summary judgment and leave the factual issues for future resolution following the December 2, 2021 continued status conference.

2. *Legal Issues*

a. *The Real Property is the type of property described in § 522(p)(1)(A) and (D).*

For the exemption cap imposed under § 522(q)(1)(A) to apply, Debtors must have exempted an interest in property described in subparagraphs (A), (B), (C), or (D) of subsection (p)(1). In relevant part, subsection (p)(1) provides:

> [A] debtor may not exempt any amount of interest that was acquired by the debtor during the 1215-day period preceding the date of the filing of the petition that exceeds in the aggregate $170,350 in value in--
>
> (A) real or personal property that the debtor or a dependent of the debtor uses as a residence;
>
> . . . . [or]
>
> (D) real or personal property that the debtor or dependent of the debtor claims as a homestead.

11 U.S.C. § 522(p)(1).

The parties do not dispute that Debtors acquired the Real Property more than 1215 days before filing their petition or that it is used as a residence and claimed as a homestead. The parties only dispute the extent that (q)(1) incorporates (p)(1). At the heart of this dispute is whether the phrase "property described in subparagraphs [(A) and (D)] of subsection (p)(1)" imports the 1215-day time limitation of (p)(1) into (q)(1), or whether the cross-reference to the

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[6] Because the Judgment is only against Mr. Cotton's interest in the community property, the second issue can be further divided into the following two sub-issues: (1) Whether the parties dispute the value of the Real Property; and (2) What is Mr. Cotton's interest in the community property? On November 9,2021, Debtors filed a declaration stating that each Debtor owns a 50% interest in the community property. Currently, it is not clear if Ms. Moore plans to dispute Mr. Cotton's claimed interest in the community property.

[7] The issue of whether the felony conviction demonstrates that the filing of the case was an abuse of the Bankruptcy Code is a disputed factual issue that may require further hearing.

subparagraphs of (p)(1) incorporates only the types of property described without importing the time limitation.[8]

Debtors argue that (p)(1) only applies to property acquired during the 1215-day period preceding the date the petition was filed, and therefore, subparagraphs (A) and (D), as incorporated in to § 522(q), also contain this 1215-day temporal requirement. Debtors argue that because they acquired the Real Property more than 1215 days before filing their petition, the Real Property is not the type of property described in the subparagraphs of (p)(1) and therefore, the exemption cap imposed by (q)(1) is inapplicable. Conversely, Ms. Moore argues that (q)(1) specifically references the subparagraphs of (p)(1)—not the entire subsection. Because the subparagraphs of (p)(1) list types of property, (q)(1)'s cross-reference is intended to incorporate these types of property without importing the 1215-day temporal requirement of the greater subsection.

In interpreting the meaning of a statute, a court must start "with the language of the statute itself." *United States v. Ron Pair Enterprises, Inc.*, 489 U.S. 235 (1989). If the language is clear, the court's inquiry ends, and the court will enforce the statute according to its terms. *See Ron Pair*, 489 U.S. at 241. A statute is ambiguous if it "gives rise to more than one reasonable interpretation." *Woods v. Carey*, 722 F.3d 1177, 1181 (9th Cir. 2013) (internal quotations omitted). If the term is ambiguous, the court "may use canons of construction, legislative history, and the statute's overall purpose to illuminate Congress's intent." *Woods*, 722 F.3d at 1181 (internal quotations omitted). A fundamental principle of statutory construction is that "[i]nterpretive constructions [of statutes] which would render some words surplusage . . . are to be avoided." *In re Kun*, 868 F.2d 1069, 1071 (9th Cir. 1989).

[8] On November 15, 2021, Debtors filed a supplemental memorandum and provided the Court with excerpts of a secondary source and cases interpreting this issue for the purposes of § 522(q)(1)(B)(ii). The Court has taken these sources into consideration in deciding the issues addressed in this order.

The language in dispute specifically states, "property described in *subparagraphs* (A) [through] (D) of subsection (p)(1)." 11 U.S.C. § 522(q) (emphasis added). This language is neither vague nor ambiguous and must be enforced according to its terms. This language refers only to the subparagraph and does not incorporate the 1215-day temporal requirement of the greater subsection. *See* Lawrence R Ahern, III, *Homestead and Other Exemptions Under the Bankruptcy Abuse Prevention and Consumer Protection Act: Observations on 'Asset Protection' After 2005*, 13 AM. BANKR. INST.L. REV. 585, 597 (2005) (explaining that section 522(q) applies "regardless of when the property was acquired").

However, even if the language were ambiguous, interpreting § 522(q) as incorporating the entirety of (p)(1) would run afoul of the fundamental principles of statutory construction and Congress's intent. Congress enacted § 522(p) and (q) as part of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ("BAPCPA"). Section 522(p) attempts to close the "mansion loophole" by capping the amount of a homestead exemption. *See Greene v. Savage (In re Greene)*, 583 F.3d 614, 619 (9th Cir. 2009). "Section 522(q) *further limits* the exemption permitted by Section 522(p) for a debtor who is convicted of certain felonies or if the debtor has a debt arising from certain types of wrongful conduct*." In re Tarkanian*, 562 B.R. 424, 451 (Bankr. D. Nev. 2014) (emphasis added).

If Congress intended to incorporate the 1215-day time limitation of (p)(1) into (q)(1), it could have simply stated "property described in subsection 522(p)(1)." Instead, Congress chose to specifically reference only the subparagraphs of (p)(1). This indicates that Congress did not intend to incorporate the 1215-day period of the great (p)(1) subsection. *See* Leigh J. Francis, *Calling All Debtors, Want to Defraud Your Creditors? Here Is How: The Tenancy by the Entirety Loophole and the Nullification of Section 522(o), (p), and (q) of the 2005 Bankruptcy Amendments*, 18 U. MIAMI BUS. L. REV., Winter 2010, at 1, n.204. Additionally, interpreting § 522(q)'s cross-reference to the subparagraphs of (p)(1) as importing the entirety of (p)(1)

would render the language "subparagraphs (A), (B), (C), and (D)" superfluous. Under such an interpretation, (q)(1) effectively serves as a restatement of (p)(1), not as a further limitation on the permitted exemption. Conversely, interpretating the cross-reference as incorporating only the types of property listed in the subparagraphs, without importing the time limitation, would not create any redundancies. Such an interpretation is consistent with the view that § 522(q) is a further limitation on the permitted exemption. Therefore, the Court rejects Debtors' arguments. Because the Real Property is used as a residence and claimed as a homestead, the Court concludes that it is the type of property described in subparagraphs (A) and (D) of subsection (p)(1). Accordingly, this element of § 522(q)(1) is satisfied.

b. *Mr. Cotton has been convicted of a felony as defined in Section 3156 of Title 18.*

For § 522(q)(1)(A) to apply, Ms. Moore must show that "the debtor has been convicted of a felony (*as defined in section 3156 of title 18*)[.]" 11 U.S.C. § 522(q)(1)(A) (emphasis added). The parties do not dispute that Mr. Cotton has been convicted of a felony under RCW 9A.44.083. The issue here is whether a felony under state law is a "felony" as defined in Section 3156 of Title 18, for the purposes of § 522(q)(1)(A). The parties have not provided, and the Court is not aware of, any caselaw addressing this issue.

Section 3156 provides:

> the term "felony" means an offense punishable by a maximum term of imprisonment of more than one year. 18 U.S.C. § 3156(a)(3).

Debtors argue that this definition of "felony" is limited to violations of federal law—not violations of state law. Debtors argue that the definition of "felony" in § 3156(a)(3) includes the word "offense," which is defined in § 3156(a)(2).

Section 3156 (a)(2) provides:

> the term "offense" means any criminal offense, other than [certain military offenses], which is in violation of an Act of Congress and is triable in any court established by an Act of Congress. 18 U.S.C. § 3156(a)(2).

Debtors argue that because "offense" is defined in subsection (a)(2), the subsequent use in subsection (a)(3) has the same meaning. In sum, Debtors argue that Mr. Cotton's state law conviction is not a violation of an "Act of Congress" and therefore, is not a "felony" as defined by 18 U.S.C. § 3156. Ms. Moore argues that "felony (as defined in section 3156 of title 18)" incorporates only the definition of "felony" provided in § 3156(a)(3). She argues that this definition of felony is not limited to violations of federal law and that the term "offense" in § 3156(a)(3) should be read according to its dictionary definition, not the limited definition provided in § 3156(a)(2). Thus, whether Mr. Cotton's felony conviction falls within the definition of the statute turns on whether the definition of felony in § 3156(a)(3) uses the dictionary definition of "offense" or uses "offense" as a term of art.

When considering a disputed term, the court should first consider it in the context of the statute, or identify any ambiguity or absurdity, before looking to secondary sources. Whether a statutory term is unambiguous does not turn solely on dictionary definitions. *Yates v. United States*, 135 S. Ct. 1074, 1081 (2015). "Rather, [t]he plainness or ambiguity of statutory language is determined [not only] by reference to the language itself, [but as well by] the specific context in which that language is used, and the broader context of the statute as a whole.'" *Yates*, 135 S. Ct. at 1081–82 (quoting *Robinson v. Shell Oil Co.*, 519 U.S. 337, 341 (1997)). While a word's usage ordinarily accords with its dictionary definition, in law, "the same words, placed in different contexts, sometimes mean different things." *Yates*, 135 S. Ct. at 182.

First turning to the statute as a whole, the term "offense" is defined twice and is given separate definitions each time.[9] Further, both definitions of "offense" use the word "offense"

[9] Section 3156(a)(2) provides "the term 'offense' means any criminal offense, other than [certain military offenses], which is in violation of an Act of Congress and is triable in any court established by an Act of Congress." 11 U.S.C. § 3156(a)(2).

Section 3156(b)(2) provides "the term 'offense' means any Federal criminal offense which is in violation of any Act of Congress and is triable by any court established by Act of Congress (other than a Class B or C misdemeanor or an infraction, or an offense triable by court-martial, military commission, provost court, or other military tribunal). 11 U.S.C. § 3156(b)(2).

within the definition. This indicates that the statute uses the word "offense" as its ordinary definition, as well as two separate terms of art. Nonetheless, this seeming ambiguity subsides when viewed in the specific context in which it is used.

When viewed in the specific context of § 3156(a)(3), only the ordinary definition of "offense" is consistent with the statute as a whole. Applying either of the term of art definitions to "offense", as used in § 3156(a)(3), would create internal inconsistencies. First, § 3156 specifically limits the definitions of subsection (a) to "sections 3141–3150 of this chapter" and the definitions of subsection (b) to "sections 3152–3155 of this chapter." Because the application of the term of art definitions is limited to §§ 3141–55, neither definition applies to the word "offense" within § 3156(a)(3). Second, even if the term of art definitions were applicable, both § 3156(a)(2) and (b)(2) use the ordinary definition of "offense" within their definitions. Therefore, the use of the ordinary definition of "offense" within the definition of § 3156(a)(3) would be internally consistent with how it is used within the definition of other defined terms in the statute. Conversely, applying a term of art definition only within the definition § 3156(a)(3) would be internally inconsistent with the rest of the statue. Thus, the context of § 3156 as a whole tugs strongly in favor of giving "offense" its dictionary definition. Accordingly, the Court concludes that the word "offense" within § 3156(a)(3) must be read in accord with its ordinary meaning. Black's Law Dictionary defines the term "offense" as "a violation of the law." *Black's Law Dictionary* 885 (9th ed.2009).

In defining "felony" for the purpose of § 522(q)(1)(A), the Court adopts the definition "a violation of the law punishable by a maximum term of imprisonment of more than one year." A conviction under RCW 9A.44.083 is a violation of the law punishable by a maximum term of imprisonment of more than one year. Accordingly, for the purpose of § 522(q)(1)(A), Mr. Cotton has been convicted of a felony as defined in Section 3156 of Title 18.

III. CONCLUSION

Based on the foregoing, the Court concludes that Debtors' residence located at 4128 South J Street, Tacoma, Washington is property as described in § 522(p)(1)(A) and (D); and Mr. Cotton has been convicted of a felony as defined in 18 U.S.C. § 3156.

Until the facts on the record are further developed, the Court makes no determination on whether Mr. Cotton has exempted an interest in the Real Property that exceeds in the aggregate $170,350 or whether Mr. Cotton's felony conviction demonstrates that the filing of the case was an abuse of the Bankruptcy Code. These remaining issues will be continued to the status conference scheduled for December 2, 2021.

Accordingly, for the reasons stated herein, it is hereby

ORDERED that partial summary judgment on Debtors' Motion to avoid lien is granted.

/ / / End of Order / / /

Entered on Docket January 21, 2022

Below is a Memorandum Decision of the Court.

Mary Jo Heston
U.S. Bankruptcy Judge

(Dated as of Entered on Docket date above)

UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT OF WASHINGTON AT TACOMA

In re:

ROBERT DANIEL COTTON, JR., and

TINA MARIE COTTON,

Debtors.

Case No. 21-40847-MJH

MEMORANDUM DECISION ON DEBTORS' MOTION FOR SUMMARY JUDGMENT

This matter came before the Court on January 6, 2022, on Robert Daniel Cotton and Tina Marie Cotton's (collectively "Debtors") motion for summary judgment ("SJ Motion") to avoid the judicial lien held by Suzanne Moore against Debtors' residence located at 4128 South J Street, Tacoma, Washington ("Real Property"). The Court having considered the arguments of counsel and pleadings in the record[1] hereby makes the following conclusions of law.

I. BACKGROUND AND FACTS

The background and undisputed facts regarding the above-captioned case are set forth in detail in the Court's Order Granting Partial Summary Judgment on Debtors' Motion to Avoid Lien ("Partial Summary Judgment Decision") at ECF No. 35, which the Court hereby

[1] On January 13, 2022, Debtors filed a letter responding to cases cited at the January 6, 2022 hearing. The Court has taken this letter into consideration in rendering this decision.

incorporates by reference. In addition to the facts incorporated by reference, the following material facts are undisputed, and they are stated generally in chronological order.[2]

September 2008: Robert Daniel Cotton ("Mr. Cotton") and Tina Marie Cotton ("Mrs. Cotton") married.

April 2014: The Real Property was purchased.[3]

April 8, 2014: Mrs. Cotton executed a quitclaim deed in favor of Mr. Cotton, in which she conveyed her current interest in the Real Property and "all after acquired title" to the Real Property "for and in consideration of To Establish Separate Property." ECF No. 39.

April 9, 2014: Fannie Mae A/K/A Federal National Mortgage Association executed a special warranty deed conveying the Real Property to "Robert D Cotton Jr., A Married Man as his separate estate." ECF No. 39.

October 12, 2020: Ms. Moore obtained a civil judgment against Mr. Cotton in the amount of $358,775. The judgment became a lien against Mr. Cotton's interest in the Real Property pursuant to RCW 4.56.190 and RCW 4.56.200.

November 19, 2020: Ms. Moore recorded the judgment against Mr. Cotton's interest in the Real Property.

II. BURDENS OF PROOF

A. Overview

Debtors moved to avoid Ms. Moore's lien under § 522(f)[4] ("Motion to Avoid"). To avoid a lien under § 522(f), Debtors must establish the following: "(1) there was a fixing of a lien on an interest of the debtor in property; (2) such lien impairs an exemption to which the debtor would have been entitled; and (3) such lien is a judicial lien." *Culver, LLC v. Chiu (In re Chiu)*, 304

[2] To the extent that the dates of the facts set forth herein conflict with the dates incorporated by reference, the dates set forth in this decision control.

[3] After the Partial Summary Judgment Decision, Debtors filed a declaration stating that they mistakenly listed the purchase year as 2016 on Schedule A. ECF No. 39.

[4] Unless otherwise indicated, all chapter, section and rule references are to the Federal Bankruptcy Code, 11 U.S.C. §§ 101–1532, and to the Federal Rules of Bankruptcy Procedure, Rules 1001–9037.

F.3d 905, 908 (9th Cir. 2002). Neither party disputes that Ms. Moore's lien was fixed on Debtors' property or that such lien is a judicial lien. Thus, to avoid Ms. Moore's lien, Debtors bear the burden of establishing that it impairs Debtors' homestead exemption.

Generally, a debtor's claimed exemption is presumptively valid, and the party objecting to a debtor's exemption has the burden of proving that the exemption is improper. *Carter v. Anderson (In re Carter)*, 182 F.3d 1027, 1029 n.3 (9th Cir.1999); Rule 4003(c). If the objecting party can produce evidence sufficient to rebut the presumption of validity, then the burden shifts to the debtor to provide unequivocal evidence to demonstrate that the exemption is proper. *Carter*, 182 F.3d at 1029 n.3.

As currently claimed, Ms. Moore's lien impairs Debtors' homestead exemption. Accordingly, Ms. Moore has the burden of establishing by a preponderance of the evidence that Debtors' claimed exemption is improper. Ms. Moore has objected to Debtors' exemption, arguing that it must be capped at $170,350 under § 522(q)(1)(A) ("Objection"). To meet her burden under § 522(q)(1)(A), Ms. Moore must establish the following four elements:

1. The Real Property is the type of property described in subparagraph (A), (B), (C), or (D) of § 522(p)(1);
2. Mr. Cotton has exempted an interest in the Real Property exceeding $170,350;
3. Mr. Cotton has been convicted of a felony as defined in 18 U.S.C. § 3156; and,
4. Mr. Cotton's felony conviction demonstrates that the filing of this case was an abuse of the Bankruptcy Code.

The Court ruled in Ms. Moore's favor on the first and third elements in the Partial Summary Judgment Decision. At this stage, only the second and fourth elements of Ms. Moore's Objection remain to be determined. Ms. Moore has the burden to establish both the second and fourth elements. If Ms. Moore is unable to establish either of the two remaining elements, her Objection fails as a matter of law. Debtors' Motion seeks a determination that Ms. Moore cannot establish the second element and therefore the Objection should be overruled and the Motion to Avoid should be granted as a matter of law.

B. Burden on Summary Judgment

The party seeking summary judgment bears the burden of demonstrating that there are no genuine issues of material fact and that the movant is entitled to judgment as a matter of law. Fed. R. Civ. P. 56(a), made applicable by Fed. R. Bankr. P. 7056; *Celotex Corp. v. Catrett*, 477 U.S. 317, 322–23, 106 S. Ct. 2548 (1986). All inferences drawn from the evidence presented must be drawn in favor of the party opposing summary judgment, and all evidence must be viewed in the light most favorable to that party. Summary judgment should be granted if, after taking all reasonable inferences in the nonmoving party's favor, the court finds that no reasonable jury could find for the nonmoving party. *Anderson v. Liberty Lobby*, Inc., 477 U.S. 242, 255, 106 S. Ct. 2505 (1986). The responding party may not rest upon mere allegations or denials of his pleadings but must set forth specific facts showing that there is a genuine issue for trial. *Liberty Lobby*, 477 U.S. at 256.

The Debtors, as the moving party, bear the burden of establishing that there are no genuine issues of material fact and that they are entitled to judgment as a matter of law.

III. DISCUSSION

Debtors contend that the Real Property is community property and therefore Mr. Cotton has only exempted his one-half interest. Debtors argue that because they claimed an exemption of $254,782.60, Mr. Cotton has only exempted his interest of $127,391.15. Debtors also argue that § 522(m) as applied to § 522(q), doubles the exemption cap of § 522(q) by applying it separately to each Debtor. In sum, Debtors argue that they are entitled to judgment in their favor because neither Debtor has an ownership interest that exceeds $170,350 and therefore Ms. Moore cannot establish the second element of her Objection.

Ms. Moore argues that the Real Property is Mr. Cotton's separate property; therefore, Mr. Cotton has exempted an interest in the Real Property exceeding $170,350, and the Court should deny Debtors' SJ Motion.

The initial question for the Court to resolve is whether the Real Property is community property or Mr. Cotton's separate property.

A. Characterization of the Real Property

Washington community property law places great importance on presumptions in determining the character of property as either separate or community property. "The presumptions are *true* presumptions, and in the absence of evidence sufficient to rebut an applicable presumption, the court must determine the character of property according to the weight of the presumption." *In re Estate of Borghi*, 167 Wn.2d 480, 484 (2009) (emphasis in original). The character of property as separate or community property is determined at the date of acquisition. *Id.* Under the "inception of title" theory, property acquired subject to a mortgage is acquired when the obligation is undertaken. *Id.* (citing Harry M. Cross, *The Community Property Law,* 61 Wash. L. Rev. 13, 39 (1986)); *see also*, *In re Estate of Binge,* 5 Wn.2d 446, 454 (1940); *Beam v. Beam,* 18 Wn. App. 444, 453 (1977). Once property is established as either separate or community property, it is presumed that it maintains that character absent clear and convincing evidence to the contrary. *Guye v. Guye,* 63 Wash. 340, 352 (1911).

In Washington, property acquired during marriage is presumed to be community property, regardless of how title is held. *Dean v. Lehman*, 143 Wn.2d 12, 19 (2001). "The burden of rebutting this presumption is on the party challenging the asset's community property status, and 'can be overcome only by clear and convincing proof that the transaction falls within the scope of a separate property exception.'" *Id.* at 19–20 (internal citations omitted) (quoting *Estate of Madsen v. Comm'r of Internal Revenue*, 97 Wn.2d 792, 796 (1982), *overruled in part on other grounds* by *Aetna Life Ins. v. Wadsworth*, 102 Wn.2d 652, 659–60 (1984)).

RCW 26.16.050 sets forth a separate property exception for conveyances between spouses. In relevant part, RCW 26.16.050 provides:

> A spouse . . . may give, grant, sell or convey directly to the other spouse . . . his or her community right, title, interest or estate in all or any portion of their community real property: And every deed made from one spouse to the other . . . shall operate to divest the real estate therein recited from any or every claim or demand as community property and shall vest the same in the grantee as separate property. The grantor in all such deeds, or

> the party releasing such community interest or estate shall sign, seal, execute and acknowledge the deed as a single person without the joinder therein of the married party . . . named as grantee . . . .

RCW 26.16.050.

Under this statute, one spouse may divest herself of an interest in community real property by conveying that interest to the other spouse, and the conveyed interest will vest in the grantee as separate property. These conveyances have long been held to be clear and convincing evidence of the creation of separate property.[5]

Here, the undisputed evidence is that Mrs. Cotton executed a quitclaim deed on April 8, 2014. In executing the quitclaim deed, Mrs. Cotton expressed a clear intent to convey her interest in the Real Property to Mr. Cotton. Thus, as of April 8, 2014, any interest Mrs. Cotton had in the Real Property vested in Mr. Cotton as his separate property. The quitclaim deed also contained a clear expression of intention to convey all after acquired title in the Real Property. Thus, any interest created in the Real Property after April 8, 2014, became Mr. Cotton's separate property. *See* RCW 64.04.050. Accordingly, absent clear and convincing evidence to the contrary, the Real Property is presumed to maintain its character as Mr. Cotton's separate property.

1. Intent of the Parties

Debtors first argue that quitclaim deeds are often used to qualify for purchase and for better terms on loans and therefore are not a true transfer of property. Debtors further argue that Mrs. Cotton executed the quitclaim deed to qualify for better financing terms and did not intend to transfer her interest to her husband as separate property.

The long-established rule in Washington is that when one spouse quitclaims land to another, the land becomes the separate property of the grantee and is not liable for community

[5] *See, e.g., Bryant v. Stablein* 28 Wn.2d 739, 747 (1947) (execution of quitclaim deed, from husband to wife, of property purchased after marriage, had effect of divesting husband of all right, title and interest in property); *Findley v. Findley*, 193 Wash. 41, 47 (1937) (execution of deed from husband to his wife "thereby divested [him] of any right, title, or interest he had in the real property and it became and remained the separate property of [his wife]"); *Shorett v. Signor*, 58 Wash. 89, 96 (1910) (the legal effect of a deed from one member of a community to the other is to convey the community property and title to the grantee, so that it becomes the grantee's separate property in which the community ceases to have any further title or interest).

debts regardless of the intent of the grantor. *See Goodfellow v. Le May*, 15 Wash. 684, 685 (1896). This long-established rule has been followed in subsequent cases for over a hundred years.[6]

Courts also have held that the subjective intent of a grantor does not control when a recorded instrument is unambiguous. *See Johnson v. Wheeler*, 41 Wn.2d 246, 249 (1952). In *Johnson* a husband recorded a deed conveying his interest in community property to his wife and later argued that the deed was not intended to take effect until after his death. The court held that the husband's intention could not contradict an unambiguous deed, reasoning that "secret intentions cannot contradict an unambiguous recorded instrument, and evidence to that effect is not admissible." *Johnson*, 41 Wn.2d at 249 (1952) (citing *Parke v. Case*, 113 Wash. 263 (1920)).

Here, Debtors seems to argue that the quitclaim deed was effectually a sham document without legal consequence. Debtors offer no legal authority for the Court to disregard both the express language set forth in RCW 26.16.050 and well over a century of Washington caselaw. Further, holding that the quitclaim deed was without legal effect would be problematic as presumably the mortgage lender understood that the quitclaim deed would extinguish Mrs. Cotton's rights in the Real Property and was likely a factor in the calculation of the terms of the mortgage. Accordingly, the Court rejects Debtors' argument that the quitclaim deed was not a true transfer of property.

Next, Debtors contend that they did not intend to create separate property and that their intent controls, not the deeds. Citing *Borghi*, Debtors argue that the names on the special

[6] *See, e.g., Sponogle v. Sponogle* 86 Wash. 649, 651 (1915) ("It is plain, that conveyance of community property by a husband to his wife makes it thereafter her separate property under our laws.") (cleaned up); *Chaudoin v. Claypool*, 174 Wash. 608, 611 (1933) (wife's quitclaim deed to her husband expressed her intent for title to vest title in him as separate property and was "the effect the law gave to the deed."); *Bryant*, 28 Wn.2d at 747 (in executing quitclaim deed, husband "divested himself of all right, title, and interest in the property, and it thereby became the separate property of the wife"); *Sec. Sav. & Loan Ass'n v. Busch*, 84 Wn.2d 52, 56, (1974) ("A quitclaim deed is deemed a good and sufficient conveyance of all then existing legal and equitable rights of the grantor in the described premises," and extinguishes grantor's homestead right); *Snohomish Cty. v. Hawkins*, 121 Wn. App. 505, 512 (2004) (same).

warranty deed and quitclaim deed do not determine the character of the property and therefore, the Court must look to the intent of the parties. Debtors further argue that they treated the Real Property as community property and their use of community funds demonstrates their intent to retain the Real Property as community property. In sum, Debtors argue that under *Borghi*, the Court must disregard the deeds and look only to Debtors' intent. For the reasons explained below, Debtors read *Borghi* too broadly.

In *Borghi*, the woman later known as Jeanette Borghi entered into a real estate purchasing contract before marriage. *Borghi*, 167 Wn.2d at 482. Three months after she married, the contract seller issued a fulfillment deed in the names of the husband and wife. *Id.* Ms. Borghi later died intestate and her son from a prior marriage sought rights to that property. *Id.* at 482–83. The court held that the joint titling on the fulfillment deed alone was insufficient to overcome the presumption that the property was Ms. Borghi's separate property. The court reasoned that the names on the title alone does not sufficiently evidence an intent to change the characteristic of property. *Id*. at 488–89.

Here, Debtors' contention is true in that the names on the title do not control the characterization of property. The fact that Mrs. Cotton's name is not listed on the special warranty deed is not dispositive. However, the *Borghi* court did not hold that a quitclaim deed from one spouse to the other is insufficient evidence of intent to transfer property. The *Borghi* Court noted that married individuals are free to dispose of their interests in community or separate property, including changing the characteristics of the property. *See Id.* at 488–89. The court went on to explain that "[w]ith respect to real property, a spouse may execute a quitclaim deed transferring the property to the community [or to the other spouse as separate property],[7] join in a valid community property agreement, or otherwise in writing evidence his or her intent." *Id.* The quitclaim deed acknowledged by Mrs. Cotton is a writing that evidences

[7] The Court noted that there is no reason to differentiate between the evidence needed to overcome the presumption in favor of either community or separate property "given our recognition that the right of a party in her separate property is 'as sacred' as the right of spouses in their community property." *Borghi*, 167 Wn.2d at 490 n.4 (citing *Guye,* 63 Wash. at 352).

her intent to transfer her interest in the Real Property to Mr. Cotton and create separate property. Accordingly, the Court rejects Debtors' argument.

2. Transmutation

Debtors argue that even if the Real Property was acquired as Mr. Cotton's separate property, it has since been transmuted to community property. Debtors assert that all mortgage payments were made with community funds and "where separate funds have been so commingled with community funds that it is no longer possible to distinguish or apportion them, all of the commingled fund, or the property acquired thereby, is community property." *In re Dougherty's Estate*, 27 Wn.2d 11, 24 (1947). Therefore, Debtors argue that the Real Property was community property on the date of filing their petition.

Under Washington law, it is well established that the mere joinder in a mortgage on separate property or the use of community funds to pay off a mortgage on separate property does not change the property's status, but at most entitles the community to an equitable lien against the property. *See Merkel v. Merkel*, 39 Wn.2d 102, 114–15 (1951); *In re Marriage of Harshman*, 18 Wn. App. 116, 123, (1977); *Seaton v. Smith*, 186 Wash. 447, 452 (1936); *Guye*, 63 Wash. at 352–53; *Dobbins v. Dexter Horton & Co*., 62 Wash. 423, 428 (1911). As the Washington Supreme Court explained in *Borghi:*

> Later community property contributions to the payment of obligations, improvements upon the property, or any subsequent mortgage of the property may in some instances give rise to a community right of reimbursement protected by an equitable lien, but such later actions do not result in a transmutation of the property from separate to community property.

Borghi, 167 Wn.2d at 490 n.7.

In this case, Mrs. Cotton executed a quitclaim deed and divested herself of any interest in the Real Property at the time of its acquisition. Therefore, at the time of its acquisition, the Real Property was Mr. Cotton's separate property. Once property is established to be of a separate character, it will be presumed to maintain that character until clear and convincing evidence to the contrary shows otherwise. *Guye,* 63 Wash. 340 at 352. Debtors' use of community funds

for mortgage payments may give Mrs. Cotton a community right of reimbursement protected by an equitable lien, however, it does not transmute the Real Property from Mr. Cotton's separate property to the community property of both spouses.

B. Mrs. Cotton's Separate Exemption

Debtors argue that Mrs. Cotton can claim Mr. Cotton's interest in the Real Property as her homestead under RCW 6.13.010 as her dependent spouse.[8] RCW 6.13.010 states in relevant part, "The homestead consists of real or personal property that the owner or a dependent of the owner uses as a residence." RCW 6.12.020 states that the homestead may consist of the community property of the spouses or the separate property of either spouse. Debtors argue that Mr. Cotton is Mrs. Cotton's dependent spouse and that she may claim his separate property, here the Real Property, as her homestead.

A dependent may only assert exemption claims that are available to the debtor. *See* 4 *Collier on Bankruptcy* para. 522.04 (16th ed. 2021). In a joint case, debtors are limited to a single homestead exemption under Washington law. *See* RCW 6.12.020. In this case, if § 522(q) is applicable, Mr. Cotton's homestead exemption would be capped at $170,350 and Mrs. Cotton could only claim up to that amount as a dependent spouse. On the other hand, if § 522(q) is inapplicable, Mr. Cotton could claim the full homestead exemption in his separate property without Mrs. Cotton claiming it as the property of her dependent. Allowing Mrs. Cotton to claim Mr. Cotton's full interest in the Real Property regardless of the applicability of § 522(q) would have the effect of Mr. Cotton claiming the full exemption, which would serve only to defeat Mrs. Moore's objection by form over substance. The Court rejects Debtors' argument.

IV. CONCLUSION

The Court concludes that the Real Property is Mr. Cotton's separate property, and he has exempted an interest in the Real Property exceeding $170,350. Accordingly, Debtors have failed to establish that Ms. Moore is unable to meet her burden of proof, and their motion for

[8] Under § 522(a)(1), a "dependent" includes a spouse, whether or not actually dependent.

summary judgment is denied. Based on the Court's conclusion herein, the Court hereby grants partial summary judgment to Ms. Moore on the issue of whether Mr. Cotton has claimed an exemption in the Real Property exceeding $170,350.[9] The remaining issue of whether Mr. Cotton's felony conviction demonstrates that the filing of this case was an abuse of the Bankruptcy Code, raises questions of material fact that must be decided before the Court makes a final ruling on Debtors' Motion to Avoid. The heavy burden of establishing this final element remains with Ms. Moore.

The parties should appear at the status conference scheduled for 2:00 PM on February 3, 2022, to discuss how to best proceed in this case in light of the Court's Memorandum Decision.

/ / / End of Memorandum Decision / / /

[9] When one party moves for summary judgment and, at the hearing, it is made to appear from all the records, files, affidavits and documents presented that there is no genuine dispute respecting a material fact essential to the proof of movant's case the court may sua sponte grant summary judgment to the non-moving party. *See* Fed. R. Civ. P. 56(f). In this case, by submitting the ultimate legal issue herein involved to the Court for resolution, Debtors assumed or conceded that as to the resolution of the issue, there were no material facts in dispute. Debtors have addressed the issue of whether there are any genuine issues of material fact for trial in their briefs filed in this Court, and they have had the opportunity to convince the Court of their position at oral argument.

Entered on Docket April 15, 2022

Below is a Memorandum Decision of the Court.

Mary Jo Heston
U.S. Bankruptcy Judge

(Dated as of Entered on Docket date above)

UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT OF WASHINGTON AT TACOMA

In re:

ROBERT DANIEL COTTON, JR., and

TINA MARIE COTTON,

Debtors.

Case No. 21-40847-MJH

MEMORANDUM DECISION ON DEBTORS' MOTION TO AVOID LIEN

This matter came before the Court on March 10, 2022, on Robert Daniel Cotton and Tina Marie Cotton's (individually "Mr. Cotton" and "Mrs. Cotton" respectively) (collectively "Debtors") motion to avoid the judicial lien held by Suzanne Moore ("Ms. Moore") against Debtors' residence located at 4128 South J Street, Tacoma, Washington ("Real Property"). The Court having considered the arguments of counsel and pleadings in the record hereby makes the following findings of fact and conclusions of law.

I. PROCEDURAL BACKGROUND[1]

On August 16, 2021, Debtors moved under § 522(f)[2] to avoid Ms. Moore's judicial lien. On the same day, Ms. Moore amended her claim, increasing the total amount claimed to

[1] The background and undisputed facts regarding the above-captioned case are set forth in detail in the Court's Order Granting Partial Summary Judgment on Debtors' Motion to Avoid Lien at ECF No. 35, and in the Court's Memorandum Decision on Debtors' Motion for Summary Judgment at ECF No. 45, which the Court hereby incorporates by reference.

[2] Unless otherwise indicated, all chapter, section and rule references are to the Federal Bankruptcy Code, 11 U.S.C. §§ 101–1532, and to the Federal Rules of Bankruptcy Procedure, Rules 1001–9037.

$395,104.65 and indicating that the claim is secured by a lien on the Real Property.[3] On August 18, 2021, Debtors received a discharge for community liabilities in the amount of $64,924. On October 6, 2021, Ms. Moore responded to Debtors' motion to avoid the judicial lien, arguing that § 522(q)(1)(A) limits the amount of Debtors' homestead exemption to $170,350. The Court procedurally treated Ms. Moore's objection as an objection to the homestead exemption.

On November 4, 2021, the Court held a status conference, at which time the Court identified for the parties four discrete issues raised by Ms. Moore's objection.[4] At this status conference, both parties requested that the Court bifurcate and rule initially only on the first and third issues. The Court ruled in Ms. Moore's favor on these two issues in the Order Granting Partial Summary Judgment. *See* ECF No. 35 ("Initial SJ Order").

On December 3, 2021, Debtors filed a motion for summary judgment to resolve the remaining two issues under § 522(q). On January 21, 2022, the Court entered an order on the summary judgment motion: 1) holding in favor of Ms. Moore as a matter of law on the second issue (i.e. that Mr. Cotton's claimed exemption in separate property exceeded the applicable § 522(q) exemption cap);[5] and 2) denying Debtors' motion for summary judgment on the remaining fourth issue because of the existence of material issues of fact. *See* ECF Nos. 45 and 46 ("Second SJ Order").

On February 3, 2022, the Court held a status conference to determine whether the parties wished to hold an evidentiary hearing on the remaining issues under § 522(q). Both parties requested the opportunity to submit additional briefing and new declarations to address the final and fourth issue under § 522(q)(1) (i.e., whether, under the circumstances, the felony

[3] The parties do not contest that Ms. Moore's claim is non-dischargeable. *See* Debtors' Resp. 15:18–19, ECF No. 49 ("here the underlying separate debt is not dischargeable").

[4] The four discrete issues raised by the objection are: (1) whether the Real Property is the type of property described in subparagraph (A), (B), (C), or (D) of § 522(p)(1); (2) whether Mr. Cotton exempted an interest in the Real Property which exceeds in the aggregate $170,350; (3) whether Mr. Cotton has been convicted of a felony as defined in 18 U.S.C. § 3156; and, (4) whether the felony conviction demonstrates that the filing of the case was an abuse of the Bankruptcy Code.

[5] In a memorandum decision the Court held that the Real Property was Mr. Cotton's separate property. (ECF No. 45),

conviction demonstrates that the filing of the case was an abuse of the Bankruptcy Code). The parties also requested the opportunity to present oral arguments and agreed to waive their right to an evidentiary hearing. The parties further asked the Court to defer ruling on the § 522(q)(2) issue (i.e., that the cap shall not apply to the extent that amount of an interest is reasonably necessary for the support of the debtor or the debtor's dependents) until after it ruled on the § 522(q)(1) issue. The Court held a hearing on March 10, 2022, to resolve the issue of whether under the circumstances, including Mr. Cotton's felony conviction, the filing of the chapter 7 case constitutes an abuse of Title 11. Based on the record, including the pleadings filed in this contested matter to date, the Court's findings and conclusions in both the Initial and Second SJ Orders, and the arguments of counsel at the March 10 hearing, the Court makes the following findings of fact and conclusions of law.

II. FINDINGS OF FACT, DISCUSSION, AND CONCLUSIONS OF LAW

A. Findings of Fact.

The following facts are undisputed. In 1997 and 1998, Mr. Cotton sexually abused Ms. Moore when she was ten and eleven years old. In 1999, Mr. Cotton was convicted of two counts of child molestation in the first degree under RCW 9A.44.083, a class A felony. In April 2014, Debtors purchased the Real Property for $160,000. On April 8, 2014, in anticipation of the purchase, Mrs. Cotton executed a quitclaim deed in favor of Mr. Cotton, in which she conveyed all her current and after acquired interest in the Real Property to Mr. Cotton. On April 9, 2014, the sale of the Real Property closed, and Mr. Cotton acquired title as his separate property. On October 13, 2019, Ms. Moore commenced an action against Mr. Cotton in Pierce County Superior Court seeking damages for her injuries caused by the sexual abuse. On October 12, 2020, Ms. Moore obtained a civil judgment against Mr. Cotton in the amount of $358,775 ("Judgment"). On November 19, 2020, Ms. Moore recorded the Judgment against the Real Property.

On May 12, 2021, amendments to the Homestead Act became effective, increasing the maximum allowed homestead exemption from $125,000 to "the greater of: (a) $125,000; [or]

(b) The county median sale price of a single-family home in the preceding calendar year." RCW 6.13.030. On May 17, 2021, five days after the increased homestead exemption became effective, Debtors filed their chapter 7 bankruptcy case.

Debtors' schedules reflect that the Real Property had a value of $400,614 as of the petition date. Schedule A, ECF No. 1. At the time of the petition, the Real Property was encumbered by a deed of trust in the amount of $145,831.40. Debtors claimed a homestead exemption in the Real Property in the amount of $254,782.60. Schedule C, ECF No. 1. On June 15, 2021, a meeting of the creditors was held under § 341. On June 30, 2021, Ms. Moore timely filed a proof of claim asserting that, as of the petition date, she was owed $389,442.89.

B. Discussion and Conclusions of Law.

In relevant part, § 522(q)(1) provides:

> (1) . . . a debtor may not exempt any amount of an interest in [certain property, including real or personal property that the debtor or a dependent of the debtor uses as a residence] which exceeds in the aggregate $170,350 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.

The current issue before the Court in this matter is whether, under the facts and circumstances of this case, Mr. Cotton's prior felony conviction demonstrates that the filing of the Debtors' chapter 7 case was an abuse of the Bankruptcy Code.

1. Burdens of proof.

Debtors' claimed exemption is presumptively valid, and the objecting party[6] has the burden of proving that the exemption is improper. *Carter v. Anderson (In re Carter)*, 182 F.3d 1027, 1029 n.3 (9th Cir.1999); Fed. R. Bankr. P. 4003(c). If the objecting party can produce evidence sufficient to rebut the presumption of validity, then the burden shifts to the debtor to provide

[6] As noted in the Initial SJ Order, the Court treated Ms. Moore's § 522(q) objection to the Debtors' motion to avoid her judgment lien under § 522(f) as an objection to the validity of Debtors' claimed exemption. *See* Initial SJ Order, pp. 3–5. ECF No. 35.

unequivocal evidence to demonstrate that the exemption is proper. *Carter*, 182 F.3d at 1029 n.3.

Here, Ms. Moore has the burden of establishing by a preponderance of the evidence that the prior felony conviction demonstrates that the filing of the case was an abuse of the Bankruptcy Code. If Ms. Moore carries her burden, thereby establishing § 522(q)(1)(A) and rebutting the presumption of validity, then the burden shifts to the Debtors to establish that they are entitled to more than the capped amount pursuant to the § 522(q)(2) savings clause, which will be dealt with in a subsequent hearing.[7]

2. The definition of "abuse" under § 522(q)(1)(A)—in general.

The Bankruptcy Code does not define "abuse" for the purpose of § 522(q)(1)(A). The legislative history of § 522(q) also fails to provide any insight into the standards for determining abuse. *See* H.R. REP. No. 109-31, pt.1, at 16 (2005) (Stating only that the intent of § 522(q) is to prevent "[debtors] who have engaged in criminal conduct from shielding their homestead assets from those whom they have defrauded or injured.").

The Ninth Circuit has no controlling caselaw on this issue. In fact, the Court is aware of only one case in which the § 522(q)(1)(A) exemption cap was referenced. *See*, *In re Prince*, No. 09-43627, 2011 Bankr. LEXIS 5511 (Bankr. E.D. Tex. July 25, 2011). However, because *Prince* involved post-filing bankruptcy crimes including the debtor's knowing and fraudulent concealment of assets and the making of false oaths in the bankruptcy schedules, the bankruptcy court does not discuss the definition of or standards for determining abuse under § 522(q)(1)(A).

Here, Debtors argue that *Prince* supports their position that "abuse" can only be proven under § 522(q)(1)(A) where the felony conviction at issue is for a financial or bankruptcy crime. The Court rejects this argument as there is no limitation of the type of felony referenced under

[7] § 522(q)(2) provides that: Paragraph (1) shall not apply to the extent the amount of an interest in [the property described in paragraph (1)] is reasonably necessary for the support of the debtor and any dependent of the debtor.

§ 522(q)(1)(A).[8] In sum, *Prince* provides no insight into the definition of abuse. For this same reason, the Court also rejects Debtors' argument that abuse under § 522(q)(1)(A) only applies in circumstances where the filing of the bankruptcy case constitutes a "malicious abuse of legal process . . . for some unlawful object." (Debtors' Resp. 2:20–3:6, ECF No. 49). The statute makes no reference to maliciousness. Instead, the statute merely requires that under the circumstances the felony conviction demonstrates that the filing of the case was an abuse of the provisions of this title. *Cf. In re Price*, 353 F.3d 1135, 1139–40 (9th Cir. 2004) (holding that under the pre-BAPCPA definition of substantial abuse for dismissal of a chapter 7 case, a finding of maliciousness or unlawful aims is not required).

While § 522(q)(1)(A) does not provide any guidance on what constitutes an abuse, its use of the language "under the circumstances" clearly directs the court to make a fact specific inquiry. The statute's use of the phrase "demonstrates that the filing of the case was an abuse" as a modifier of the required felony conviction suggests that there must, at a minimum, be some connection between the conviction and the filing of the case for the court to find that such filing constitutes an abuse.

If the court finds that the filing of the case constitutes an abuse under this provision, the resulting consequence is to limit the debtor's available exemption to $170,350. However, even if the court finds an abuse, the statute provides the debtor with an additional protection under § 522(q)(2). When viewed together, the resulting consequence and the additional protection suggest, at a minimum, that the standard for what constitutes an abuse under § 522(q)(1)(A) should be lower than the standard for a finding of abuse under other substantial abuse tests where the consequences are either the denial of all bankruptcy relief or a limitation of the type of relief available. *See* §§ 707(b), 1307(c).

With these general principals in mind, we must determine whether under the facts of this case, Mr. Cotton's felony conviction for sexually abusing Ms. Moore when she was a child

[8] As illustrated in § 522(q)(1)(B), Congress clearly knows how to limit types of felonies where it intends to limit the scope of the statute.

demonstrates that the filing of his chapter 7 bankruptcy case is an abuse such that his homestead exemption should be limited to $170,350 under § 522(q)(1)(A).

3. The required nexus exists between Mr. Cotton's felony conviction and his filing of the chapter 7 bankruptcy case.

The mere existence of a felony conviction, as defined in § 522(q)(1)(A), will not by itself trigger the § 522(q)(1)(A) exemption cap. Instead, as a threshold matter, for a felony conviction to demonstrate that the filing of the case is an abuse, there must be some nexus between the felonious conduct and the bankruptcy case. *See* COLLIER ON BANKRUPTCY ¶ 522.13 (Richard Levin & Henry J. Sommer eds., 16th ed.) ("Although the statutory language is less than clear, the objecting party will need to establish some connection between the felony conviction and the bankruptcy proceeding such that the bankruptcy filing would be deemed an abuse.").

Debtors argue that there is no nexus between Mr. Cotton's felony conviction and the bankruptcy case. Citing *Prince*, Debtors contend that § 522(q) only applies when a debtor has been convicted of a felony arising out of his or her conduct during a bankruptcy proceeding. (Debtors' Resp. at 9:1–11:2.) Debtors argue that because Mr. Cotton was convicted of felony child molestation and not a felony stemming from conduct in the bankruptcy case, no nexus exists between his conviction for sexually abusing Ms. Moore and the filing of this bankruptcy case twenty-two years later. Debtors' reliance on *Prince* is misguided.

Prince makes clear that felony convictions for crimes such as bank fraud, engaging in transactions of property derived from unlawful activity, and making false declarations under oath in a bankruptcy proceeding will trigger the § 522(q)(1)(A) cap. *See*, *In re Prince*, 2011 Bankr. LEXIS 5511 at *9. However, *Prince* does not stand for the proposition that only felonies arising from bankruptcy or financial crimes will trigger § 522(q)(1)(A). Neither the clear statutory language of § 522(q) nor any judicial decision interpreting it suggest that the cap only applies when the debtor has been convicted of a felony arising out of a bankruptcy proceeding or for financial crimes or fraud. Although a felony conviction arising out of the bankruptcy proceeding is one way to demonstrate the required nexus, it is not the only way. Another way

that an objecting party might demonstrate this nexus is by showing that the debtor is "attempting to discharge civil liability owing to victims of the crime, or that the bankruptcy filing may in some manner impede the debtor's obligation to pay restitution related to the felony conviction." COLLIER ON BANKRUPTCY ¶ 522.13 (Richard Levin & Henry J. Sommer eds., 16th ed.).

In this case, Mr. Cotton's felony conviction arises from sexually abusing Ms. Moore when she was ten and eleven years old. Ms. Moore—the party objecting to Mr. Cotton's homestead exemption—is the victim of the exact conduct that gave rise to the felony conviction. The Judgment entitles Ms. Moore to damages for the injuries she received as a direct result of the sexual abuse that led to Mr. Cotton's conviction. But for this exact conduct, neither Ms. Moore's Judgment nor her lien against the Real Property would exist. Thus, Debtors are attempting to use this bankruptcy case to avoid a lien that exists as a direct result of the sexual abuse that led to the felony conviction and is held by the victim of that exact abuse. In sum, the Court holds that the required nexus exists between Mr. Cotton's felony conviction and this bankruptcy case. Having found that this minimum threshold has been met for application of § 522(q)(1), the Court turns to the additional facts that exist in this case to determine whether to apply the exemption cap under this section.

4. Additional facts considered also support the application of § 522(q)(1).

Ms. Moore argues that under the totality of the circumstances, Mr. Cotton's felony conviction demonstrates that the filing of the case was an abuse of the Bankruptcy Code for the following four reasons: (1) the severity of the crime; (2) the Judgment arose out of the exact criminal acts for which Mr. Cotton was convicted; (3) the Judgment is by far the largest claim against the estate; and (4) avoiding Ms. Moore's lien would effectively allow Mr. Cotton to escape civil liability for the injuries he caused to the victim of his sexual abuse.

Debtors argue that the Court should not consider the severity of the crime nor whether the creditor at issue is the victim of the conduct that led to the conviction because these factors should only be considered in a determination of non-dischargeability. Debtors further contend

that the Court should not place weight on the percentage of the total debt attributable to Ms. Moore's Judgment. Debtors' argument is not persuasive.

The Court holds that in viewing the totality of the circumstances, it is important to consider all facts that exist and that are relevant to the analysis, including those suggested by Ms. Moore, as well as other nonexclusive factors such as Debtors' overall financial situation, the timing of Debtors' petition filing, and the effect of avoiding Ms. Moore's lien on her ability to recover under the Judgment.

i. Mr. Cotton's felony conviction.

Mr. Cotton was convicted of two counts of child molestation in the first degree under RCW 9A.44.083, a class A felony. Under Washington law, class A felonies are the most serious. *See* RCW 9A.20.021. Ms. Moore is the victim of the exact conduct that gave rise to Mr. Cotton's felony conviction and her judgment resulted from that same conduct. Both the severity of the crime and its impact on Ms. Moore, the objecting party, are relevant to the Court's analysis.

ii. Debtors' financial situation.

Debtors report a combined monthly income of $1,859.22. Mr. Cotton is unemployed and reports a total monthly income of $244.00 from non-cash governmental assistance. Mr. Cotton's only asset of consequence is the equity in the Real Property, which is Mr. Cotton's separate property. *See* Second SJ Order at ECF Nos. 45 and 46. Ms. Moore's Judgment is by far the largest debt, equating to approximately eighty-five percent of Debtors' total liabilities excluding the mortgage. Ms. Moore's lien is against Mr. Cotton's interest in the Real Property, not Debtors' community assets. Outside of Ms. Moore's Judgment, Debtors' schedules reflect community liabilities of $64,924 consisting of $57,305 of credit card debt incurred between November 2018 and June 2019, and $7,619 of medical debt incurred between April 2015 and November 2019. The size and timing of Ms. Moore's Judgment relative to the total debt suggests that avoiding Ms. Moore's lien was a substantial—if not the primary—motivation in Debtors' decision to file the chapter 7 case.

iii. Timing of Debtors' bankruptcy filing.

Debtors filed their bankruptcy petition five days after the increased homestead exemption became effective. Pre-bankruptcy planning does not automatically indicate an abuse of the Bankruptcy Code and the Court is not prepared to find that Debtors filed their petition in bad faith. But, had Debtors filed their petition five days earlier, they would have been restricted to a maximum homestead exemption of $125,000. If Debtor's homestead exemption was limited to $125,000, they would have only been able to partially avoid Ms. Moore's lien under § 522(f) and no issue would have arisen under § 522(q). Because the increased homestead exemption would permit the total avoidance of Ms. Moore's judicial lien on the Real Property, it is clear that the timing of the Debtors' chapter 7 filing was intended to maximize the impact that the filing would have on Ms. Moore's ability to collect on her judgment.

iv. The effect of totally avoiding Ms. Moore's judicial lien.

Ms. Moore's Judgment is secured by a lien on Mr. Cotton's only asset of consequence, the Real Property. If her lien is wholly avoided, she would then hold a non-dischargeable unsecured claim. Mr. Cotton is unemployed, therefore, an attempt to garnish his wages likely would be unsuccessful. Because Mr. Cotton has no other assets of consequence from which Ms. Moore could attempt to collect from, any protection offered by the non-dischargeability of the claim would likely be illusory. Such a result would effectively allow Mr. Cotton to use the Bankruptcy Code to avoid paying any damages to the victim of his sexual abuse.

Conversely, if § 522(q)(1)(A) applies, Ms. Moore's lien would be only partially avoided. She would continue to hold a lien against the Real Property in the amount above the capped exemption. RCW 6.13.070 would preclude Ms. Moore from forcing a sale of the Real Property. However, with a partially secured claim, Ms. Moore will have a chance of recovering a small portion of the Judgment if the Real Property is ultimately sold. Such a result would not deny Debtors a homestead exemption. Instead, Debtors will at a minimum still receive a sizable homestead exemption of $170,350, subject to their ability to argue for the allowance of a greater amount under § 522(q)(2).

Accordingly, under the facts of this case, the use of the bankruptcy filing to wholly avoid Ms. Moore's lien supports a finding of abuse.

C. Section 522(q)(1)(A) Conclusion.

Based on consideration of the foregoing, the Court finds that the totality of the circumstances of this case demonstrates that Mr. Cotton's filing of his chapter 7 case is an abuse of the Bankruptcy Code. Therefore, Ms. Moore has carried her burden of establishing her objection under § 522(q)(1)(A) and rebutting the presumption of validity. The burden now shifts to the Debtors to establish whether the savings clause of § 522(q)(2) applies to increase the amount of their exempt interest above $170,350.

D. Section 522(q)(2).

The remaining issue is whether Debtors can establish that the § 522(q)(2) savings clause applies to increase the amount of their exempt interest above $170,350. To meet their burden, Debtors must establish that the amount of interest above the cap is reasonably necessary for their support. This issue raises questions of material fact; therefore, it is inappropriate for the Court to address this issue summarily. These remaining questions of material fact must be decided before the Court makes a final ruling on Debtors' motion to avoid Ms. Moore's lien.

III. CONCLUSION

In conclusion, the Court holds that under the totality of the circumstances, Mr. Cotton's felony conviction demonstrates that the filing of the case was an abuse of the Bankruptcy Code. Ms. Moore has established her burden of proof. Accordingly, the Court grants partial summary judgment to Ms. Moore on the issue of whether, under the facts and circumstances of this case, Mr. Cotton's prior felony conviction demonstrates that the filing of the case was an abuse of the Bankruptcy Code.

Debtors bear the burden of establishing that the § 522(q)(2) savings clause applies to increase the amount of their exempt interest above $170,350 before the Court makes a final ruling on Debtors' motion to avoid Ms. Moore's lien.

The parties should contact Judge Heston's Courtroom Deputy, Samantha Bergeson, at samantha_bergeson@wawb.uscourts.gov to schedule a status conference to discuss how to best proceed in this case in light of the Court's Memorandum Decision.

/ / / End of Memorandum Decision / / /

Entered on Docket June 6, 2022

Below is the Order of the Court.

Mary Jo Heston
Mary Jo Heston
U.S. Bankruptcy Judge
(Dated as of Entered on Docket date above)

UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT OF WASHINGTON AT TACOMA

In re:

ROBERT DANIEL COTTON, JR., and TINA MARIE COTTON,

Debtor.

Case No. 21-40847-MJH

ORDER ON DEBTORS' MOTION TO AVOID JUDGMENT LIEN OF SUZANNE MOORE

This matter came before the Court on June 6, 2022, on Robert Daniel Cotton and Tina Marie Cotton's (individually "Mr. Cotton" and "Mrs. Cotton" respectively) (collectively "Debtors") motion to avoid the judicial lien held by Suzanne Moore against Debtors' residence located at 4128 South J Street, Tacoma, Washington ("Real Property").

The background and undisputed facts regarding the above-captioned case are set forth in detail in the Court's Memorandum Decision on Debtors' Motion to Avoid Lien at ECF No. 52; Memorandum Decision on Debtors' Motion for Summary Judgment at ECF No. 45; and in the Order Granting Partial Summary Judgment on Debtors' Motion to Avoid Lien at ECF No. 35, which the Court hereby incorporates by reference.

In addition to the facts incorporated by reference, the Court hereby makes the following finding of facts and conclusions of law:

(1) Suzanne Moore has a judgment lien against the Real Property which is recorded in Pierce County under recording number 202011191070 ("Ms. Moore's Lien").

(2) Ms. Moore's Lien does not secure a debt for child support or for or any of the statutory exceptions set forth in 11 U.S.C. § 522(f)(1)(A).

(3) The maximum homestead exemption for real property located in Pierce County for a bankruptcy filed in 2021 is $424,300.

(4) As of the petition date, the Real Property had a value of $400,614, and was encumbered in the amount of $145,831.40.

(5) Debtors claimed a homestead exemption of $254,782.60 and Ms. Moore objected, arguing that Debtors' claimed homestead exemption is improper and should be capped at $170,350 pursuant to 11 U.S.C. § 522(q)(1)(A).

(6) Ms. Moore has met her burden of establishing her objection and Debtors agreed to waive their ability to argue whether the savings clause of 11 U.S.C. § 522(q)(2) applies to increase the capped homestead exemption above $170,350.

(7) Ms. Moore's Lien partially impairs Debtors' homestead exemption. The portion of Ms. Moore's Lien that does not impair Debtors' homestead exemption is $84,432.60.

The Court having considered the arguments of counsel and pleadings in the record, now therefore, it is

ORDERED that Ms. Moore's objection to Debtors' claimed homestead exemption is SUSTAINED. Debtors' homestead exemption is capped in the aggregate amount of $170,350 pursuant to 11 U.S.C. § 522(q)(1)(A); it is further

ORDERED that Debtors' motion to avoid Ms. Moore's Lien pursuant to 11 U.S.C. § 522(f) is GRANTED in part. Ms. Moore Lien is hereby avoided to the extent it impairs Debtors' $170,350 homestead exemption. Ms. Moore's Lien shall and does remain on the Real Property in the amount of $84,432.60, with interest accruing thereon at twelve percent per annum as of May 17, 2021. The avoided portion of Ms. Moore's Lien shall have no further force or effect as to the Real Property unless the Debtors' bankruptcy proceeding is dismissed.

/ / / End of Order / / /

Caution
As of: August 30, 2022 8:55 PM Z

In re Prince

United States Bankruptcy Court for the Eastern District of Texas, Sherman Division

July 25, 2011, Decided; July 25, 2011, Filed, Entered

Case No.: 09-43627, Chapter No.: 7

Reporter
2011 Bankr. LEXIS 5511 *

In Re: Clovis L. Prince Debtor

Core Terms

exemption, financial affairs, knowingly and willfully, penalty of perjury, false information, bankruptcy schedule, disclosure requirements, answered, transfer of property, fraudulently, ordinary course of business, immediately preceding, real estate, commencement, transferred, homestead, knowingly

Case Summary

Procedural Posture
The court heard the Amended Objections to Debtor's Exemptions filed by a bank and the Chapter 7 Trustee. The Objections to Exemptions sought to limit the amount of debtor's claimed exemption of his homestead in Murphy, Texas, and to invalidate debtor's claimed exemption of certain personal property.

Overview

11 U.S.C.S. § 522(q)(1)(A) limited a debtor's homestead exemption limit where the debtor had been convicted of a felony which under the circumstances, demonstrated that the filing of the case was an abuse of the provisions of Title 11 of the U.S. Code. Here, a Guilty Verdict in the U.S. District Court for the Eastern District of Texas for, inter alia, making false declarations under oath in a proceeding in his bankruptcy, demonstrated that the filing of debtor's bankruptcy was an abuse of the provisions of Title 11 of the U.S. Code. Accordingly, § 522(q)(1)(A) limited the amount of debtor's homestead exemption for the Covington Court Property to $146,450. Next, the bank carried its burden to establish that debtor was not entitled to an exemption for a certain Individual Retirement Account identified in Schedule C of debtor's bankruptcy schedules. The bank also carried its burden to establish that debtor was not entitled to exemptions for the "Books," "Pictures," "Sports memorabilia," "Movies ("DVDs)," and "Music (Compact discs)" identified in Schedule C. Finally, the bank carried its burden to establish that debtor was not entitled to exemptions for certain other personal property.

Outcome
The Objections to Exemptions were sustained. The Chapter 7 Trustee could immediately take all steps necessary to sell the Covington Court Property. Debtor and any and all parties with any interest in the Covington Court Property were ordered to cooperate with the Trustee's efforts to sell the Covington Court Property.

LexisNexis® Headnotes

Bankruptcy Law > Exemptions > General Overview

Real Property Law > Exemptions & Immunities > Homestead Exemptions

HN1[] **Bankruptcy Law, Exemptions**

11 U.S.C.S. § 522(q)(1)(A) limits a debtor's homestead exemption limit where the debtor has been convicted of a felony which under the circumstances, demonstrates that the filing of the case was an abuse of the provisions of Title 11 of the U.S. Code.

Counsel: **[*1]** Clovis L Prince, Debtor, Pro se, Beaumont, TX.

For Michelle Chow, Trustee: Larry A. Levick, Todd A. Hoodenpyle, Singer & Levick, P.C., Addison, TX.

Judges: HONORABLE BRENDA T. RHOADES, CHIEF UNITED STATES BANKRUPTCY JUDGE.

Michael Rogers

Opinion by: BRENDA T. RHOADES

Opinion

ORDER ON AMENDED OBJECTIONS TO DEBTOR'S EXEMPTIONSFILED BY AMERICAN BANK OF TEXAS AND CHAPTER 7 TRUSTEE

On May 10, 2011, the Court heard the Amended Objections to Debtor's Exemptions ("Objections to Exemptions") filed by American Bank of Texas ("American Bank") and the Chapter 7 Trustee. The Objections to Exemptions seek to limit the amount of Debtor's claimed exemption of his homestead in Murphy, Texas, and to invalidate Debtor's claimed exemption of certain personal property. The Court exercises its core jurisdiction over this matter, *see* 28 U.S.C. § 1334 and 28 U.S.C. § 157(b)(2)(A), (B) and (O), and makes the following findings of fact and conclusions of law.

1. American Bank and the Chapter 7 trustee provided due and proper notice of the Objections to Exemptions, and the hearing thereon, in accordance with the Federal Rules of Bankruptcy Procedure and the Local Bankruptcy Rules for the Eastern District of Texas.

2. Clovis Prince ("Debtor") is married to Katherine **[*2]** M. Robinson.

3. The real property located at 318 Covington Court, Murphy, Texas 75094 (the "Covington Court Property") is Debtor's homestead under 11 U.S.C. § 522 and Texas Property Code § 41.002. Debtor is entitled to a homestead exemption for the Covington Court Property under 11 U.S.C. § 522 and Texas Property Code §§ 41.001- 41.002.

4. Debtor has been convicted of felonies (as defined in 18 U.S.C. § 3156) in *United States of American v. Clovis Prince*, Case No. 4:09-CR-161, in the United States District Court for the Eastern District of Texas. In particular, on December 9, 2010, a jury found Debtor guilty of (1) bank fraud in connection with loans that Debtor or his companies obtained from various banks, including American Bank; (2) engaging in monetary transactions in property derived from unlawful activity; (3) making false declarations under oath in a proceeding in his bankruptcy; (4) making false declarations in the statement of financial affairs and bankruptcy schedules submitted in his bankruptcy and in the bankruptcies for companies he owns and controls; and (5) making false declarations in his Rule 2004 examination taken in his bankruptcy (the "Guilty Verdict").

5. The Guilty **[*3]** Verdict includes the following specific violations of Title 18 of the United States Code:

a. In violation of 18 U.S.C. § 1621(1), Debtor knowingly and willfully gave false testimony under oath during the creditors' meeting on December 14, 2009 in his bankruptcy when he testified that he was not a beneficiary of the Clovis L. Prince, Katherine M. Robinson, and Tamika D. Prince Trust.

b. In violation of 18 U.S.C. § 1621(1), Debtor knowingly and willfully gave false testimony under oath during the creditors' meeting on December 14, 2009 when he testified that he failed to disclose transfers of real property on the Bankruptcy Schedules and Statements of Financial Affairs in his bankruptcy and in Case No. 09-43628, *In re Crown Project Management, Inc.*; and in Case No. 09-43645, *In re C. Prince & Associates Consulting, Inc.* because he transferred, or caused the transfer, of the real property in the "normal" or "ordinary course of business."

c. In violation of 18 U.S.C. § 1621(2), Debtor knowingly and willfully provided false information under penalty of perjury in the Statement of Financial Affairs filed in his bankruptcy when he answered "None" to the required disclosure 10(a): "List all other **[*4]** property, other than property transferred in the ordinary course of business or financial affairs of the debtor, transferred either absolutely or as security within two years immediately preceding the commencement of this case."

d. In violation of 18 U.S.C. § 1621(2), Debtor knowingly and willfully provided false information under penalty of perjury in the Statement of Financial Affairs filed in his bankruptcy when he answered "None" in response to the required disclosure 10(b): "List all property transferred by the debtor within ten years immediately preceding the commencement of this case to a self-settled trust or similar device of which the debtor is a beneficiary."

e. In violation of 18 U.S.C. § 1621(2), Debtor knowingly and willfully provided false information under penalty of perjury on the Statement of

Financial Affairs filed in his bankruptcy when he answered "None" in response to the required disclosure 14: "List all property owned by another person that the debtor holds or controls."

f. In violation of *18 U.S.C. § 1621(2)*, Debtor knowingly and willfully provided false information under penalty of perjury on the Statement of Financial Affairs filed in Case No. 09-43645; *In re C. Prince & Associates Consulting, Inc.* **[*5]** when he answered "C. Prince & Associates sold one property in the normal course of business" in response to the required disclosure 10(a): "List all other property, other than property transferred in the ordinary course of business or financial affairs of the debtor, transferred either absolutely or as security within two years immediately preceding the commencement of this case."

g. In violation of *18 U.S.C. § 1621(2)*, Debtor knowingly and willfully provided false information under penalty of perjury on the Statement of Financial Affairs filed in Case No. 09-43628; *In re Crown Project Management, Inc.* when he answered "Crown sold some properties in the normal course of business" in response to the required disclosure 10(a): "List all other property, other than property transferred in the ordinary course of business or financial affairs of the debtor, transferred either absolutely or as security within two years immediately preceding the commencement of this case."

h. In violation of *18 U.S.C. § 1621(2)*, Debtor knowingly and willfully provided false information under penalty of perjury on the Statement of Financial Affairs filed in Case No. 09-43628; **[*6]** *In re Crown Project Management, Inc.* when he answered "None" in response to the required disclosure 10(b): "List all property transferred by the debtor within ten years immediately preceding the commencement of this case to a self-settled trust or similar device of which the debtor is a beneficiary."

i. In violation of *18 U.S.C. § 1621(2)*, Debtor knowingly and willfully provided false information under penalty of perjury on the Schedule B—Personal Property filed in his bankruptcy when he answered "None" in response to the required disclosure 20 to list: "Contingent and noncontingent interests in the estate of a decedent, death benefit plan, list insurance policy, or trust."

j. In violation of *18 U.S.C. § 1621(2)*, Debtor knowingly and willfully provided false information under penalty of perjury on the Schedule B—Personal Property filed in his bankruptcy when he answered "None" in response to the required disclosure 35 to list: "Other personal property of any kind not already listed. Itemize."

k. In violation of *18 U.S.C. § 152(1)*, Debtor knowingly and fraudulently concealed from a trustee and other officer of the court charged with the control and custody of property, and, in connection **[*7]** with Debtor's bankruptcy and Case No. 09-43628, *In re Crown Project Management, Inc.*; and Case No. 09-43645, *In re C. Prince & Associates Consulting, Inc.*, Debtor knowingly concealed from creditors and the United States Trustee property belonging to the estate of Debtor, including real estate, an interest in the Clovis L. Prince and Katherine M. Robinson Trust, and an interest in the Clovis L. Prince, Katherine M. Robinson, and Tamika D. Prince Trust.

l. In violation of *18 U.S.C. § 152(2)*, Debtor knowingly and fraudulently provided false information under penalty of perjury on Schedule A— Real Estate, Schedule B—Personal Property, and Statement of Financial Affairs, and knowingly and willfully gave false testimony under oath at the creditors' meetings on December 14, 2009, when Debtor falsely claimed that real estate transfers were made in the "normal" or "ordinary course of business" and falsely denied that he was a beneficiary of the Clovis L. Prince, Katherine M. Robinson, and Tamika D. Prince Trust in his bankruptcy and in Case No. 09-43628, *In re Crown Project Management, Inc.*; and in Case No. 09-43645, *In re C. Prince & Associates Consulting, Inc.*

m. In violation of *18 U.S.C. § 152(3)*, **[*8]** Debtor knowingly and fraudulently provided false information under penalty of perjury on the Bankruptcy Schedules and Statements of Financial Affairs filed in his bankruptcy and in Case No. 09-43628, *In re Crown Project Management, Inc.*; and in Case No. 09-43645, *In re C. Prince & Associates Consulting, Inc.* when he failed to disclose property transfers and interests in real estate and trusts.

n. In violation of *18 U.S.C. § 152(9)*, Debtor knowingly and fraudulently withheld recorded information, including books, documents, records, and papers, relating to the property and financial affairs of a debtor, namely recorded information

concerning the Clovis L. Prince, Katherine M. Robinson, and Tamika D. Prince Trust, from a custodian, trustee, marshal, or other officer of the Court and a United States Trustee who were entitled to possession of the recorded information.

o. In violation of *18 U.S.C. § 157(3)*, having devised and intending to devise a scheme and artifice to defraud and for the purpose of executing and concealing such scheme and artifice and attempting to do so, Debtor made false and fraudulent representations, claims, and promises when he fraudulently failed to disclose property **[*9]** transfers and falsely denied the existence of interests in real estate and trusts in his bankruptcy and in Case No. 09-43628, *In re Crown Project Management, Inc.*; and in Case No. 09-43645, *In re C. Prince & Associates Consulting, Inc.*

6. **HN1**[↑] *Section 522(q)(1)(A) of the Bankruptcy Code* limits a debtor's homestead exemption limit where "the debtor has been convicted of a felony ... which under the circumstances, demonstrates that the filing of the case was an abuse of the provisions of this title." Here, the Guilty Verdict demonstrates that the filing of Debtor's bankruptcy was an abuse of the provisions of Title 11 of the Bankruptcy Code. Accordingly, in this case, *§ 522(q)(1)(A) of the Bankruptcy Code* limits the amount of Debtor's homestead exemption for the Covington Court Property to $146,450.00.

7. American Bank has carried its burden to establish that Debtor is not entitled to an exemption for the "American Fund IRA" identified in Schedule C of Debtor's Bankruptcy Schedules. The objection to Debtor's exemption for the "American Fund IRA" is hereby sustained.

8. American Bank has carried its burden to establish that Debtor is not entitled to exemptions for the "Books," "Pictures," "Sports **[*10]** memorabilia," "Movies ("DVDs)," and "Music (Compact discs)" identified in Schedule C of Debtor's Bankruptcy Schedules. The objection to Debtor's exemptions for the "Books," "Pictures," "Sports memorabilia," "Movies ("DVDs)," and "Music (Compact discs)" identified in Schedule C of Debtor's Bankruptcy Schedules is hereby sustained.

9. American Bank has carried its burden to establish that Debtor is not entitled to an exemption for the "Clothing (including accessories and shoes)" identified in Schedule C of Debtor's Bankruptcy Schedules to the extent that any amount attributable to the clothing exceeding Debtor's claimed exemption inures to the benefit of the Bankruptcy Estate. The objection to Debtor's exemption for the Clothing (including accessories and shoes)" is hereby sustained to the extent that any amount attributable to the clothing exceeding Debtor's claimed exemption inures to the benefit of the Bankruptcy Estate

10. American Bank has carried its burden to establish that Debtor is not entitled to an exemption for the "2002 Lexus SC430," or any amounts attributable to it, identified in Schedule C of Debtor's Bankruptcy Schedules to the extent that any amount attributable to the **[*11]** Lexus exceeding Debtor's claimed exemption inures to the benefit of the Bankruptcy Estate. The objection to Debtor's exemption for the "2002 Lexus SC430," including any amounts attributable to it, is hereby sustained to the extent that any amount attributable to the Lexus exceeding Debtor's claimed exemption inures to the benefit of the Bankruptcy Estate.

11. American Bank has carried its burden to establish that Debtor is not entitled to exemptions for the "Wedding rings" and "Watches" identified in Schedule C of Debtor's Bankruptcy Schedules. The objection to Debtor's exemptions for the "Wedding rings" and "Watches" is hereby sustained.

IT IS THEREFORE ORDERED that the Objections to Exemptions are hereby **SUSTAINED** as specified above.

IT IS FURTHER ORDERED that the Chapter 7 Trustee may immediately take all steps necessary to sell the Covington Court Property.

IT IS FURTHER ORDERED that Debtor and any and all parties with any interest in the Covington Court Property shall cooperate with the Chapter 7 Trustee's efforts to sell the Covington Court Property.

Signed on 7/25/2011

/s/ Brenda T. Rhoades

HONORABLE BRENDA T. RHOADES

CHIEF UNITED STATES BANKRUPTCY JUDGE

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KeyCite Yellow Flag - Negative Treatment
Declined to Extend by Parks v. Anderson, D.Kan., May 19, 2009

332 B.R. 479
United States Bankruptcy Court,
S.D. Florida.

In re Charles H. WAYRYNEN, Debtor.

No. 05–32144–BKC–SHF.
|
Oct. 14, 2005.

Synopsis

Background: Chapter 7 trustee objected to state law homestead exemption claimed by Florida debtor who had acquired his current residence within 1,215 days of petition date.

Holdings: The Bankruptcy Court, Steven H. Friedman, J., held that:

[1] phrase "as a result of electing," as used in provision of the Bankruptcy Abuse Prevention and Consumer Protection Act limiting the maximum state law homestead exemption available to debtors who have acquired homestead within 1,215 days of petition date and who have "elect[ed]" to claim state law exemptions, could not be interpreted so as to limit this homestead cap only to debtors who reside in states that have not opted out of federal bankruptcy exemptions, and who thus have choice between state and federal exemptions; but

[2] term "previous principal residence," as used in "safe harbor" provision indicating that statutory cap on state law homestead exemption available to debtors who acquire homestead within 1,215 days of petition date will not apply to limit exemption that debtor can claim, to extent that value of debtor's present residence is attributable to his accrual of equity through his ownership of previous residence located in same state that debtor acquired prior to start of this 1,215-day period, was not limited in its application only to residence that debtor owned immediately prior to current residence.

Objection overruled.

West Headnotes (5)

[1] **Bankruptcy** Validity and effect of opt-out legislation

Bankruptcy Waiver or Loss of Exemption

Phrase "as a result of electing," as used in provision of the Bankruptcy Abuse Prevention and Consumer Protection Act limiting the maximum state law homestead exemption available to debtors who have acquired homestead within 1,215 days of petition date and who have "elect[ed]" to claim state law exemptions, could not be interpreted so as to limit this homestead cap only to debtors who reside in states that have not opted out of federal bankruptcy exemptions, and who thus have choice between state and federal exemptions; rather, to avoid violating Congress' clear intent that homestead cap should apply in opt-out as well as in non-opt-out states, debtors residing in opt-out states had to be regarded as "electing" state law exemptions by virtue of having chosen to live in that state. 11 U.S.C.A. § 522(p)(1).

7 Cases that cite this headnote

[2] **Statutes** Extrinsic Aids to Construction

Court will look beyond plain language of statute at extrinsic materials to determine Congressional intent only if: (1) statute's language is ambiguous; (2) applying it according to its plain meaning would lead to absurd result; or (3) there is clear evidence of contrary legislative intent.

[3] **Statutes** Plain language; plain, ordinary, common, or literal meaning

Statutes Relation to plain, literal, or clear meaning; ambiguity

When statute's language is plain, sole function of courts, at least where disposition required by statutory text is not absurd, is to enforce it according to its terms.

[4] **Bankruptcy** Waiver or Loss of Exemption

Term "previous principal residence," as used in "safe harbor" provision indicating that statutory cap on state law homestead exemption available to debtors who acquire homestead within 1,215 days of petition date will not apply to limit exemption that debtor can claim, to extent that value of debtor's present residence is attributable to his accrual of equity through his ownership of previous residence located in same state that debtor acquired prior to start of this 1,215-day period, was not limited in its application only to residence that debtor owned immediately prior to current residence; rather, where equity that Chapter 7 debtor accrued in Florida residence that he owned two houses prior to his current residence, in amount of $205,000, was in excess of total $150,000 value of current Florida residence, and where other residence was acquired more than 1,215 days prior to petition date, statutory cap did not apply to limit maximum state law homestead exemption available to debtor in his current residence. 11 U.S.C.A. § 522(p)(2)(B).

11 Cases that cite this headnote

[5] **Bankruptcy** Waiver or Loss of Exemption

Gravamen of provision of the Bankruptcy Abuse Prevention and Consumer Protection Act limiting the maximum state law homestead exemption available to debtors who have acquired homestead within 1,215 days of petition date is to limit ability of individuals desiring to take advantage of lenient exemption provisions of "debtor-friendly" states by relocating to such states. 11 U.S.C.A. § 522(p)(1).

3 Cases that cite this headnote

Attorneys and Law Firms

***481** Jon L. Martin, Esq., Stuart, FL, for debtor.

Michael R. Bakst, West Palm Beach, FL, Chapter 7 Trustee.

ORDER OVERRULING OBJECTION TO CLAIMED EXEMPTIONS

STEVEN H. FRIEDMAN, Bankruptcy Judge.

THIS CAUSE came on to be heard on July 25, 2005 upon the Objection to Claimed Exemptions (C.P. 10), filed by Michael R. Bakst, chapter 7 trustee ("Trustee"). The Trustee asserts that, pursuant to 11 U.S.C. §§ 522(b)(2) and (p)(1), the homestead exemption available to Charles H. Wayrynen ("Debtor"), a Florida resident, is limited to $125,000 in equity, since he purchased his home within 1215 days of the commencement of this case. Based upon this Court's interpretation of the new provisions implemented with the enactment of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, the Court determines that the Debtor is entitled to exempt the full value of his home.

JURISDICTION

This Court has jurisdiction of this matter pursuant to 28 U.S.C. §§ 157 and 1334(b). This is a core proceeding as to which the Court is authorized to hear and determine all matters regarding this case in accordance with 28 U.S.C. § 157(b)(2)(B).

PROCEDURAL BACKGROUND

This case was commenced on April 29, 2005, with the Debtor's filing of his voluntary chapter 7 petition. Pursuant to 11 U.S.C. § 341, the Trustee conducted the Meeting of Creditors on June 1, 2005 (C.P. 3). Thereafter, the Trustee filed his Objection to Claimed Exemptions (C.P. 10), in accordance with Bankruptcy Rule 4003(b). In his Objection to Claimed Exemptions, the Trustee asserts that pursuant to 11 U.S.C. § 522(p), the Debtor is limited to $125,000 as the amount of the homestead exemption which he may claim. The Trustee's objection is premised upon the following indicia:

- The Debtor purchased his current residence, located at 592 NW San Remo, Port St. Lucie, Florida in March, 2005.

• Since the home was acquired within 1215 days of the April 29, 2005 commencement of this case, § 522(p) limits the extent of the homestead's exempt value to $125,000.00.

• Although § 522(p)(2)(B) provides that the $125,000.00 exemption does not include any interest transferred from a debtor's previous principal residence which was acquired prior to the beginning of the 1215–day period, if the previous and current residences are located within the same state, this provision does not benefit the Debtor. His previous residence, located at 8233 SE Double Tree Drive, Hobe Sound, Florida, was acquired on September 6, 2002, and was sold on March 14, 2005. Since the Debtor's interest in the Double Tree property was acquired within 1215 days preceding the filing of his case, the $125,000.00 exemption limitation applies.

***482** • Based upon the foregoing, the Debtor must account to the bankruptcy trustee for $25,000, representing the value of the Debtor's present home, listed at $150,000 in Schedule A of the Debtor's bankruptcy schedules, less the $125,000 homestead exemption to which the Debtor is entitled.

The Debtor, in his Response to Trustee's Objection to Claimed Exemptions (C.P. 12), asserts that he is entitled to a homestead exemption for the full measure of the equity in his home, as provided under Article X, Section 4 of the Florida Constitution. The Debtor further asserts that since he made no election pursuant to 11 U.S.C. § 522(p)(1) to invoke the exemption provisions delineated under the Federal scheme of exemptions as set forth in § 522(b)(2), or under the exemption provisions provided under Florida law [1] pursuant to § 522(b)(3), the $125,000 limitation does not apply. Accordingly, the Debtor contends that he is entitled to exempt all of the equity in his home. The Debtor further asserts that even if this Court was to determine that the $125,000 limitation on a debtor's residence is applicable, he nonetheless would be entitled to exempt the full value of his home as a result of the exclusion provided under § 522(p)(2)(B), as the equity in the Debtor's present home derives from the sale of his previous home within the State of Florida which he had acquired more than 1215 days prior to his bankruptcy filing.

ANALYSIS

Determination of Applicable Exemption Provisions

Pursuant to 11 U.S.C. § 522(b)(1), "...an individual debtor may exempt from property of the estate the property listed in either paragraph 2 (sic.) or, in the alternative, paragraph (3) of this subsection." Under § 522(b)(2), a debtor may exempt "[p]roperty listed in this paragraph...that is specified under subsection (d), unless the State law that is applicable to the debtor under paragraph (3)(A) specifically does not so authorize." Pursuant to § 522(b)(2), a debtor is entitled to exempt various categories of real and personal property, subject to the dollar value limitations delineated therein. *See,* 11 U.S.C. § 522(d). However, a debtor, rather than exempting the property delineated under § 522(d), ostensibly may select property listed under 11 U.S.C. § 522(b)(3). Such property would consist of (1) property exempt under Federal law, other than the categories of property specifically delineated under § 522(d); and (2) property exempt under state law, if the state in which the debtor resides has chosen to limit the exemptions available for its residents to those available under state law. Virtually all states, including Florida, have chosen to "opt out" of the Federal scheme of exemptions as manifest by Florida Statutes § 222.20.

Override of Florida Exemptions by Bankruptcy Abuse Prevention and Consumer Protection Act of 2005

The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ("Reform Act"), was enacted on April 20, 2005. Pursuant to § 1501 of the Reform Act, virtually all of its provisions become effective on October 17, 2005. However, § 1501(b)(2) of the Reform Act provides that §§ 308, 322, and 330 of the Reform Act were to ***483** become effective on the date of enactment. Sections 308 and 322 of the Reform Act are implicated in the instant controversy, as with their enactment, Congress has limited the extent of the homestead exemption which may be claimed by a debtor under certain circumstances. Section 322 of the Reform Act, codified as 11 U.S.C. § 522(p)(1), provides:

> Except as provided in paragraph (2) of this subsection and sections 544 and 548, 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 interest that was acquired by the debtor during the 1215–day period preceding the date of the filing of the petition that exceeds in the aggregate $125,000 in value in—
>
> (A) real or personal property that the debtor or a dependent of the debtor uses as a residence;
>
> (B) a cooperative that owns property that the debtor or a dependent of the debtor uses as a residence;
>
> (C) a burial plot for the debtor or a dependent of the debtor; or
>
> (D) real or personal property that the debtor or dependent of the debtor claims as a homestead.

"Effective Election" of State Exemptions by Florida Debtors

[1] **[2]** The revisions to 11 U.S.C. § 522 contain an incongruity, the effect of which, if certain of its provisions are strictly construed, would render application of this provision inconsequential. Section 522(b)(1) states that an individual debtor "...**may exempt** from property of the estate..." (emphasis added) certain property. Section 522(p)(1) provides that, "...**as a result of electing** under subsection (b)(3)(A) to exempt property under State or local law..." (emphasis added), a debtor may not exempt any amount of interest in real or personal property used as a residence which exceeds $125,000 in value, if the property interest was acquired within 1215 days of the petition date. As noted above, a Florida resident generally is entitled to an unlimited homestead exemption. If this Court were to construe the language of § 522(p)(1) literally, the $125,000 limitation as to the value of a home acquired by a debtor within 1215 days of the debtor's bankruptcy filing would be rendered inconsequential. More specifically, since the $125,000 limitation delineated in § 522(p)(1) is applicable only "...**as a result of electing**..." (emphasis added) to claim state law exemptions, and since a Florida resident is not entitled to claim Federal exemptions, it could be construed that, at least as to Florida residents filing for bankruptcy relief, the limitations provided in § 522(p)(1) do not apply. "We will only look beyond the plain language of a statute at extrinsic materials to determine the congressional intent if: (1) the statute's language is ambiguous; (2) applying it according to its plain meaning would lead to an absurd result; or (3) there is clear evidence of contrary legislative intent." *In re International Administrative Services, Inc.*, 408 F.3d 689, 707 (11th Cir.2005), *citing* *United States v. DBB, Inc.*, 180 F.3d 1277, 1281 (11th Cir.1999). To exclude Florida residents from the limitations provided in § 522(p)(1) would be contrary to the intention of the Reform Act's drafters.

> The Bill also restricts the so-called "mansion loophole." Under current bankruptcy law, debtors living in certain states can shield from their creditors virtually all of the equity in their homes. In light of this, some debtors actually relocate to these states just to take advantage of their "mansion loophole" laws.

***484** H.R. REP. NO. 109–31, pt. 1, at 15–16, U.S.Code Cong. & Admin.News 2005, pp. 88, 102 (2005).

Since Congress clearly intended for the exemption limitations provided under § 522(p)(1) to apply to **all** debtors, the only plausible reconciliation of the afore-referenced provisions contained in § 522 is that a Florida resident who files for bankruptcy protection, by virtue of **(1)** having chosen to reside in the State of Florida; **(2)** having chosen to purchase a residence in the State of Florida; **(3)** having chosen to make the residence his/her permanent residence; and **(4)** having availed himself/herself of the relief available under Title 11, United States Code; thereby elects to invoke the exemption provisions available under Florida law. *Contra* *In re McNabb*, 326 B.R. 785 (Bankr.D.Ariz.2005) (holding that the Bankruptcy Code's $125,000 homestead cap, as added by the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, applies only in non-"opt out" states).

[3] It is well-established that, "when the statute's language is plain, the sole function of the courts—at least where the disposition required by the text is not absurd—is to enforce

it according to its terms." *Hartford Underwriters Ins. Co. v. Union Planters Bank, N. A.,* 530 U.S. 1, 6, 120 S.Ct. 1942, 147 L.Ed.2d 1 (2000) (quoting *United States v. Ron Pair Enterprises, Inc.,* 489 U.S. 235, 241, 109 S.Ct. 1026, 103 L.Ed.2d 290 (1989) (in turn quoting *Caminetti v. United States,* 242 U.S. 470, 485, 37 S.Ct. 192, 61 L.Ed. 442 (1917))). This is because by strictly interpreting the provisions contained in § 522, that which § 522(b)(1) "giveth", § 522(p)(1), combined with § 522(b)(2) and Florida Statutes § 222.20, "taketh away". Since pursuant to Florida Statutes § 222.20, Florida has "opted out" with regard to the Federal exemptions provided under § 522(d), the only property exemptions available to Florida residents who file for bankruptcy protection are as to those property interests delineated under § 522(b)(3)(A), consisting of **(1)** property that is exempt under Federal law **other than** the specifically delineated categories of property which otherwise would be exempt under § 522(d), and **(2)** property that is exempt under state or local law. The recently enacted provision limiting the dollar value of a residence which may be claimed as exempt to $125,000 becomes effective only as a result of electing to exempt property under state or local law, pursuant to § 522(p)(1). Since a Florida debtor does not have the option of "**electing**", the referenced limitation upon the extent to which a debtor may exempt property would not be applicable. As such, Florida residents would be "limited" under the Reform Act to precisely the same degree as they were prior to the enactment of the Reform Act.

Relief Afforded Under 11 U.S.C. § 522(p)(2)(B) is not Limited Solely to Previous Principal Residence Acquired Prior to Beginning of 1215–Day Period

[4] The Trustee submits that, since the Debtor purchased his present residence (592 NW San Remo, Port St. Lucie, Florida) on March 16, 2005 and within 1215 days of his April 29, 2005 bankruptcy filing, the extent to which he may claim an exemption in his residence is limited to $125,000, pursuant to § 522(p)(1)(A). The Debtor, however, contends that § 522(p)(2)(B) provides him with a "safe harbor" to the extent that the value of his present residence is attributable to his accrual of equity through his ownership of previous residences located within the State of Florida. Section 522(p)(2)(B) provides:

> ***485** For purposes of paragraph (1), any amount of such interest does not include any interest transferred from a debtor's previous principal residence (which was acquired prior to the beginning of such 1215–day period) into the debtor's current principal residence, if the debtor's previous and current residences are located in the same State.

At the hearing conducted upon the Trustee's Objection to Claimed Exemptions, the Trustee and the Debtor stipulated to the accuracy of a table, contained within the Debtor's Response to Trustee's Objection to Claimed Exemptions, reflecting ownership by the Debtor of previous residences located within the State of Florida within the 1215–day period immediately preceding the commencement of this case (C.P. 12—pg.4). The referenced table, supplemented by the Court with the street addresses and sales prices for the respective properties, is set forth below:

PROPERTY	DATE PURCHASED/ PRICE	NUMBER OF DAYS PRE–PETITION PROPERTY WAS PURCHASED	DATE SOLD/ PRICE	NUMBER OF DAYS PRE–PETITION PROPERTY WAS SOLD

592 NW San Remo Port St. Lucie, Florida	03/16/05 — $146,000	44 days	Not Applicable	Not Applicable
8233 SE Double Tree Hobe Sound, Florida	09/06/02 — $174,800	966 days	03/14/05 — $271,500	46 days
421 North O Street Lake Worth, Florida	05/19/89 — $99,500 [Based upon Clerk of Court's entry reflected upon face of Warranty Deed]	5,824 days	08/20/02 — $250,000	983 days

The Trustee contends that, since the Debtor purchased his current residence within the 1215–day period preceding the date of the filing of his petition, and since the value of the residence, listed at $150,000, exceeds the $125,000 exemption for a residence, the differential of $25,000 represents non-exempt property. However, such an analysis misconstrues § 522(p)(2)(B). The statute is clear that the limitation contained therein applies to that portion of the value of a debtor's residence, acquired **within** 1215 days of the petition date, which **exceeds** $125,000. In addition, however, the extent of the limitation is determined **only after deducting** from the value of a debtor's current residence that portion of the property's value attributable to the debtor's ownership of a previous residence, provided that the previous residence is located within the same state as the current residence and was acquired in excess of 1215 days before the petition date. As reflected above, the equity possessed by the Debtor in his current residence represents "... interest transferred from a debtor's previous principal residence (which was acquired prior to the beginning of such 1215–day period) into the debtor's current principal residence ...". Specifically, the equity which the Debtor possesses in his present residence is attributable to his purchase of the property located at 421 North O Street in Lake Worth, Florida, on May 19, 1989 for $99,500. This property was purchased 5,824 days prior to the petition date, and with the subsequent sale of the property on August 20, 2002 for $250,000, the "interest" transferred from the Debtor's previous ***486** principal residence (the Lake Worth property) into his current residence amounts to $150,500. Since the amount of the "interest" transferred from the Debtor's previous principal residence ($150,500), which is *excluded* in calculating the "interest" of the Debtor subject to being exempted, actually exceeds the value of the Debtor's present principal residence ($125,000), there is no portion of the value of the Debtor's present principal residence which constitutes non-exempt property.

[5] The Trustee argues that, since the Debtor's "previous principal residence" was acquired by the Debtor on September 6, 2002 (the Double Tree property), and within the 1215–day delineated under § 522(p)(1), the Debtor may not avail himself of the protection afforded under § 522(p)(2)(B), as the Lake Worth residence was not the Debtor's

"**previous** principal residence". The Court finds the Trustee's construction of the limitation contained in § 522(p)(2)(B) to be too narrow. The gravamen of § 522(p)(1) is to limit the ability of individuals desiring to take advantage of the lenient exemption provisions of "debtor-friendly" states by relocating to such states. H.R. REP. NO. 190–31, pt. 1, at 102 (2005). To the contrary, the "safe harbor" language of § 522(p)(2)(B) would appear to have been intended to afford protection to individuals like the Debtor who, rather than seeking to take advantage of Florida's exemption provisions to shelter illicitly– or improperly-obtained funds, simply have benefitted as a result of their ownership of Florida real property and the general appreciation of property values attributable to previous intra-state transactions. Accordingly, the Trustee's Objection to Claimed Exemptions is **overruled**, and the Debtor's home located at 592 NW San Remo, in Port St. Lucie, Florida **is exempt in its entirety**.

All Citations

332 B.R. 479, Bankr. L. Rep. P 80,391, 18 Fla. L. Weekly Fed. B 452

Footnotes

1 Pursuant to Article X, Section 4, Florida Constitution, a debtor residing in the State of Florida may claim a homestead exemption of an unlimited value, subject to a size limitation of 160 acres if located outside of a municipality, or to the extent of one-half acre if located within a municipality.

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Declined to Extend by In re Meguerditchian, Bankr.D.Mass., March 28, 2017

385 B.R. 1
United States Bankruptcy Appellate Panel
of the First Circuit.

Hannah B. AROESTY, Debtor.
Hannah B. Aroesty, Appellant,
v.
Carolyn Bankowski, Chapter 13 Trustee,
and Francis Sullivan, Appellees.

BAP Nos. MB 07–048, 07–049.
|
Bankruptcy No. 06–14993–JNF.
|
April 10, 2008.

Synopsis

Background: Chapter 13 trustee objected to state law homestead exemption claimed by debtor and sought to limit debtor to exemption of $125,000, in accordance with statutory cap by the Bankruptcy Abuse Prevention and Consumer Protection Act (BAPCPA). The United States Bankruptcy Court for the District of Massachusetts, William C. Hillman, J., entered order sustaining objection and limiting debtor to $125,000 exemption, and debtor appealed.

[Holding:] The Bankruptcy Appellate Panel, Vaughn, J., held that statutory cap upon state homestead exemption rights with respect to interests in property acquired within 1,215 days of petition date applied to debtor who had beneficial interest in property on which she lived for more than a decade prior to petition date, but who acquired legal title within this 1,215-day period when trust established to hold property for sole benefit of debtor conveyed property to her and she recorded second declaration of homestead as title holder.

Affirmed.

Procedural Posture(s): On Appeal.

West Headnotes (11)

[1] **Bankruptcy** Appellate Panel

Bankruptcy Appellate Panel (BAP) is duty-bound to determine its jurisdiction prior to proceeding to merits, even if no jurisdictional objection is raised by litigants.

2 Cases that cite this headnote

[2] **Bankruptcy** Finality

Bankruptcy court order granting or denying a claimed exemption is final, appealable order. 28 U.S.C.A. § 158(a)(1).

4 Cases that cite this headnote

[3] **Bankruptcy** Conclusions of law; de novo review

Bankruptcy Clear error

Bankruptcy Appellate Panel (BAP) generally applies "clearly erroneous" standard to bankruptcy court's findings of fact and de novo review to conclusions of law. Fed.Rules Bankr.Proc.Rule 8013, 11 U.S.C.A.

[4] **Bankruptcy** Conclusions of law; de novo review

Bankruptcy court's decision as to whether $125,000 cap on state homestead exemption rights with respect to interests in property acquired within 1,215 days of petition date applied to debtor who had beneficial interest in property on which she lived for more than a decade prior to petition date, but who acquired legal title within this 1,215-day period when trust established to hold property for sole benefit of debtor conveyed property to her and she recorded second declaration of homestead as title holder, was legal conclusion, which did not involve any disputed facts, and which Bankruptcy Appellate Panel (BAP) would review de novo. 11 U.S.C.A. § 522(p)(1).

6 Cases that cite this headnote

[5] **Homestead** Nature of estate or right

Under Massachusetts law, estate of homestead is free from attachment or levy on execution by creditors, up to amount allowed by law. M.G.L.A. c. 188, § 1.

[6] **Homestead** Necessity

Under Massachusetts law, owner of property does not have right to claim homestead exemption therein until declaration of homestead is recorded. M.G.L.A. c. 188, § 2.

[7] **Homestead** Equitable estates and interests
Trusts Merger of estates

Under Massachusetts law, when debtor is the sole trustee and sole beneficiary of nominee trust that owns the residential property on which debtor lives, nominee trust ceases to exist, and debtor is eligible for the Massachusetts homestead exemption as "owner" of the trust property. M.G.L.A. c. 188, § 1.

2 Cases that cite this headnote

[8] **Homestead** Equitable estates and interests
Trusts Merger of estates

There was no merger of legal and equitable titles in debtor, so as to allow her to claim Massachusetts homestead exemption in property on merger theory, where debtor was merely the beneficiary of trust that she had established to hold title to real property on which she lived, and debtor had named her parents as trustees. M.G.L.A. c. 188, § 1.

2 Cases that cite this headnote

[9] **Homestead** Duration and termination

Under Massachusetts law, estate of homestead may be terminated by a deed conveying the subject property without reserving estate, by recording a release of homestead, or by recording a new declaration of homestead. M.G.L.A. c. 188, §§ 2, 7.

[10] **Homestead** Construction and operation

Under Massachusetts law, debtor's recording of second declaration of homestead, as holder of legal title, after trust that had previously owned property for debtor's sole benefit executed deed in her favor, had effect of discharging any and all prior declarations, including declaration that she had recorded as sole beneficiary of nominee trust. M.G.L.A. c. 188, §§ 2, 7.

2 Cases that cite this headnote

[11] **Bankruptcy** Waiver or Loss of Exemption

Statutory cap upon state homestead exemption rights with respect to interests in property acquired within 1,215 days of petition date applied to debtor who had beneficial interest in property on which she lived for more than a decade prior to petition date, but who acquired legal title within this 1,215-day period when trust established to hold property for sole benefit of debtor conveyed property to her and she recorded second declaration of homestead as title holder; as result of conveyance by trust, debtor acquired a title interest having quantifiable monetary value, thereby triggering application of cap. 11 U.S.C.A. § 522(p)(1).

8 Cases that cite this headnote

Attorneys and Law Firms

***2** Herbert Weinberg, Esq., on brief for Appellant.

Carolyn A. Bankowski, on brief for Appellee Bankowski.

Before VAUGHN, CARLO, and KORNREICH, United States Bankruptcy Appellate Panel Judges.

Opinion

VAUGHN, Bankruptcy Judge.

Hannah B. Aroesty (the "Debtor") appeals from the bankruptcy court's order sustaining objections by Francis Sullivan and Carolyn A. Bankowski, Chapter 13 Trustee (the "Trustee"), to the Debtor's claim of homestead exemption to the extent the exemption exceeds $125,000. Francis Sullivan and the Trustee do not dispute the validity of the Debtor's homestead exemption, but seek to impose the $125,000 limitation set forth in § 522(p)(1) of the Bankruptcy Code. [1] The issue presented here is whether legal title in real ***3** property transferred by a nominee trust to the Debtor within 1,215 days of her petition date, is an interest acquired by the Debtor, triggering the limitation under § 522(p)(1). For the reasons set forth below, the Panel affirms the decision of the bankruptcy court.

BACKGROUND

The facts are undisputed. The Debtor has owned and resided at the subject property located in Newton, Massachusetts (the "Property"), since 1985. The Debtor became the sole owner of the Property on December 1, 1999, when her ex-husband conveyed his interest in the Property to her as part of their divorce settlement. On October 6, 2000, the Debtor conveyed the Property to her parents as trustees of a nominee trust (the "Trust"). The Debtor was the sole beneficiary of the Trust. On December 19, 2006, three transactions occurred: the Debtor recorded a declaration of homestead as the beneficiary of the Trust, the Trust conveyed the Property to the Debtor, and the Debtor recorded a second declaration of homestead as the title owner of the Property. The deed making this conveyance was recorded.

Shortly thereafter, on December 27, 2006, the Debtor filed a voluntary Chapter 13 petition. In her schedules, the Debtor lists the Property value as $1,064,512 and total liens of $658,000, leaving a net equity of $406,512 in the Property. The Debtor then claimed the full $500,000 homestead exemption in the Property under Massachusetts state law. *See* Mass. Gen. Laws. ch. 188, § 1; 11 U.S.C. § 522(b) (permitting debtors to elect exemptions under the Bankruptcy Code or under applicable nonbankruptcy law). Francis Sullivan and the Trustee filed separate objections to the Debtor's claimed homestead exemption under § 522(p)(1). On June 7, 2007, the bankruptcy court held a hearing on the matter and sustained the objections, denying the Debtor's claimed exemption amount to the extent it exceeded $125,000. This appeal followed. [2]

JURISDICTION

[1] **[2]** A bankruptcy appellate panel is duty-bound to determine its jurisdiction before proceeding to the merits even if not raised by the litigants. *See In re George E. Bumpus, Jr. Constr. Co.,* 226 B.R. 724 (1st Cir. BAP 1998). A bankruptcy appellate panel may hear appeals from "final judgments, orders and decrees [pursuant to 28 U.S.C. § 158(a)(1)] or with leave of the court, from interlocutory orders and decrees [pursuant to 28 U.S.C. § 158(a)(3)]." *Fleet Data Processing Corp. v. Branch (In re Bank of New England Corp.),* 218 B.R. 643, 645 (1st Cir. BAP 1998). "A decision is final if it 'ends the litigation on the merits and leaves nothing for the court to do but execute the judgment.' " *Id.* at 646 (citations omitted). "An order granting or denying a claimed exemption is a final, appealable order." *Khan v. Bankowski (In re Khan),* 375 B.R. 5, 8 (1st Cir. BAP 2007); *Howe v. Richardson (In re Howe),* 232 B.R. 534, 535 (1st Cir. BAP 1999), *aff'd,* 193 F.3d 60 (1st Cir.1999).

STANDARD OF REVIEW

[3] **[4]** The Panel generally applies the clearly erroneous standard to findings of fact and *de novo* review to conclusions of law. *See T.I. Fed. Credit Union v. DelBonis,* 72 F.3d 921, 928 (1st Cir.1995); ***4** *Western Auto Supply Co. v. Savage Arms, Inc. (In re Savage Indus., Inc.),* 43 F.3d 714, 719 n. 8 (1st Cir.1994). There are no disputed facts involved in the bankruptcy court's decision, and the Panel's review of the order denying the claimed exemption is *de novo.*

DISCUSSION

[5] **[6]** Chapter 188 of the Massachusetts General Laws provides:

> An estate of homestead to the extent of $500,000 in the land and buildings may be acquired pursuant to this chapter by an owner or owners of a home or one or all who rightfully possess the premise by lease or otherwise and who occupy or intend to occupy said home as a principal residence. Said estate shall be exempt from the laws of conveyance, descent devise, attachment, levy on execution and sale for payment of debts or legacies[.]

Mass. Gen. Laws. ch. 188, § 1. An estate of homestead is "free from attachment or levy on execution by creditors up to the amount allowed by law." *Assistant Recorder of N. Registry Dist. of Bristol County v. Spinelli,* 38 Mass.App.Ct. 655, 651 N.E.2d 411, 411 n. 2 (1995). "To acquire an estate of homestead in real property, the fact that it is designed to be held as such shall be set forth in the deed of conveyance by which the property is acquired; or, after the title has been acquired, such design may be declared by a writing duly signed, sealed and acknowledged and recorded in the registry of deeds for the county or district in which the property is situated." [3] Mass. Gen. Laws. ch. 188, § 2. "Accordingly, under the explicit requirements of the Massachusetts law statute, the owner of property does not have the right to claim a homestead exemption until the declaration is recorded." *In re Perry,* 357 B.R. 175, 178 (1st Cir. BAP 2006); *see* *Houghton v. Szwyd (In re Szwyd),* 370 B.R. 882, 886 (1st Cir. BAP 2007) (providing that a homestead exemption in Massachusetts does not arise automatically as a matter of law but is an "estate in land" that requires a writing to acquire and terminate).

Section 522(p)(1) of the Bankruptcy Code in relevant part provides:

> ... a debtor may not exempt any amount of interest that was acquired by the debtor during the 1215–day period preceding the date of the filing of the petition that exceeds in the aggregate [$125,000] ... in value in—
>
> (A) real or personal property that the debtor or a dependent of the debtor uses as a residence[.]

11 U.S.C. § 522(p)(1)(A). Thus, a homestead exemption permitted under state law is subject to the limitation under § 522(p)(1) when three elements exist: (i) an interest in property (ii) is acquired by the debtor (iii) within 1,215 days of the petition filing date. *Id.* The objecting party has the burden of proving that the debtor is not entitled to the claimed exemption. Fed. R. Bankr.P. 4003(c).

I. Debtor's Beneficial Interest and Homestead Exemption Argument

The Debtor argues that § 522(p)(1) does not apply to her case. The Debtor's position is that an individual may file a declaration of homestead in real property held in trust. The Debtor argues that her beneficial interest in the Property was a legally cognizable interest that she protected by recording her first declaration of homestead. She avers that this protection preserved her right to claim the full $500,000 ***5** homestead exemption under Massachusetts law. In support, the Debtor argues that the Massachusetts case of *Spinelli* is not controlling. The *Spinelli* court, an intermediate appellate court, held that an individual must have both a beneficial and legal interest in the subject property to be considered an "owner" to claim a homestead exemption. [4] 38 Mass.App.Ct. at 658–59, 651 N.E.2d 411; *see* *In re Bowers,* 222 B.R. 191, 193 n. 3 (Bankr.D.Mass.1998) (citing to *Spinelli* in noting that a debtor generally may not claim a homestead exemption in trust property); *but see* *Khan,* 375 B.R. at 12 (finding that *Spinelli* is not controlling law in Massachusetts because it was decided by an intermediate appellate court, and the Supreme Judicial Court overruled the strict construction applied in *Spinelli* in *Dwyer v. Cempellin,* 424 Mass. 26, 673 N.E.2d 863, 867 (1996)).

A. Merger Theory

[7] **[8]** First, the Panel notes that there is precedent establishing a debtor's right to claim a homestead exemption in real property held by a trust under a merger theory. *See* *Szwyd,* 370 B.R. 882; *Khan,* 375 B.R. at 9. "[I]n a nominee trust, the legal title of the trustee and the equitable

title of the beneficiary merge when the same person hold both titles." *Khan,* 375 B.R. at 9. As such, when the debtor is the sole trustee and sole beneficiary, the nominee trust ceases to exist, and the debtor is eligible for the Massachusetts homestead exemption as the "owner" of the trust property. *Szwyd,* 370 B.R. at 890–91. In the instant case, the Debtor was only the beneficiary, and third parties served as the trustees of the Trust. Thus, there was no merger of legal and equitable titles in the Debtor allowing her to claim a homestead exemption under this theory.

B. Spinelli Issue

Next, turning to the Debtor's argument regarding *Spinelli,* the Debtor argues *Spinelli* is not controlling and a debtor may claim a homestead exemption in trust property. The Trustee alerts the Panel that this issue is a red herring because she objects to the amount of the homestead exemption, not on the basis that the Debtor cannot claim an exemption in trust property. Nonetheless, the Trustee argues that even if the Debtor created an estate of homestead in the Property while it was held in the Trust, that estate of homestead was terminated by the second declaration of homestead she subsequently recorded as the title owner.

[9] For the following reasons, the Panel agrees with the Trustee that it need not consider *Spinelli* in deciding this appeal. "Mass. Gen. Laws ch. 188 provides three methods for terminating an estate of homestead." *In re Taylor,* 280 B.R. 294, 296 (Bankr.D.Mass.2002); *In re Leigh,* 307 B.R. 324, 329–30 (Bankr.D.Mass.2004). First, "[t]he acquisition of a new estate or claim of homestead shall defeat and discharge any such previous estate." Mass. Gen. Laws, ch. 188, § 2. Additionally:

> An estate of homestead created under section two may be terminated during the lifetime of the owner by either of the following methods:—(1) a deed conveying the property in which an estate of homestead exists, signed by the owner and the owner's spouse, if any, which does not specifically reserve said estate ***6** of homestead; or by (2) a release of the estate of homestead, duly signed, sealed and acknowledged by the owner and the owner's spouse, if any, and recorded in the registry of deeds for the county or district in which the property is located.

Id. § 7. In sum, the estate of homestead may be terminated by a deed conveying the subject property without reserving the estate, by recording a release of homestead, or by recording a new declaration of homestead. *Id.* §§ 2 and 7; *see* *Leigh,* 307 B.R. at 330 (finding that the recording of a sequential declaration of homestead in the same residence acts to discharge any previous declaration).

[10] On December 19, 2006, the Debtor recorded her first declaration of homestead as the beneficiary of the Trust. Subsequently, the Trust conveyed legal title in the Property to her and the Debtor recorded the deed. She then recorded a second declaration of homestead as the title owner of the Property. Without having to discuss the validity of the first declaration, the Panel can and does conclude that the deed and second declaration discharged all and any alleged prior declarations. Thus, the Panel need not consider the *Spinelli* issue. The Panel finds that the second declaration is operative in considering this appeal, and the Debtor's argument that she preserved her full exemption by recording her first declaration fails.

II. Application of § 522(p)(1)

[11] This then brings the Panel to the crux of the appeal, which is the question of whether the Debtor acquired an interest within 1,215 days of filing her petition, triggering the $125,000 limitation set forth in § 522(p)(1). The Debtor argues that an individual who owns a beneficial interest in the subject property beyond the 1,215–day period and later becomes the title owner, does not acquire an "interest" by recording a declaration of homestead during the requisite period. Her position is that by recording the declaration, she merely classified her interest in the Property as a homestead.[5] However, this argument fails to account for the legal title the Trust conveyed. Thus, the Trustee correctly points out that the issue is not whether the ***7** recording of the declaration created an "interest," but whether the legal title is an "interest" under § 522(p)(1).

"Although the word 'interest' is not defined in the Bankruptcy Code, it has been interpreted in the context of § 522(p) to mean 'some legal or equitable interest that can be quantified by a monetary figure,' ... or simply as 'equity in the homestead.' " *Khan,* 375 B.R. at 9 (citations omitted). Prior to the December 19, 2006 conveyance, the Debtor held a beneficial interest in the Property. As a result of the conveyance, the Debtor obtained title interest in Property. Since the net equity in the Property is $406,512, the Debtor received title interest in property with a value of $406,512. This title interest has a quantifiable monetary value, and thus, it is an "interest" under § 522(p)(1).

Although not disputed, the Panel notes that the other two elements required under § 522(p)(1) are present in this case, namely that the Debtor "acquired" the interest in property within the meaning of § 522(p)(1) and within the requisite time. The Debtor "acquired" the title interest by accepting and recording the deed, and then recording the second declaration of homestead. *See In re Leung,* 356 B.R. 317, 322 (Bankr.D.Mass.2006) (finding that the debtor "acquired" an interest when he "accepted delivery of the deed and then made the affirmative step to declare a homestead"); *see also In re Rasmussen,* 349 B.R. 747, 757 (Bankr.M.D.Fla.2006). Additionally, the Trust conveyed the title interest on December 19, 2006, and the Debtor filed her petition on December 27, 2006. As such, the Debtor acquired the interest within 1,215 days of her petition date. Thus, the Panel finds that the bankruptcy court did not err in sustaining the Trustee's objection and limiting the Debtor's homestead exemption amount to $125,000.

CONCLUSION

The bankruptcy court's order limiting the Debtor's homestead exemption pursuant to 11 U.S.C. § 522(p)(1) is AFFIRMED.

All Citations

385 B.R. 1, Bankr. L. Rep. P 81,216

Footnotes

1 Unless otherwise indicated, the terms "Bankruptcy Code," "section" and " § " refer to Title 11 of the United States Code, 11 U.S.C. § 101 *et seq.,* as amended by the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub.L. No. 109–8.

2 The Panel did not hear appellee Francis Sullivan at oral argument because he failed to file his brief.

3 Here, the Debtor recorded two declarations of homestead in an effort to create an estate of homestead in the Property.

4 Relying on the tax exemption case of *Kirby v. Assessors of Medford,* 350 Mass. 386, 215 N.E.2d 99 (1966), the *Spinelli* court found that the homestead exemption statute must be "strictly construed." 38 Mass.App.Ct. at 658–59, 651 N.E.2d 411. The court found that a beneficiary of a trust did not get the protection of a declaration of homestead in real estate held by a trust. *Id.* at 659, 651 N.E.2d 411.

5 In support of her argument, the Debtor cites to *Perry, In re Lyons,* 355 B.R. 387 (Bankr.D.Mass.2006), and *Wallace v. Rogers (In re Rogers),* 354 B.R. 792 (N.D.Tex.2006). These cases are distinguishable from the instant case and are not helpful. In *Perry,* the Chapter 7 trustee objected to the debtor's claimed exemption on the grounds that the debtor filed his declaration of homestead and voluntary bankruptcy petition

simultaneously. 357 B.R. at 176. The issue there was whether the debtor's declaration of homestead was valid, where Massachusetts law did not permit a debtor to create a homestead exemption after entry of an order for relief in a bankruptcy case. *Id.* at 179. At issue in this case is not the validity of the Debtor's homestead exemption, but whether § 522(p)(1) limits her exemption.

In *Lyons,* the bankruptcy court overruled a creditor's objection to the debtor's homestead exemption, finding that recording a declaration of homestead during the requisite period was a classification of an interest, not an acquired interest triggering § 522(p)(1). 355 B.R. at 390–91. There, the debtor was the title owner of the subject property for over twenty years. *Id.* at 389.

In *Rogers,* the debtor owned the subject property for eleven years but began occupying the premises during the 1,215–day period. 354 B.R. at 794, 796. A creditor objected to the debtor's claimed homestead exemption on the grounds that shifting classification of the property from non-homestead to homestead property during the requisite period was an "interest" under § 522(p)(1). *Id.* at 796. The bankruptcy court found that the debtor did not acquire an "interest" but merely classified the property as a homestead. *Id.* at 798.

Both *Lyons* and *Rogers* are distinguishable from the instant case because the debtors there were title owners beyond the 1,215–day period. Here, the Debtor became the title owner during the 1,215–day period. As such, these cases do not apply to the Debtor's case.

End of Document

KeyCite Yellow Flag - Negative Treatment
Disagreed With by Parks v. Anderson, D.Kan., May 19, 2009

334 B.R. 374
United States Bankruptcy Court,
N.D. Texas,
Dallas Division.

In re Kevin Edward BLAIR and
Susan Robin Blair, Debtors.

No. 05–35922–HDH7.
|
Nov. 21, 2005.

Synopsis

Background: Unsecured creditor objected to state homestead exemption claim by Chapter 7 debtors.

[Holding:] The Bankruptcy Court, Harlin D. Hale, J., held that debtors' increased equity in their homestead property as result, at least in part, of mortgage payments that they continued to make during the 1,215-day period immediately preceding petition date was not "interest" in homestead property that debtors "acquired" within 1,215 days of petition date, of kind sufficient to trigger cap imposed by the Bankruptcy Abuse Prevention and Consumer Protection Act (BAPCPA) on debtors' state homestead exemption rights.

Objection overruled.

Opinion, 2005 WL 3101837, amended and superseded.

West Headnotes (4)

[1] **Bankruptcy** Waiver or Loss of Exemption

Chapter 7 debtors' increased equity in their homestead property as result, at least in part, of mortgage payments that they continued to make during the 1,215-day period immediately preceding petition date was not "interest" in homestead property that debtors "acquired" within 1,215 days of petition date, of kind sufficient to trigger cap imposed by the Bankruptcy Abuse Prevention and Consumer Protection Act (BAPCPA) on debtors' state homestead exemption rights, where debtors purchased homestead property in question 1,773 days prior to petition date and more than 550 days prior to start of this 1,215-day period. 11 U.S.C.A. § 522(p).

22 Cases that cite this headnote

[2] **Statutes** Clarity and Ambiguity; Multiple Meanings

Only if statutory language is ambiguous should court attempt to construe it.

[3] **Statutes** Reason, reasonableness, and rationality

Statutes Relation to plain, literal, or clear meaning; ambiguity

All laws are to be given a sensible construction, and literal application of statute which would lead to absurd consequences should be avoided, whenever a reasonable application can be given to it consistent with legislative purpose.

[4] **Bankruptcy** Waiver or Loss of Exemption

One purpose of cap imposed by the Bankruptcy Abuse Prevention and Consumer Protection Act (BAPCPA) upon state homestead rights of debtors who acquire their residence within 1,215 days of petition date was to prevent out-of-state residents from moving to certain states in order to file for bankruptcy under their more advantageous state homestead exemption laws. 11 U.S.C.A. § 522(p).

10 Cases that cite this headnote

Attorneys and Law Firms

***375** Mark C. Alfieri, Curtis Law Firm, PC, Dallas, TX, for Debtors.

David M. O'Dens, Cliff Wade, Michael P. Menton, SettlePou, Dallas, TX, for Southwest Security Bank.

AMENDED MEMORANDUM OPINION ON OBJECTION TO DEBTORS' EXEMPTION OF INTEREST IN HOMESTEAD

HARLIN D. HALE, Bankruptcy Judge.

Kevin Edward Blair and Susan Robin Blair ("Debtors") filed a voluntary Chapter 7 petition and elected the Texas exemptions, including the generous homestead exemption. An unsecured creditor, Southwest Security Bank ("SSB"), filed its Objection to the Debtors' Claim of Exemption in the Homestead ("Objection"). At issue in the contested matter is § 522(p) of the Bankruptcy Code, which provides that a debtor who has elected state law exemptions may not exempt any amount of interest that exceeds $125,000 in value in the debtor's homestead that was acquired by the debtor within 1215 days preceding the petition. [1] After consideration, the Court finds the Debtors are entitled to the full, uncapped, exemption made in their schedules.

The Court has jurisdiction pursuant to 28 U.S.C. §§ 1334 and 151, and the standing order of reference in this district. The matter is core, pursuant to 28 U.S.C. § 157(b)(2)(A), (B) & (O). This Memorandum Opinion constitutes findings of fact and conclusions of law, pursuant to Federal Rules of Bankruptcy Procedure 7052 and 9014.

I. FACTS

On May 27, 2005 (the "Petition Date"), the Debtors filed for protection under Chapter 7 of the United States Bankruptcy Code. On July 18, 2000, 1773 days prior to the Petition Date, the Debtors purchased their homestead property at 3316 Marquette Street, University Park, Texas (the "Homestead"). On the Debtors' Schedule C—Property Claimed as Exempt, the equity in the Homestead is valued at $688,606. On August 17, 2005, SSB timely filed its Objection to the exemption claimed as "any and all interest that the Debtors acquired between January 27, 2002 (1215 days prior to the Petition Date) and the Petition Date which exceeds $125,000" citing 11 U.S.C. § 522(p). *See* Objection at ¶ 5.

II. ISSUE

This case requires the interpretation of a new provision of the Bankruptcy Code, section 522(p), created by the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (the "BAPCPA"). The Court must determine whether debtors, who acquired title and fee to real property outside of the 1215 day period prior to the Petition Date, but continued to make regular payments and build equity in the property during the 1215 day period, are subject to the $125,000.00 cap on their homestead exemption provided in section 522(p).

III. ANALYSIS

Statutory Provisions

[1] Section 522 of the Bankruptcy Code allows debtors to select either state or federal exemptions to exempt property from the bankruptcy estate. *See generally* ***376** 11 U.S.C. § 522. The majority of states have chosen the "opt-out" provision in § 522(b) forcing the debtor to utilize state exemptions. But Texas allows debtors to choose between federal and state exemptions. [2] Most debtors in Texas prefer to use the state exemptions because Texas provides for an unlimited homestead exemption. 11 U.S.C. § 522(b)(2)(A),

The recently enacted BAPCPA made specific changes to section 522. [3] New section 522(p) provides in pertinent part:

> (1) Except as provided in paragraph (2) of this subsection and sections 544 and 548, 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 interest that was acquired by the debtor during the 1215–day period preceding the date of the filing of the petition that exceeds in the aggregate $125,000 in value in—
>
> (A) real or personal property that the debtor or a dependent of the debtor uses as a residence;
>
> (B) a cooperative that owns the property that the debtor or a dependent of the debtor uses as a residence;

(C) a burial plot for the debtor or a dependent of the debtor; or

(D) real or personal property that the debtor or dependent of the debtor claims as a homestead.

11 U.S.C. § 522(p).

On its face, the statutory language is unambiguous in stating that a homestead cap of $125,000 is imposed for those debtors who elect to use state law exemptions for any interest acquired during the statutory period.[4] However, the term "interest", which must be acquired by the debtors during the 1215–day period to trigger the new homestead cap is not defined. SSB argues the Debtors' equity in the homestead is in excess of $125,000 and the increase in the equity position in the house during the 1215 period above $125,000 is subject to this statutory cap and not exempt. *See* Objection ¶¶ 4–5.

However, one does not actually "acquire" equity in a home. One acquires title to a home. The Debtors acquired title and fee to their home in early 2000, about five years before Congress passed the BAPCPA, and one and half years prior ***377** to the start of the 1215 day period applicable to their bankruptcy case. *See* Deed of Trust listed as Exhibit A in the Debtor's Response to Southwest Securities Bank's Objection to Debtor's Exemption of Interest in Homestead. The "interest" the Debtors acquired was the actual purchase of the home, which was completed well before the 1215–day period. Thus, the "interest" held by the debtors in their homestead is outside the 1215–day period and not subject to the $125,000 cap. This interpretation is consistent with other courts considering the applicability of section 522(p). *See* *In re Virissimo,* 332 B.R. 201, 207 (Bankr.D.Nev.2005) ("The monetary cap applies if the debtor acquired such property within the 1,215–day period preceding the filing of the petition."); *In re Wayrynen,* 332 B.R. 479, 483 (Bankr.S.D.Fla.2005) ("[T]he $125,000 limitation as to the value of a home acquired by a debtor within 1215 days of the debtor's bankruptcy filing."); *In re McNabb,* 326 B.R. 785, 788 (Bankr.D.Ariz.2005) ("Code § 522(p), as added by BAPCPA, applies a $125,000 cap on a homestead if it was acquired by the debtor within 1215 days prepetition"). This is also the interpretation reached by commentators. *See* 4 COLLIER ON BANKRUPTCY ¶ 522.13 [2] (Lawrence P. King ed., 15th ed. rev.2005); *see also* Roger S. Cox, Sanders Baker, Asset Protection & Exemptions Under the New Act, presented at the University of Texas School of Law 24th Annual Bankruptcy Conference, November 10–11, 2005.

Other parts of section 522 related subsections support this construction. *See* 11 U.S.C. § 522(d)(1)-(6). This interpretation is also consistent with the companion provision in section 522(p) added by the BAPCPA. Section 522(p)(2)(B) allows for an exception to the homestead cap. "Any amount of such interest does not include any interest transferred from a debtor's previous principal residence (which was acquired prior to the beginning of such 1215–day period) into the debtor's current principal residence, if the debtor's previous and current residences are located in the same State." *See* 11 U.S.C. § 522(p)(2)(B).

Essentially, this subsection allows for rollover by debtors of the equity in one home to another home located in the same state. A debtor is not subject to the homestead cap if he takes the proceeds of his first residence and reinvests them in a second residence even within the prescribed period of section 522(p). The bank's reading of the statute would seem at odds with this provision. If debtors had sold their home during the 1215 day period and bought another they would be protected. Surely the non-selling debtors should enjoy the same protections.

Legislative History Also Helps

[2] **[3]** Only if the statutory language is ambiguous should the Court attempt to construe the statutory language. *Blum v. Stenson,* 465 U.S. 886, 896, 104 S.Ct. 1541, 79 L.Ed.2d 891 (1984). "All laws are to be given a sensible construction; and a literal application of a statute, which would lead to absurd consequences, should be avoided whenever a reasonable application can be given to it, consistent with legislative purpose." *United States v. Katz,* 271 U.S. 354, 357, 46 S.Ct. 513, 70 L.Ed. 986 (1926). As mentioned above, the statute is reasonably clear in its application to real property acquired within the statutory period. However, in this instance, even if the term "interest" in Section 522(p) is sufficiently ambiguous to warrant inquiry into the legislative history, Debtors would still prevail.

The legislative comments state that the amended Section 522(p) restricts the "mansion loophole." HR Rep. 109–31(I), 109th Cong., 1st Sess.2005, 2005 WL 832198 *15–16 (2005), ***378** 2005 U.S.Code Cong. & Admin.News 2005, pp. 88, 102. Congress briefly explains:

> Under current bankruptcy law, debtors living in certain states can shield from their creditors virtually all of the equity in their homes. In light of this, some debtors actually relocate to these states just to take advantage of their mansion loophole laws. S.256 [BAPCPA] closes this loophole for abuse by requiring a debtor to be a domiciliary in the state for at least two years before he or she can claim that state's homestead exemption; the current requirement can be as little as 91 days.

Id. "A footnote (# 72) in this legislative history further explains that: If the debtor owns the homestead for less than 40 months, the provision imposes a $125,000 homestead cap. In effect, this provision overrides state exemption law authorizing a homestead exemption in excess of this amount and allows such law to control if it authorizes a homestead exemption in a lesser amount." *Virissimo,* 332 B.R. at 207.

[4] Essentially, while the language of the statute is broader, one purpose was to prevent out of state residents from moving to certain states in order to file for bankruptcy under more advantageous state homestead exemption laws. This is not the case at hand.

IV. CONCLUSION

The Court determines that the increase in the value of the equity in the debtors' homestead, which was acquired over 1215 days prior to the Petition Date, is not subject to the $125,000 cap in section 522(p).

The Court will enter a separate order consistent with this decision.

All Citations

334 B.R. 374, Bankr. L. Rep. P 80,415

Footnotes

1 *See* 11 U.S.C. § 522(p) (2005). The Bankruptcy Code references are to the provisions as amended or added by the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005.

2 Now 11 U.S.C. § 522(b)(2), as amended by the BAPCPA.

3 The Bankruptcy Abuse Prevention and Consumer Protection Act was signed into law on April 20, 2005 and goes into effect on October 17, 2005. However, certain changes, such as Section 522(p) became effective immediately.

4 Whether or not an "election" is made by using an "opt-out" state's exemptions is another story however. *Compare* *In re McNabb,* 326 B.R. 785 (Bankr.D.Ariz.2005) (holding that the Bankruptcy Code's $125,000 homestead cap, as added by the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, applies only in states that have not chosen to "opt out"); *with* *In re Wayrynen,* 332 B.R. 479, 2005 WL 2756059 (Bankr.S.D.Fla.2005) (holding that based on the fact that statutes should not be interpreted to reach an absurd result and the intent of the drafters, the "as a result of electing" language in § 522(p) could not be interpreted so as to limit this homestead cap only to debtors who reside in states that have not opted out of

federal bankruptcy exemptions); *accord,* In *re Virissimo,* 332 B.R. 201 (Bankr.D.Nev.2005) (holding that debtors in all states must make the election in § 522(b)(1), only the effect of the election is limited in "opt-out" states—if there is an ambiguity in the statute, the clear intent of the drafters was that the cap apply to all debtors); *In re Kaplan,* 331 B.R. 483, (Bankr.S.D.Fla.2005) (criticizing the decision in *McNabb* holding that the new language is ambiguous, the congressional intent is clear, and "[t]o arrive at [the conclusion that the cap is limited to the states of Minnesota and Texas] based on the strained and convoluted use of statutory interpretation in the face of this unambiguous legislative intent is simply wrong").

KeyCite Yellow Flag - Negative Treatment
Declined to Follow by In re Anderson, Bankr.D.Kan., October 2, 2007

358 B.R. 814
United States Bankruptcy Court, M.D. Florida, Tampa Division.

In re Ginger L. CHOUINARD, et ux., Debtors.

No. 8:06–bk–00543–KRM.
|
Dec. 20, 2006.

Synopsis

Background: Chapter 7 trustee objected to debtors' claim of a Florida homestead exemption, and the parties filed cross-motions for summary judgment.

Holding: The Bankruptcy Court, K. Rodney May, J., held that the equity passively resulting from market appreciation is not to be counted against the $125,000.00 cap placed by the Bankruptcy Abuse Prevention and Consumer Protection Act (BAPCPA) on a homestead exemption claimed by a debtor in property "acquired" during the 1,215-day prepetition period.

Objection overruled.

Procedural Posture(s): Motion for Summary Judgment.

West Headnotes (1)

[1] **Bankruptcy** Waiver or Loss of Exemption

Equity passively resulting from market appreciation is not to be counted against $125,000.00 cap placed by the Bankruptcy Abuse Prevention and Consumer Protection Act (BAPCPA) on a homestead exemption claimed by a debtor in property acquired during the 1,215-day prepetition period. 11 U.S.C.A. § 522(p).

4 Cases that cite this headnote

Attorneys and Law Firms

***814** Malka Isaak, d/b/a Debt Relief Legal Centers, Tampa, FL, for Debtors.

MEMORANDUM OPINION AND ORDER ON THE OBJECTION TO THE DEBTORS' HOMESTEAD EXEMPTION FILED BY THE CHAPTER 7 TRUSTEE

K. RODNEY MAY, Bankruptcy Judge.

This case came on for hearing on competing Motions for Summary Judgment on the Trustee's Objection to the Debtors' Homestead Exemption, filed by the Chapter 7 trustee and the debtors (Document Nos. 36 and 37). In addition to the reasons stated on the record and recorded in open court on October 25, 2006, the Court makes the following findings of fact and conclusions of law.

FINDINGS OF FACT

The facts are not disputed. In May 2003, the debtors purchased their homestead for $251,000, using 100% financing. This was the only real estate the debtors have ever owned. Less than 1,215 days later, on February 16, 2006, the debtors filed a voluntary petition for relief under ***815** Chapter 7 to discharge approximately $172,313 in unsecured debts.

In their bankruptcy schedules, the debtors list the fair market value of their home as $490,000—reflecting estimated appreciation of $239,000. Their home is now encumbered by two mortgages totaling approximately $308,619.54. [1] On that basis, the debtors' equity in their homestead would be approximately $181,380.

The debtors claimed the property as exempt (up to the value of $181,380) pursuant to the Florida homestead exemption. [2] The trustee objected, arguing that the debtors are limited by 11 U.S.C. Section 522(p) to a maximum homestead exemption of $125,000. The debtors insist that they are each entitled to the homestead exemption, thereby making the Section 522(p) cap, in this joint case, $250,000.

CONCLUSIONS OF LAW

The Court finds it unnecessary to determine whether the debtors are entitled to exempt the homestead up to $125,000 each. The Court finds compelling, and hereby follows, the holding in *In re Rasmussen,* 349 B.R. 747 (Bankr.M.D.Fla.2006), that the equity passively resulting from market appreciation is not to be counted against the $125,000 cap of Section 522(p). Passive market appreciation is not an interest that a debtor "acquires" during the 1,215–day period. *Id.* at 757. *See also, In re Sainlar,* 344 B.R. 669, 674 (Bankr.M.D.Fla.2006)(concluding that Section 522(p) does not apply to increased equity from market appreciation during the 1,215–day period).

In the present case, the debtors used 100% financing to purchase their home. Thereafter, they made monthly mortgage payments. It is not asserted, and there is nothing in the record to indicate, that the debtors actively increased their equity by anything other than the scheduled amortization payments. These principal reductions presumably increased the debtors' equity, but only nominally and nowhere near $125,000. The balance of the increased equity was from market appreciation and therefore not within the purview of Section 522(p).

Accordingly, the Court does not have to reach the issue of "exemption stacking." Nevertheless, the Court notes that it finds persuasive the additional holding in *Rasmussen,* that each debtor, in a joint case involving a "1,215 homestead," is eligible to assert a homestead exemption up to the $125,000 cap, for a total exemption of up to $250,000. 349 B.R. at 755 (Bankr.M.D.Fla.2006)(allowing each debtor to claim a $125,000 homestead exemption because Florida has an unlimited homestead exemption and Section 522(m) makes the limitations imposed by Section 522(p) applicable to each debtor).

CONCLUSION

Because the trustee's objection to the debtors' homestead exemption is premised only on the increase in equity from market appreciation during the 1,215–day period, the trustee's objection to the debtors' homestead exemption will be overruled and the debtors' motion for summary judgment will be granted. Accordingly, it is hereby

ORDERED:

***816** 1. The Motion for Summary Judgment filed by the debtors (Document No. 37) is granted.

2. The Motion for Summary Judgment filed by the Chapter 7 trustee (Document No. 36) is denied.

3. The Objection to Debtors' Homestead Exemption (Document No. 11), filed by the Chapter 7 trustee, is overruled.

DONE and ORDERED in Tampa, Florida, *December 20,* 2006.

All Citations

358 B.R. 814

Footnotes

1 Wells Fargo holds a first mortgage of $243,619.54. Navy Federal Credit Union holds a second mortgage of approximately $65,000. The record does not establish when the second mortgage was acquired.

2 Fla. Const. Art. X, § 4(a)(1) (2006).

End of Document

372 Fed.Appx. 507
This case was not selected for
publication in the Federal Reporter.
Not for Publication in West's Federal Reporter See Fed.
Rule of Appellate Procedure 32.1 generally governing
citation of judicial decisions issued on or after Jan.
1, 2007. See also Fifth Circuit Rules 28.7, 47.5.3,
47.5.4. (Find CTA5 Rule 28 and Find CTA5 Rule 47)
United States Court of Appeals,
Fifth Circuit.

In the Matter of: Frank Henry FEHMEL,
Jr.; Sharon Lee Fehmel, Debtors.
Frank Henry Fehmel, Jr.; Sharon Lee Fehmel, Appellants
v.
Union State Bank; Texas Star Bank,
SSB; Curtis Durham, Appellees.

No. 08–51281.
|
April 5, 2010.

Synopsis

Background: Creditor objected to state law homestead exemption claimed by Chapter 7 debtors, on ground that debtors had purchased their homestead less than 1,215 days prepetition and were subject to statutory cap. The United States Bankruptcy Court for the Western District of Texas, Frank R. Monroe, J., 2008 WL 2151797, entered order sustaining objection, and denied debtors' motion for reconsideration, 2008 WL 2736890, and debtors appealed. The District Court affirmed, and debtors again appealed.

Holding: The Court of Appeals held that, even assuming that statutory cap on debtors' state law homestead exemption rights, for any interest in property acquired by debtors 1,215 or fewer days before petition date, was inapplicable to any increase in property's value during this 1,215 "lookback" period that was attributable to passive market forces, debtors failed to establish that any portion of $325,000 increase in value was attributable to market forces.

Affirmed.

Procedural Posture(s): On Appeal.

West Headnotes (1)

[1] **Bankruptcy** Waiver or Loss of Exemption
Bankruptcy Proceedings

Even assuming that statutory cap on debtors' state law homestead exemption rights, for any interest in property acquired by debtors 1,215 or fewer days before petition date, was inapplicable to any increase in property's value during this 1,215 "lookback" period that was attributable to passive market forces, debtors, who purchased their home for $375,000 only to see it increase in value to $700,000 by the time they filed their Chapter 7 petition less than 1,215 days later, failed to establish that any portion of this $325,000 increase in value was attributable to market forces, and not to the more than $200,000 that they spent on improvements; accordingly, debtors would each be limited to maximum $136,875 exemption pursuant to terms of statutory cap. 11 U.S.C.A. § 522(p)(1)(D).

9 Cases that cite this headnote

Attorneys and Law Firms

***507** James O. Cure, Cure & Francis, Temple, TX, for Appellants.

Stephen W. Sather, Barbara M. Barron, Barron, Newburger & Sinsley, P.L.L.C., Austin, TX, Jeffrey R. Cox, Sheehy, Lovelace & Mayfield, David Charles Alford, Waco, TX, for Appellees.

Appeal from the United States District Court for the Western District of Texas, USDC No. 6:08–cv–00215–WSS.

Before GARWOOD, WIENER, and BENAVIDES, Circuit Judges.

Opinion

***508** PER CURIAM: *

****1** Appellant debtors Frank Henry Fehmel, Jr. and Sharon Lee Fehmel appeal from the bankruptcy and district courts'

limitation of their homestead exemption. At issue in this appeal is 11 U.S.C. § 522(p)(1), a Bankruptcy Code provision that restricts debtors' ability under state law to exclude the value of their home from their bankruptcy estate and thus shield assets from creditors. Under Texas law, debtors may exempt the total value of a designated "homestead" from their bankruptcy estate. *See* Tex. Const. art. XVI, § 50; Tex. Prop.Code Ann. §§ 41.001–.002 (Vernon 2000 & Supp.2009); *In re Blair,* 334 B.R. 374, 376 (Bankr.N.D.Tex.2005). However, § 522(p)(1) of the Bankruptcy Code partially preempts this unlimited exemption. It provides that when a debtor elects:

> to exempt property under State or local law, a debtor may not exempt any amount of interest that was acquired by the debtor during the 1215–day period preceding the date of the filing of the [bankruptcy] petition that exceeds in the aggregate [$136,875] in value in ... real or personal property that the debtor or dependent of the debtor claims as a homestead.

11 U.S.C. § 522(p)(1)(D) (2006).[1] In other words, § 522(p)(1) caps Texas's homestead exemption at $136,875 per debtor for any interest in property acquired 1,215 or fewer days before the petition date (the "lookback period"). However, for any interest acquired more than 1,215 days before the petition date, Texas's homestead exemption remains unlimited. It is undisputed that the Fehmels acquired their home during the lookback period.

The Fehmels assert that the bankruptcy court inappropriately curtailed their homestead exemption by adopting the so-called "title" interpretation of § 522(p)(1). They urge us to break from the bankruptcy court's reasoning and adopt what has been called the "equity" interpretation of § 522(p)(1). They argue that under this interpretation, § 522(p)(1)'s exemption cap would not apply to any appreciation in the value of their homestead caused by market forces after they acquired the property. Conversely, appellee Union State Bank[2] argues that the bankruptcy court correctly adopted the "title" interpretation and thereby properly applied § 522(p)(1)'s cap to any lookback period appreciation in the value of the Fehmel's property. However, we conclude that we need not presently adopt either the title or equity interpretations of the statute, nor resolve whether § 522(p)(1)'s cap is applicable to home equity obtained from market appreciation. Like the district court, we find that even if we were to assume that the cap does not reach such appreciation, the evidence presented below does not support granting the Fehmels an exemption any greater than that afforded them by the bankruptcy court. Consequently, we affirm the bankruptcy court's limitation of the Fehmels' exemption to $273,750.

I.

On May 4, 2005, the Fehmels bought a residence and 150 acres of surrounding ***509** land in Lampasas, Texas for $375,000. They made a down payment of $73,841.23 and obtained a mortgage of $304,000 to finance the rest of their purchase. They then moved into the house on the property and, in the years that followed, made certain improvements, remodeling their new home and building a barn, workshop, and guest apartment. Appellee Curtis Durham performed much of the work improving the property, for which the Fehmels paid him approximately $150,000 and traded him a tractor, the value of which was not established below. Durham also filed a claim in these proceedings, asserting that the Fehmels owed him an additional $42,830.87 for his work on the property. Beyond Durham's work, the Fehmels made certain improvements themselves, including $8,000 to $10,000 worth of plumbing work. In its findings of fact, the bankruptcy court did not determine the total value of all of the improvements to the Lampasas property, but they appear to have at least cost approximately $200,830.87.[3]

****2** Subsequently, on August 28, 2007, the Fehmels filed a voluntary petition for relief under chapter 7 of the Bankruptcy Code. In the Fehmels' schedules of assets and liabilities, they listed the value of the Lampasas property as being $700,000.[4] Consequently, between the date the Fehmels purchased the Lampasas property and the petition date, the property appreciated in value by $325,000. The bankruptcy court did not make a specific finding resolving whether market forces, the Fehmels' improvements, or some combination of both were responsible for this appreciation. In their schedules, the Fehmels also listed mortgage debt on the property totaling

$297,811.30.[5] As a result, on the petition date, the Lampasas property had a total equity value of $402,188.70.[6]

The Fehmels' 2005 acquisition of the Lampasas property occurred within the lookback period, thereby arguably limiting their homestead exemption to $273,750.[7] However, in their schedules, the Fehmels claimed an exemption of $402,188.70, in other words, the total equity value of their homestead. In response, the chapter 7 trustee and the appellees in this case objected to the claimed exemption, requesting that it be limited to $273,750.

The bankruptcy court sustained the objection and limited the Fehmels' exemption to $273,750. The court reached this decision by adopting what has been called the "title" interpretation of § 522(p)(1), concluding that the term "interest" used in the provision refers to title or some ownership interest in property. *See, e.g.,* ***510** *In re Greene,* 583 F.3d 614, 624–25 (9th Cir.2009) (adopting title interpretation); *In re Sainlar,* 344 B.R. 669, 673 (Bankr.M.D.Fla.2006) (same); *Blair,* 334 B.R. at 376–77 (same). Under the title theory, § 522(p)'s cap is triggered solely when a debtor acquires an ownership interest in a homestead within the lookback period. *Greene,* 583 F.3d at 625; *Sainlar,* 344 B.R. at 673; *Blair,* 334 B.R. at 376–77. Since the Fehmels acquired the Lampasas property during the lookback period, the bankruptcy court concluded that the cap applied to the total equity value of the homestead on the petition date.

On appeal, the district court affirmed the bankruptcy court, but under a different rationale. The district court noted that certain courts have found that the term "interest" in § 522(p)(1) refers to equity. *See, e.g., Parks v. Anderson,* 406 B.R. 79, 95 (D.Kan.2009) (adopting equity interpretation); *Rasmussen,* 349 B.R. at 756 (same). Under this "equity" interpretation, § 522(p)'s cap is triggered by the acquisition of equity in homestead property during the lookback period, even for property originally acquired *before* the lookback period. *See Rogers,* 513 F.3d at 222 n. 8 (5th Cir.2008) (explaining that "[t]he date of acquisition of title is irrelevant for purposes of the equity definition"); *Parks,* 406 B.R. at 86, 95; *Rasmussen,* 349 B.R. at 756, 757 n. 5. Notably, courts adopting the equity theory have drawn a distinction between active and passive acquisition of equity during the lookback period; they have concluded that obtaining equity actively falls under § 522(p)(1)'s cap, while obtaining it passively does not. One court has described the distinction between active and passive acquisition of equity as follows:

> ****3** [A] debtor may acquire or obtain equity either by making a down payment, by paying down the mortgage, or by appreciation due to market conditions. The first two methods of acquiring equity require active conduct on the part of the debtor—payment of money. The third, appreciation, is passive, requiring no active conduct.

Rasmussen, 349 B.R. at 757. Consequently, under the equity theory, the appreciation in the value of the Fehmels' property could be excluded from § 522(p)(1)'s cap, if it were passively acquired.

However, the district court concluded that it could affirm the bankruptcy court without formally adopting either the title or equity interpretation, as even under the equity theory, the Fehmels were only entitled to an exemption of $273,750. The court found that the $325,000 appreciation in the value of the Lampasas property was likely attributable to the Fehmels' active investments improving the property. *See Rogers,* 513 F.3d at 222 (assuming that equity acquired due to improving property would be subject to cap); *In re Presto,* 376 B.R. 554, 581–82 (Bankr.S.D.Tex.2007) (holding that equity acquired due to improving property is subject to cap). Therefore, since the appreciation in the value of the Fehmels' homestead was not due to passive market appreciation, the court held that the appreciation was subject to § 522(p)(1)'s cap on exemptions. The present appeal followed.

II.

"The bankruptcy court's findings of fact are subject to clearly erroneous review, while its conclusions of law are reviewed de novo." *Rogers,* 513 F.3d at 216. The parties do not contest any of the bankruptcy court's specific findings of fact, which we have described in the preceding section.

We conclude that the bankruptcy court and district court did not err in limiting the Fehmels' exemption to $273,750. Like the district court, we reach this conclusion without adopting either the title or equity ***511** interpretations of the statute. [8] Even if we were to assume that § 522(p)(1)'s cap only applies to actively acquired equity, and not to equity passively obtained from market appreciation, the bankruptcy court's findings of fact do not show that the Fehmels would be entitled to an exemption any greater than $273,750.

Under Fed. R. Bankr.P. 4003(c), "the objecting party has the burden of proving that the exemptions are not properly claimed." Objectors "must establish that the exemption is improper by a preponderance of the evidence." *Presto,* 376 B.R. at 563. The Ninth Circuit has described the burden shifting framework created by Rule 4003(c) in the following terms:

> A claimed exemption is presumptively valid.... Once an exemption has been claimed, it is the objecting party's burden ... to prove that the exemption is not properly claimed. Initially, this means that the objecting party has the burden of production and the burden of persuasion. The objecting party must produce evidence to rebut the presumptively valid exemption. If the objecting party can produce evidence to rebut the exemption, the burden of production then shifts to the debtor to come forward with unequivocal evidence to demonstrate that the exemption is proper. The burden of persuasion, however, always remains with the objecting party.

****4** *Carter v. Anderson (In re Carter),* 182 F.3d 1027, 1029 n. 3 (9th Cir.1999) (internal quotation marks and citations removed); *see also Pequeno v. Schmidt,* 307 B.R. 568, 584 (S.D.Tex.2004) (describing burden shifting process), *aff'd,* 126 Fed.Appx. 158 (5th Cir.2005).

In this case, the unchallenged findings of fact show that under the equity interpretation of § 522(p)(1), the Fehmels would not be entitled to their claimed exemption of $402,188.70, the full equity value of their homestead. At the very least, the Fehmels actively acquired approximately $278,019.57 of the equity in the Lampasas property: $71,000 from their down payment, [9] $6,188.70 from their mortgage payments, and $200,830.87 from the cost of their improvements. Under the equity interpretation, all of this actively acquired equity would be capped at $273,750, demonstrating that the Fehmels clearly have no right to exempt the full equity value of the Lampasas property from their estate. [10]

However, it is probable that the Fehmels actively acquired far more than $278,019.57 of the equity in their homestead: The extensive improvements to the Lampasas property more likely than not acted synergistically to increase its value by more than their cost. We conclude that Union State Bank has satisfied its burden by pointing to this evidence demonstrating that the Fehmels' exemption was improperly claimed. As such, this evidence is sufficient to shift the burden of production to the Fehmels "to come forward with unequivocal evidence to demonstrate that [their] exemption is proper." *Carter,* 182 F.3d at 1029 n. 3. However, they have ***512** made no such showing. [11] Given the extensive improvements made to the Lampasas property and the Fehmels' failure to meet their burden of production, [12] we find that all of the appreciation was attributable to the Fehmels' improvements, [13] and thus is actively acquired home equity subject to the statute's $273,750 cap.

III.

Accordingly, we AFFIRM the bankruptcy and district courts' limitation of the Fehmels' homestead exemption to $273,750. [14]

All Citations

372 Fed.Appx. 507, 2010 WL 1287618

Footnotes

* Pursuant to 5TH CIR. R. 47.5, the court has determined that this opinion should not be published and is not precedent except under the limited circumstances set forth in 5TH CIR. R. 47.5.4.

1 The original text caps exemptions at $125,000, but the cap was indexed for inflation and has now been increased to $136,875. *See* *Wallace v. Rogers (In re Rogers),* 513 F.3d 212, 217 n. 2 (5th Cir.2008).

2 Appellees Curtis Durham and Texas State Bank have not submitted any briefing nor participated in this appeal, relying instead on Union State Bank's position in this case.

3 Together, the Fehmels' payment of $150,000, Durham's claim of $42,830.87, and $8,000 of plumbing work amount to $200,830.87.

4 Prior to the petition date, a potential buyer offered the Fehmels $740,000 for the Lampasas property and certain chattels. Frank Fehmel testified that he believed the value of the Lampasas property without the chattels to be $700,000.

5 Between the Fehmels' acquisition of the Lampasas property and the petition date, they seem to have paid off $6,188.70 of their mortgage.

6 $700,000 less $297,811.30, the remaining value of the Fehmels' mortgage, is $402,188.70.

7 Pursuant to 11 U.S.C. § 522(m), the exemption cap established by § 522(p) applies separately to each debtor, creating a cap of $273,750 for the Fehmels rather than $136,875. *See, e.g.,* *In re Rasmussen,* 349 B.R. 747, 755 (Bankr.M.D.Fla.2006) (concluding that § 522(p)'s exemption cap applies separately to each debtor in joint cases).

8 Similarly, in *Wallace v. Rogers (In re Rogers),* we also passed on an opportunity to adopt either the title or equity interpretations of § 522(p)(1), finding that it was unnecessary to the resolution of the case before us at that time. 513 F.3d at 222–23.

9 The bankruptcy court found that the Fehmels made a down payment of $73,841.23. However, they took out a mortgage of $304,000 on the property, larger than was necessary to finance the rest of its purchase price of $375,000. Consequently, when the Fehmels took title to the Lampasas property, they only had equity in their property of $71,000, not $73,841.23.

10 If the Fehmels acquired $278,019.57 of the equity in their homestead actively, and such equity is capped at $273,750, then at the very least, $4,269.57 of the Fehmels' exemption would be improperly claimed.

11 For example, the Fehmels likely could have introduced evidence showing whether similar properties in Lampasas appreciated during the same period without any improvements.

12 We note that this case bears some resemblance to the many cases where courts have reviewed debtors' exemption of the proceeds of settlement agreements from their bankruptcy estates. In such cases, courts have held that debtors do not have the initial burden of breaking down these awards into exempt proceeds for bodily injury and nonexempt proceeds for pain and suffering. *See, e.g., In re Harrington,* 306 B.R. 172, 183 (Bankr.E.D.Tex.2003) (holding that objector "cannot escape the burden of proof assigned to an objecting party under Rule 4003(c) because the exemption claim relates to a settlement agreement which fails to allocate damages into specific categories of recovery"); *Lester v. Storey (In re Lester),* 141 B.R. 157, 162 (S.D.Ohio 1991) (holding that "the burden of proof is initially placed upon the [objector] with respect to any objections he files, and ... this burden does not shift to the Debtor merely upon a showing that the Debtor has failed to allocate the personal injury settlement into its various component parts"). In this case, the Fehmels' decision to claim the total equity value of their homestead as exempt, without breaking down actively from passively acquired equity, has not shifted the burden to them to demonstrate the validity of their exemption. Instead, the bankruptcy court's findings of fact have demonstrated by a preponderance that the Fehmels' exemption was improperly claimed.

13 Admittedly, the bankruptcy court's findings of fact may not clearly and convincingly demonstrate that all appreciation in the value of the Lampasas property was attributable to the Fehmels' improvements. However, Union State Bank has only needed to show that the Fehmels' exemption is improper by a preponderance of the evidence. *See* *Kelley v. Locke (In re Kelley),* 300 B.R. 11, 16–17 (9th Cir. B.A.P. 2003) (explaining that preponderance standard is satisfied when "proposition is more likely true than not") (quoting *United States ex rel. Farmers Home Admin. v. Arnold & Baker Farms (In re Arnold & Baker Farms),* 177 B.R. 648, 654 (9th Cir. B.A.P. 1994)). Union State Bank has met this burden.

14 The bankruptcy court granted the Fehmels an exemption of $273,750, in addition to any post-petition principal reduction for the mortgage on the Lampasas property. Union State Bank has not challenged this portion of the bankruptcy court's order, and we have not reviewed it on this appeal.

End of Document

483 B.R. 50
United States Bankruptcy Court, D. Massachusetts, Central Division.

In re Charles E. GENTILE and Debra A. Gentile, Debtors.

No. 11–44587–MSH.
|
Nov. 28, 2012.

Synopsis

Background: Creditors objected to Massachusetts homestead exemption claimed by Chapter 7 debtors.

Holdings: The Bankruptcy Court, Melvin S. Hoffman, J., held that:

[1] debtors' transfer of homestead property between themselves in the months immediately preceding their Chapter 7 filing provided basis for capping each debtor's Massachusetts homestead exemption at $146,450, notwithstanding that debtors had continuously occupied property as their residence from time well before the 1,215-day "lookback" period of bankruptcy statute, but

[2] debtors were entitled to "stack" their capped exemptions and to claim up to $292,900 of their homestead as exempt in their joint Chapter 7 case.

Objections overruled.

West Headnotes (7)

[1] **Bankruptcy** Proceedings

Massachusetts homestead exemption claimed by Chapter 7 debtors was presumed valid, unless objected to by a party in interest. 11 U.S.C.A. § 522(*l*); M.G.L.A. c. 188, § 3.

1 Cases that cite this headnote

[2] **Bankruptcy** Proceedings

Objecting party had burden of establishing that Massachusetts homestead exemption claimed by Chapter 7 debtors was invalid. Fed.Rules Bankr.Proc.Rule 4003(c), 11 U.S.C.A.; M.G.L.A. c. 188, § 3.

1 Cases that cite this headnote

[3] **Homestead** Construction of homestead laws in general

Massachusetts homestead exemption should be construed liberally in favor of debtors. M.G.L.A. c. 188, § 3.

1 Cases that cite this headnote

[4] **Bankruptcy** Waiver or Loss of Exemption

That Chapter 7 debtors' alleged debt to objecting creditors might be nondischargeable on "willful and malicious injury" theory, or that debtors might not be entitled to discharge based on allegedly fraudulent prepetition transfer of homestead property between each other, was not basis for denying them the protection of Massachusetts homestead exemption to protect their principal residence from creditors. 11 U.S.C.A. §§ 523(a)(6), 727(a)(2)(A); M.G.L.A. c. 188, § 3.

[5] **Bankruptcy** Avoided transfers

Prerequisite for denying debtors an exemption in voluntarily transferred property recovered by trustee in exercise of his avoidance powers is recovery of property by trustee. 11 U.S.C.A. § 522(g).

[6] **Bankruptcy** Waiver or Loss of Exemption

Debtors' transfer of homestead property between themselves in the months immediately preceding their Chapter 7 filing provided basis for capping each debtor's Massachusetts homestead exemption at $146,450 pursuant to bankruptcy statute imposing cap for interests in homestead

property acquired within 1,215 days prior to petition date, notwithstanding that debtors had continuously occupied the property as their residence from a time well before the 1,215-day "lookback" period of bankruptcy statute. 11 U.S.C.A. § 522(p); M.G.L.A. c. 188, § 3.

1 Cases that cite this headnote

[7] **Bankruptcy** Co-debtors; stacking
Bankruptcy Waiver or Loss of Exemption
Bankruptcy Proceedings

While debtors' transfer of homestead property between themselves in the months immediately preceding their Chapter 7 filing provided basis for capping each debtor's Massachusetts homestead exemption at $146,450 pursuant to bankruptcy statute, debtors were entitled to "stack" their capped exemptions and to claim up to $292,900 (2 x $146,450) of their homestead as exempt in their joint Chapter 7 case, such that creditors' objection to the combined $195,667 homestead exemption claimed by debtors had to be overruled. 11 U.S.C.A. § 522(m, p); M.G.L.A. c. 188, § 3.

4 Cases that cite this headnote

Attorneys and Law Firms

***51** Jarrod Hochman, Revere, MA, for Creditors.

Amber Kovach, Methuen, MA, for Debtors.

MEMORANDUM OF DECISION AND ORDER ON OBJECTION TO DEBTORS' CLAIM OF EXEMPTION

MELVIN S. HOFFMAN, Bankruptcy Judge.

Before me is an objection by 62–64 Pontiac Street, LLC and Parker Hill Avenue, LLC, two creditors of the debtors, Charles and Debra Gentile, to the debtors' claimed exemption of their residence at 74 Wayside Inn Road, Marlborough, Massachusetts.

The relevant facts in this case, drawn from the pleadings and accompanying exhibits, are not in material dispute. On August 9, 2011, a deed was recorded at the Middlesex County South District Registry of Deeds by which Charles Gentile conveyed the Marlborough property to Debra Gentile for $1.00.[1] On September 16, 2011, a deed was recorded by which Ms. Gentile conveyed the property to herself and Mr. Gentile as tenants by the entirety. Both debtors signed and recorded a declaration of homestead, under MASS. GEN. LAWS ch. 188 § 3, concurrently with the September 2011 transfer. The debtors commenced this case on October 31, 2011. Schedule C (property claimed as exempt) accompanying their bankruptcy petition claims an exemption in the amount of $195,667 in the Marlborough property.

Section 522(b) of the Bankruptcy Code (11 U.S.C. § 101, *et seq.*) permits debtors to elect to exempt property of the estate in accordance with either state or federal law provided that spouses who file jointly must make the same election.[2] The Gentiles chose the Massachusetts exemptions, including the Massachusetts homestead exemption, with respect to the Marlborough property.

[1] [2] [3] The Massachusetts homestead statute permits individuals who own and occupy or intend to occupy real property as their residence to place their equity in the residence, up to a maximum of $500,000,[3] beyond the reach of creditors. MASS. GEN. LAWS ch. 188, § 3. A claimed homestead exemption is presumed valid unless it is objected to by a party in interest. Bankruptcy Code § 522(*l*). The objecting party has the burden of establishing that the claimed homestead exemption is invalid. Fed. R. Bank. Pro. 4003(c); *see also* ***52** *In re Gordon,* 479 B.R. 9 (Bankr.D.Mass.2012). The Massachusetts homestead law is intended to protect a declarant's residence from the claims of creditors. *Dwyer v. Cempellin,* 424 Mass. 26, 30, 673 N.E.2d 863, 866 (1996). "[I]n light of the public policy and the purpose of the statute, the State homestead exemption should be construed liberally in favor of the debtors." *Id.*

The creditors appear to raise three arguments in support of their objection to the Gentiles' homestead exemption. First, they assert that if the homestead exemption is held to be valid, it should be limited to the $146,450 cap established by Bankruptcy Code § 522(p)(1).[4] Second, the creditors

suggest that the homestead exemption should be denied altogether because the Gentiles incurred debts to the creditors that are allegedly not dischargeable under Bankruptcy Code § 523(a)(6).[5] Third, they argue that their objection to the homestead exemption should be sustained because the August 2011 transfer of the Marlborough property by Mr. Gentile to Ms. Gentile was a fraudulent transfer under Bankruptcy Code § 548 and thus the Gentiles are not entitled to a discharge under Bankruptcy Code § 727(a)(2)(A).

[4] The creditors' second and third arguments fail to provide a valid basis for objecting to a claimed homestead exemption. Bankruptcy Code § 523(a)(6) prevents the dischargeability of a debt for willful or malicious injury to another. Even if the transfer from Mr. Gentile to Ms. Gentile could be grounds for holding non-dischargeable the debts owed to the creditors in this case, a finding I do not make at this time, a determination of non-dischargeability does not preclude a debtor from claiming a homestead exemption to protect a principal residence from creditors. *Stornaway Financial Corp. v. Hill (In re Hill),* 387 B.R. 339 (1st Cir.2008) *aff'd,* 562 F.3d 29, 35 (1st Cir.2009). *See also In re Levasseur,* 482 B.R. 15, 32 (Bankr.D.Mass.2012) ("[T]he Bankruptcy Code in general, and § 522 in particular, do not permit denial of an exemption on the basis of conduct that would except a debt from discharge under § 523(a)(2), (4), or (6). Congress has created limited exceptions from the ability to claim an asset as exempt. See 11 U.S.C. § 522(o), (p), and (q). The causes for denying or limiting an exemption are therefore limited, and unless one of the expressly articulated exceptions applies, a claim of exemption should not be disallowed.").

The creditors also invoke Bankruptcy Code § 727(a)(2)(A), which calls for the denial of discharge if a debtor engages in the transfer of property within one year of filing a petition in bankruptcy with intent to hinder, delay, or defraud creditors, as another basis for sustaining their exemption objection. Standing alone, this argument provides no more persuasive a basis ***53** for denying the Gentiles' right to a homestead exemption than does the creditors' argument under Bankruptcy Code § 523(a)(6). *Hill,* 562 F.3d at 33.

[5] While by no means clearly articulated, the creditors' § 727 argument hints at the intention to invoke Bankruptcy Code § 522(g) as a basis for denying the debtors' exemption claim. The creditors allege that the August 2011 transfer of the property from Mr. Gentile to his wife was fraudulent. They suggest that under Bankruptcy Code § 548(a)(1), the Gentiles' chapter 7 trustee could seek to avoid the transfer because it was made within two years of the bankruptcy filing. If the transfer was successfully avoided by the trustee, it would follow, the creditors imply, that Bankruptcy Code § 522(g) would prohibit the debtors from exempting the property because the allegedly fraudulent transfer was voluntary.[6] Even if the creditors had done a better job of making this argument, it nevertheless would have been unavailing for an obvious reason. The Marlborough property has *not* been recovered by the trustee, a prerequisite to the application of Bankruptcy Code § 522(g).

[6] The creditors' sole argument offering a potentially valid basis for objecting to the amount of the Gentiles' claimed homestead exemption is under Bankruptcy Code § 522(p). The creditors rely on Bankruptcy Code § 522(p)(1) for the proposition that if the homestead exemption is allowed, it should be capped at the statutory limit of $146,450. The cap established by Bankruptcy Code § 522(p)(1) is triggered when a debtor acquires an interest in property within 1215 days of the filing of a petition in bankruptcy. In this case, it is undisputed that Mr. Gentile conveyed the Marlborough property to his wife and then his wife deeded the property back to both of them as tenants by the entirety, all within a few months of their filing a petition in bankruptcy. Despite the fact that the debtors occupied the Marlborough property for the entirety of the period in question, a transfer between spouses is sufficient to trigger application of Bankruptcy Code § 522(p)(1).[7] *In re Leung,* 356 B.R. 317, 322 (Bankr.D.Mass.2006). ("In this case, the Debtor acquired his present interest in the Property when his wife transferred her sole interest to the couple ... To the extent that 'acquired by ***54** the debtor' requires an affirmative action, I find that the Debtor acquired an interest because he accepted delivery of the deed and then made the affirmative step to declare a homestead." *Id.*) Because of the dual nature of the transfers, both debtors acquired an interest in the property

within 1215 days of filing bankruptcy. Thus both debtors are subject to the § 522(p)(1) cap.

[7] Bankruptcy Code § 522(m) directs that Bankruptcy Code § 522(p) should be applied separately to joint debtors. "[S]ection 522(m)'s reference to 'this section' makes clear that section 522(m) applies to new section 522(p), the provision limiting the homestead exemption. Thus, under section 522(m), section 522(p) 'shall apply separately with respect to each debtor in a joint case.' " *In re Rasmussen,* 349 B.R. at 755. Joint debtors may double or "stack" the cap. *Id.* at 754.

Thus even though I find that the pre-petition transfers between the Gentiles caused their Massachusetts homestead exemption to be subject to the Bankruptcy Code § 522(p) cap, that cap may be "stacked" by the Gentiles under Bankruptcy Code § 522(m), allowing a total capped exemption of $292,900. Since this amount exceeds the $195,667.00 claimed on schedule C, I find that the debtors have properly exempted the Marlborough property and the creditors' objection is OVERRULED.

All Citations

483 B.R. 50

Footnotes

1 The case record reflects disagreement among the parties over who owned the property prior to Mr. Gentile's acquiring it, but a resolution of that dispute is not required in order to rule on the creditors' objection.

2 Bankruptcy Code § 522(b)(2) permits a state to "opt out" of the federal exemption scheme, thereby requiring their residents to exempt property of the estate under state law only. Massachusetts is not an opt-out state.

3 Elderly or disabled homeowners are each entitled to a maximum $500,000 exemption and thus, for example, elderly spouses holding property as tenants by the entirety would qualify for a maximum $1,000,000 exemption. MASS. GEN. LAWS ch. 188, § 1–2.

4 Creditors' memoranda reference a limit of $125,000, but that amount has increased to $146,450. Pursuant to Bankruptcy Code § 104(a), the amount of the cap established by Bankruptcy Code § 522(p) is adjusted at three year intervals.

5 Both creditors have commenced virtually identical adversary proceedings against the debtors in which they seek a declaration that their debts are nondischargeable under Bankruptcy Code § 523(a)(2) and § 523(a)(6), and that the debtors are not entitled to receive a discharge of any of their debts under Bankruptcy Code § 727(a)(2)(A), at least according to the introductory paragraphs of the complaints. The complaints refer to "§ 727(a)" but the memoranda filed in the main case cite to Bankruptcy Code § 727(a)(2)(A). The complaints, however, only set forth two counts, namely those under Bankruptcy Code § 523(a)(2) and § 523(a)(6), and only with respect to Mr. Gentile. The prayers for relief request nondischargeability judgments against both debtors, but do not request relief under Bankruptcy Code § 727(a)(2)(A).

6 The creditors do not reference Bankruptcy Code § 522(g) specifically, but they appear to invoke the provision by implication. Bankruptcy Code § 522(g) states:

> "Notwithstanding sections 550 and 551 of this title, the debtor may exempt under subsection (b) of this section property that the trustee recovers under section 510(c)(2), 542, 543, 550, 551, or 553 of this title, to the extent that the debtor could have exempted such property under subsection (b) of this section if such property had not been transferred, if—
>
> (1)(A) such transfer was not a voluntary transfer of such property by the debtor ..."

7 The legislative history of § 522(p) makes clear that it was intended to plug the "mansion loophole" whereby an individual owning a high-priced residence in a low-dollar homestead state could sell that home and reinvest the proceeds in a high-priced residence in a state with unlimited homestead protection like Florida or Texas, then file bankruptcy and exempt from creditors the entire homestead. *In re Rasmussen,* 349 B.R. 747, 752 (Bankr.M.D.Fla.2006) *citing* *In re Kane,* 336 B.R. 477, 481–482 (Bankr.D.Nev.2006). Despite identifying in vivid detail the ailment it sought to remedy, the nostrum ultimately concocted by Congress, § 522(p), covers a far wider spectrum of maladies, including interspousal transfers of ownership interests in a continually occupied residence such as the ones at issue here. Essentially, in its current form § 522(p) is a cure looking for a disease. Unfortunately, the disconnect between Congress' motivations and a statute's text cannot justify my ignoring that text. The responsibility for harmonizing a statute with its intended purpose must be left to our elected legislators.

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KeyCite Yellow Flag - Negative Treatment
Declined to Extend by In re Willcut, 10th Cir.BAP (Okla.), May 29, 2012

583 F.3d 614
United States Court of Appeals,
Ninth Circuit.

In re Scott K. GREENE, Debtor(s).
Scott K. Greene, Appellant,
v.
Anabelle Savage, Appellee.

Nos. 07–16067, BK–N–05–54727–GWZ.
|
Argued and Submitted Dec. 12, 2008.
|
Filed Oct. 2, 2009.

Synopsis

Background: Debtor filed Chapter 7 bankruptcy petition, claiming market value of $240,000 for property as exempt under Nevada homestead statute. Upon objection by creditor, the United States Bankruptcy Court for the District of Nevada, Gregg W. Zive, J., 346 B.R. 835, limited homestead exemption to $125,000 due to debtor's establishing residency by moving recreational vehicle and tent into property and filing homestead claim within 1,215 days of filing bankruptcy petition, and subsequently denied debtor appreciation in property value. Debtor appealed. The United States District Court for the District of Nevada, Howard D. McKibben, J., affirmed. Debtor appealed.

Holdings: The Court of Appeals, Timlin, J., sitting by designation, held that:

[1] debtor's acquisition of ownership interest in property outside 1,215-day period protected homestead from exemption cap, and

[2] bankruptcy estate was entitled to retain appreciation in value of property, absent amendment to petition.

Affirmed in part, reversed in part, and remanded.

Procedural Posture(s): On Appeal.

West Headnotes (20)

[1] **Bankruptcy** Conclusions of law; de novo review

Court of Appeals reviews de novo a district court's decision on appeal from a bankruptcy court; thus, the Court of Appeals applies the same standard of review as applied by the district court.

128 Cases that cite this headnote

[2] **Bankruptcy** Conclusions of law; de novo review
Bankruptcy Clear error

The bankruptcy court's conclusions of law and interpretation of the Bankruptcy Code are reviewed de novo and its factual findings for clear error.

122 Cases that cite this headnote

[3] **Bankruptcy** Clear error

Court of Appeals must accept the bankruptcy court's findings of fact unless, upon review, the Court of Appeals is left with the definite and firm conviction that a mistake has been committed by the bankruptcy judge.

112 Cases that cite this headnote

[4] **Bankruptcy** Validity and effect of opt-out legislation

Nevada is an opt-out state, under the Bankruptcy Code opt-out provision, allowing a state to either require the debtor to exempt property under the state law exemptions or grant the debtor the option of choosing between state exemptions and the exemptions under the Bankruptcy Code.
11 U.S.C.A. § 522(b)(2), (d).

[5] **Bankruptcy** Waiver or Loss of Exemption

A debtor's perfection of a homestead exemption does not qualify the debtor as having "acquired"

a property "interest," within meaning of Bankruptcy Code provision limiting a state homestead exemption for any amount of interest in the property that the debtor acquired during the 1,215-day period preceding the date of his filing of the bankruptcy petition. 11 U.S.C.A. § 522(p)(1).

7 Cases that cite this headnote

[6] **Internal Revenue** What law governs

In determining whether federal tax lien law affects state property rights, the federal court looks initially to state law to determine what rights the taxpayer has in the property that the government seeks to reach, then to federal law to determine whether the taxpayers' state-delineated rights qualify as property or rights to property within the compass of the federal tax lien legislation.

2 Cases that cite this headnote

[7] **Homestead** Nature and extent of right created

Under Nevada law, the substantive right gained via a homestead declaration, although broad, is a legal protection of the property interest, not an "interest" in the equity or title of the property. West's NRSA 115.005(2).

1 Cases that cite this headnote

[8] **Homestead** Ownership, estate, or interest in property in general

Under Nevada law, a debtor's homestead exemption only protects the amount of equity the debtor holds in the property listed, and the statutory definition of "equity" contemplates more than a general interest in the property or the right to possession, it contemplates ownership. West's NRSA 115.005(2).

[9] **Homestead** Amount or Extent

Homestead Ownership, estate, or interest in property in general

Homestead Establishment of right of exemption in general

Under Nevada law, if a debtor has ownership in homestead property, then she can choose to protect up to $350,000 of equity in her property from legal process by invoking the state's homestead exemption, as long as she meets the procedural requirements to establish a homestead. West's NRSA 115.005(2), 115.020.

[10] **Bankruptcy** Operation and effect

Homestead Nature of estate or right

Homestead Ownership, estate, or interest in property in general

Under Nevada and Texas law, the homestead exemption and the property interest impressed with that exemption are discrete concepts, in that the former is the debtor's legal right to exempt certain property interests from the bankruptcy estate, the latter is the debtor's vested economic interest in the property itself. West's NRSA 115.005(2), 115.020.

6 Cases that cite this headnote

[11] **Bankruptcy** Waiver or Loss of Exemption

Bankruptcy Code provision, limiting a state homestead exemption for any amount of interest in the property that the debtor acquired during the 1,215-day period preceding the date of his filing of the bankruptcy petition, does not apply if the debtor owned the property before the 1,215-day period. 11 U.S.C.A. § 522(p).

2 Cases that cite this headnote

[12] **Property** Property Rights and Interests

Property Sales and conveyances in general

Various forms of relationships to real property are referred to as an "interest" in property, including possessory interests, leasehold interests, and ownership interests; such interests are said to run with the land, that is, they accompany a conveyance or assignment of land, passing from one purchaser to another through the chain of title.

[13] **Homestead** Nature of estate or right

Homestead Ownership, estate, or interest in property in general

Unlike such property interests as possessory interests, leasehold interests, and ownership interests, a homestead right, generally, does not run with the land; instead, a "homestead" is a personal right or privilege given by constitutional or statutory provisions that ordinarily is dependent on some title or interest in real property, and it does not exist as a separate estate in property independently of such title or interest.

2 Cases that cite this headnote

[14] **Homestead** Debtors or defendants

Homestead Ownership, estate, or interest in property in general

The Nevada homestead law presupposes an existing, previously acquired property right and permits only certain individuals already holding that right to claim a homestead. West's NRSA 115.005.

[15] **Homestead** Nature of estate or right

Under Nevada law, a "homestead" is a categorization of a status or a classification of property, not a property interest.

2 Cases that cite this headnote

[16] **Bankruptcy** Waiver or Loss of Exemption

Under the Bankruptcy Code provision, limiting a state homestead exemption for any amount of interest in the property that the debtor acquired during the 1,215-day period preceding the date of his filing of the bankruptcy petition, Congress intended "acquired" to mean gaining possession or control by purchasing or gaining an ownership interest, either legal or equitable. 11 U.S.C.A. § 522(p)(1).

2 Cases that cite this headnote

[17] **Bankruptcy** Waiver or Loss of Exemption

A debtor's act of recording a homestead or moving onto the property to establish residency is not "any amount of interest acquired," within meaning of the Bankruptcy Code provision, limiting a state homestead exemption for any amount of interest acquired in the property by the debtor during the 1,215-day period preceding the date of his filing of the bankruptcy petition. 11 U.S.C.A. § 522(p)(1).

1 Cases that cite this headnote

[18] **Bankruptcy** Waiver or Loss of Exemption

Although Chapter 7 debtor placed recreational vehicle and tent on his non-residential property and converted property into homestead within 1,215 days prior to filing petition for bankruptcy, debtor's perfection of homestead exemption, under Nevada law, did not qualify for monetary cap on "any amount of interest that was acquired" during 1,215-day period, within meaning of Bankruptcy Code capping provision, and thus, debtor's acquisition of ownership interest outside of 1,215-day period protected his homestead exemption claiming market value of $240,000 from monetary cap that would have limited his exemption to $125,000. 11 U.S.C.A. § 522(d), (p)(1); West's NRSA 115.005, 115.020.

3 Cases that cite this headnote

[19] **Bankruptcy** Amendment

Debtor's amendment of voluntary petition, list, schedule, or statement at any time before the bankruptcy case is closed may be disallowed only upon a showing of bad faith or prejudice to third parties. Fed.Rules Bankr.Proc.Rule 1009(a), 11 U.S.C.A.

3 Cases that cite this headnote

[20] Bankruptcy Operation and effect

Bankruptcy estate was entitled to retain all appreciation in value in excess of $240,000 for Chapter 7 debtor's homestead property that was sold by bankruptcy trustee, absent debtor's amendment to petition as to increased value of property, where debtor signed declaration under penalty of perjury in bankruptcy petition that value of property was $240,000. Fed.Rules Bankr.Proc.Rule 1009(a), 11 U.S.C.A.

1 Cases that cite this headnote

Attorneys and Law Firms

***617** David Rankine and Michael Lehners, Reno, NV, for the appellant.

Robert C. Vohl, Reno, NV, for the appellee.

Professors James J. White and John A.E. Pottow, Ann Arbor, MI, as amici curiae.

Appeal from the United States District Court for the District of Nevada, Howard D. McKibben, District Judge, Presiding. D.C. Nos. 06–CV–00567 HDM, 3:06–CV–00679–HDM–RAM.

Before: MARSHA S. BERZON and A. WALLACE TASHIMA, Circuit Judges, and ROBERT J. TIMLIN,* District Judge.

Opinion

TIMLIN, District Judge:

This case is an appeal of the district court's order affirming the bankruptcy court's decision limiting Debtor–Appellant Scott Greene's homestead exemption in his bankruptcy petition to $125,000 pursuant to 11 U.S.C. § 522(p), based on the fact that Greene established residency on his property and filed his homestead claim within 1215 days of filing his bankruptcy petition. We have jurisdiction pursuant to 28 U.S.C. §§ 158(d)(1) and 1291.

I.

BACKGROUND

The material facts of this case are not in dispute. Greene purchased a parcel of undeveloped land at 450 Alamosa Drive in Sparks, Nevada, (the "Property") in May 1994. By August 11, 2004, Greene had moved a trailer onto the Property and was living in it. On that day, Greene recorded a declaration of homestead with the Washoe County Recorder's Office for a trailer and the Property. Sixteen days later, on August 27, 2004, Greene filed a Chapter 13 bankruptcy petition. Greene concedes that until early August 2004, he never lived on or made any improvements to the Property. On October 8, 2004, Rena Wells ("Wells"), a creditor, filed an objection to Greene's claim of a homestead exemption, asserting that Greene's homestead was not his bona fide residence. Greene voluntarily dismissed the petition on February 17, 2005.

On August 11, 2005, Greene was cited by Washoe County for illegally using a recreational vehicle for dwelling purposes. At that time, Greene told authorities he was no longer using the trailer as a dwelling but was sleeping on the Property in his tent.

On October 15, 2005, Greene filed a Chapter 7 bankruptcy petition (the petition at issue in this appeal), in which he claimed the market value of the Property—$240,000, the same amount as the market value he claimed for the Property in his initial Chapter 13 petition in 2004—as exempt pursuant to the Nevada homestead statute. Wells again filed an objection to the claim of exemption, challenging the validity of the homestead exemption and also contending that, even if the homestead was valid, it should be reduced to $125,000 pursuant to 11 U.S.C. § 522(p)(1), because the homestead was acquired within 1215 days of the filing of the petition.

***618** The Bankruptcy Court for the District of Nevada concluded that Greene's homestead was a property interest acquired within 1215 days of his bankruptcy petition filing, because he filed his declaration of a homestead during that time period. Therefore, it held, Greene's homestead exemption was limited to $125,000 under Section 522(p). *See In re Greene,* 346 B.R. 835 (Bankr.D.Nev.2006). Greene appealed.

Subsequently, the trustee filed a motion for an order authorizing sale of the Property free and clear of liens and encumbrances. Greene filed an opposition to this motion, arguing, *inter alia,* that he was entitled to the post-acquisition appreciation in the market value of the Property. The bankruptcy court rejected Greene's contention, finding that there was no increase in the value of the Property from the time Greene acquired it until the time he filed his petition, and that any increase in value after that was available to the trustee as post-petition appreciation.

Greene appealed both orders of the bankruptcy court to the district court. The district court affirmed the bankruptcy court in all respects. Greene filed a timely notice of appeal to this Court.

II.

DISCUSSION

A. Standard of Review

[1] [2] [3] This court reviews de novo a district court's decision on appeal from a bankruptcy court. *See Suncrest Healthcare Ctr. LLC v. Omega Healthcare Investors, Inc.* (*In re Raintree Healthcare Corp.*), 431 F.3d 685, 687 (9th Cir.2005). Thus, this court applies the same standard of review applied by the district court. *See id.* The bankruptcy court's conclusions of law and interpretation of the Bankruptcy Code are reviewed de novo and its factual findings for clear error. *See Salazar v. McDonald* (*In re Salazar*), 430 F.3d 992, 994 (9th Cir.2005). This court must accept the bankruptcy court's findings of fact unless, upon review, the court is left with the definite and firm conviction that a mistake has been committed by the bankruptcy judge. *See Latman v. Burdette,* 366 F.3d 774, 781 (9th Cir.2004).

B. Interpretation of 11 U.S.C. § 522(p)(1)

[4] Under 11 U.S.C. § 522, a debtor in bankruptcy can exempt certain property from the bankruptcy proceedings and protect that property from creditors. *See* 11 U.S.C. § 522(b). Section 522 contains a list of various interests in property that a debtor can exempt. *See* § 522(d). However, the Bankruptcy Code provides an opt-out provision whereby the state can either require the debtor to exempt property under the state law exemptions or grant the debtor the option of choosing between state exemptions and the § 522(d) exemptions. *See* § 522(b)(2). [1]

In 2005, Congress amended the Bankruptcy Code by enacting Section 522(p)(1), which limits a debtor's ability to take advantage of the state homestead exemptions. Section 522(p)(1) provides as follows:

> Except as provided in paragraph (2) of this subsection and sections 544 and 548, 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 interest that was acquired by the debtor during the 1215–day period preceding the date of the ***619** filing of the petition that exceeds in the aggregate $136,875 [2] in value in—
>
> (A) real or personal property that the debtor or a dependent of the debtor uses as a residence;
>
> (B) a cooperative that owns property that the debtor or a dependent of the debtor uses as a residence;
>
> (C) a burial plot for the debtor or a dependent of the debtor; or
>
> (D) real or personal property that the debtor or dependent of the debtor claims as a homestead.

Section 522(p) was part of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ("BAPCPA"), enacted on April 20, 2005. [3] Although the bulk of BAPCPA became effective on October 17, 2005, Section 522(p) became effective on the date of enactment. *See, e.g., In re McNabb,* 326 B.R. 785, 788 n. 7 (Bankr.D.Ariz.2005). As Greene's petition was filed on October 15, 2005, Section 522(p) applies to this case.

Section 522(p) was intended to "address the well-documented and often-expressed concern by members of Congress about the so-called 'mansion loophole' by which wealthy individuals could shield millions of dollars from creditors by filing bankruptcy after converting nonexempt assets into expensive and exempt homesteads in one of the handful of states that have unlimited homestead

exemptions ....” *In re Kane,* 336 B.R. at 481–82. In a report issued in 1997, the National Bankruptcy Review Commission identified the problem and found: “ ‘In deferring to state law exemptions, the current system ... multiplies the opportunities for forum shopping and prebankruptcy asset conversion. ...’ ” *Id.* at 482 (quoting Nat'l. Bankr.Rev. Comm'n, Bankruptcy: The Next Twenty Years, National Bankruptcy Review Commission Final Report, Oct. 20, 1997, at 124).

Applying Section 522(p)(1), the bankruptcy court held—and the district court agreed—that the $125,000 cap does apply in this case, and that Greene's homestead exemption is limited to the cap amount. In so holding, the bankruptcy and district courts reasoned that the “interest” stated in Section 522(p)(1) includes the homestead, which was “acquired” by Greene when he moved onto the Property to establish his residence and filed a homestead declaration with the Washoe County Recorder's Office. Greene contends, to the contrary, that establishing a residence on real property and recording a homestead declaration does not establish a property “interest,” but rather is a property classification. The phrase “amount of interest,” as used in Section 522(p)(1), Greene contends, should be construed as a quantifiable measure and therefore as applicable only to an ownership interest in a property.

The amici brief of certain bankruptcy law professors takes a slightly different analytical tack: it emphasizes the use of the term “acquire” in the statute, and argues that the claiming of a homestead designation on an interest in property is different from the acquisition of the underlying property interest in the property. Amici contend that it is only the latter legal event with which Section 522(p) concerns itself.

***620** **[5]** We find these analyses helpful, and using them as well as other interpretive aids, conclude that perfection of a homestead exemption does not constitute acquisition of a property interest for purposes of Section 522(p)(1).

A recent Fifth Circuit case, *Wallace v. Rogers,* 513 F.3d 212 (5th Cir.2008), is a particularly useful starting place in determining the applicability of Section 522(p)(1) to a claimed homestead exemption. There, the debtor inherited property outside the 1215–day window prior to filing a bankruptcy petition, and subsequently moved onto it within the 1215–day period of time, but still before filing her bankruptcy petition. In her petition, the debtor elected to take the Texas homestead exemption which had no monetary limit. A judgment creditor objected, asserting that Section 522(p)(1) applied because the debtor's current residence had not been her homestead for the 1215–day period preceding her bankruptcy petition. The Fifth Circuit disagreed and allowed the debtor to claim the full homestead exemption.

[6] In construing the term “interest” as used in Section 522(p)(1), the Fifth Circuit followed the analytical steps required when federal tax lien law affects state property rights. *See id.* (citing *United States v. Craft,* 535 U.S. 274, 122 S.Ct. 1414, 152 L.Ed.2d 437 (2002)). Under that doctrine, a court “look[s] initially to state law to determine what rights the taxpayer has in the property the Government seeks to reach, then to federal law to determine whether the taxpayers state-delineated rights qualify as property or rights to property within the compass of the federal tax lien legislation.” *Craft,* 535 U.S. at 278, 122 S.Ct. 1414 (internal quotations omitted). The *Craft* court reasoned:

> A common idiom describes property as a “bundle of sticks”—a collection of individual rights which, in certain combinations, constitute property. State law determines only which sticks are in a person's bundle. Whether those sticks qualify as “property” for purposes of the federal tax lien statute is a question of federal law.
>
> In looking to state law, we must be careful to consider the *substance of the rights* state law provides, not merely the labels the State gives these rights or the conclusions it draws from them. Such state law labels are irrelevant to the federal question of which bundles of rights constitute property that may be attached by a federal tax lien.

Id. at 278–79, 122 S.Ct. 1414 (internal citations omitted, emphasis added).

We agree with the Fifth Circuit that the *Craft* approach is the proper beginning point in addressing the problem before us. Using that framework, we first look to Nevada law to determine what Greene acquired when he recorded his homestead declaration, and then to Section 522(p)(1) to determine whether that declaration qualifies as an “any

amount of interest that was acquired" within the compass of Section 522(p).

[7] The Nevada homestead exemption derives from the Nevada state constitution, which provides in relevant part that a " 'homestead as provided by law, shall be the exempt from forced sale under *any* process of law.' " *Contrevo v. Mercury Fin. Co.* (*In re Contrevo*), 123 Nev. 20, 153 P.3d 652, 654 (Nev.2007) (emphasis in original). Reading this provision broadly, the *In re Contrevo* Court held that Nevada "has a constitutional imperative that homestead property be exempt from legal process and placed outside the reach of creditors," and noted that Nevada's exemptions have historically been absolute and unqualified with a few exceptions. *Id.* As *In re* ***621** *Contrevo* indicates, the substantive right gained via a homestead declaration in Nevada, although broad, is a "legal protection of" the property interest, not "an interest" in the equity or title of the property. [4]

[8] [9] A second recent Nevada Supreme Court decision reinforces this conclusion. *Savage v. Pierson,* 123 Nev. 86, 157 P.3d 697, 700, 701 (2007), explained that the homestead exemption "only protects the amount of equity the debtor holds in the property listed in Nev.Rev.Stat. § 115.005(2)," so "a debtor must have some form of 'equity' in his residence in order to claim a homestead exemption in the residence." *Savage* went on to conclude that a security deposit in a residential lease does not qualify as equity in the property under the state's homestead exemption, because the "statutory definition of 'equity' contemplates more than a general 'interest' in the property or the right to possession, it contemplates ownership." *Id.* If the debtor has such ownership, then she can choose to protect up to $350,000 of equity in her property from legal process by invoking the state's homestead exemption, as long as she meets the procedural requirements to establish a homestead as defined by Nev.Rev.Stat. § 115.020. [5] When the requirements are met, a debtor has the substantive right to classify his property as exempt under the state homestead laws. *See generally, I.H. Kent Co. v. Miller,* 77 Nev. 471, 366 P.2d 520, 522 (1961) ("The exercise and preservation of the homestead exemption is held to be a purely personal right which can be exercised or waived by the debtor.").

[10] In Nevada, then, the role of the homestead exemption is the same as that of the Texas exemption analyzed in *Wallace*: "The homestead exemption and the property interest impressed with that exemption are discrete concepts: the former is the debtor's legal right to exempt certain property interests from the bankruptcy estate, the latter is the debtor's vested economic interest in the property itself." *Wallace,* 513 F.3d at 225.

[11] We now turn to the question whether Greene's rights to a homestead exemption under Nevada law are affected by the provisions of Section 522(p). In answering this question, we differ slightly with the Fifth Circuit in *Wallace,* although our ultimate conclusion—that Section 522(p) does not limit the homestead exemption that can be claimed under state law if the debtor owned the property before the 1215 day period—is the same. [6]

***622** Unlike the Fifth Circuit in *Wallace,* 513 F.3d at 226, we do regard the language of Section 522(p)(1) as ambiguous. As one bankruptcy court has explained:

> What Congress meant in § 522(p) is not entirely clear in this situation. At least one court has held that the phrase [in Section 522(p)(1)] encompasses the acquisition of a "homestead interest," *In re Greene,* 346 B.R. 835 (Bankr.D.Nev.2006), while other courts disagree, ... *In re Lyons,* 355 B.R. 387 (Bankr.D.Mass.2006). There is enough ambiguity to require the statute to be construed.

In re Reinhard, 377 B.R. at 319–20.

The salient terms ("amount," "interest," and "acquire") are not defined in the Bankruptcy Code, and although they have common, every-day definitions, those definitions are broad enough to have already generated contradictory lower court decisions on the matter. We therefore cannot rely on the statutory language alone, but must also turn to extra-textual sources, *e.g.,* legal dictionaries and legislative history, to shed

light on the meaning of Section 522(p). *See* *Merkel v. Comm'r,* 192 F.3d 844, 848 (9th Cir.1999) ("[I]f the statute is ambiguous, we consult the legislative history, to the extent that it is of value, to aid in our interpretation.") (internal quotations omitted).

[12] That said, we still begin with the statutory language. *See* *Leocal v. Ashcroft,* 543 U.S. 1, 8, 125 S.Ct. 377, 160 L.Ed.2d 271 (2004). First, Section 522(p) employs the term "interest" to describe what is acquired by the debtor and can be subject to the monetary limitation. The term "interest" is defined in Black's Law Dictionary as "a legal share in something; all or part of a legal or equitable claim to or right in property." *Black's Law Dictionary* 885 (9th ed.2009). Various forms of relationships to real property are referred to as property "interests," including possessory interests, leasehold interests, and ownership interests. Such interests are said to "run with the land"—that is, they accompany a conveyance or assignment of land, passing from one purchaser to another through the chain of title. *See* *Mobil Oil Corp. v. Brennan,* 385 F.2d 951, 953 (5th Cir.1967).

[13] **[14]** **[15]** Unlike such property interests, a homestead right, generally speaking, does not "run with the land." Instead, a homestead is a "personal right or privilege given by constitutional or statutory provisions ... [that] ordinarily is dependent on some title or interest in real property, and it does not exist as a separate estate in property independently of such title or interest." 40 Corpus Juris Secundum, *Homestead* § 3 (2006) (footnote omitted). Nevada law, for example, defines a homestead as "property consisting of" various structures "to be selected by the husband and wife, or either of them, or a single person claiming the homestead," Nev.Rev.Stat. § 115.005, thus presupposing an existing, previously acquired property right and permitting only certain individuals already holding that right to claim a homestead. Thus understood, a homestead is a "categorization" of a status or a classification, not a property interest. *See* *Wallace,* 513 F.3d at 220, 225; *see also* *In re Lyons,* 355 B.R. at 390 ("The homestead is not a quantifiable interest; it is a classification of property under state law.")

Second, the different verbs used in Section 522(p) provide support for this understanding. Subsection 522(p)(1), when stating ***623** what interest may be exempted, uses the phrase "amount of interest that was *acquired.*" (Emphasis added.) However, when referring to the homestead in Section 522(p)(1)(D), the verb used is different: "real or personal property that the debtor or dependent of the debtor *claims* as a homestead." (Emphasis added.) The fact that Congress used two different verbs to describe the process through which these two rights are gained by a debtor suggests a substantive distinction. [7]

Third, the use of the term "amount" to qualify "interest" indicates that the requisite "interest" must be one capable of quantification. *See* *Wallace,* 513 F.3d at 218–220; *In re Lyons,* 355 B.R. at 390–91. Further, the exception contained in Section 522(p)(2)(B) uses the term "interest" in a manner that supports the idea of a quantifiable interest. The exception states that the monetary cap will not apply to any "interest transferred from a debtor's previous principal residence (which was acquired prior to the beginning of such 1215–day period) into the debtor's current principal residence, if the debtor's previous and current residences are located in the same State." The term "interest" as used in the exception must mean the monetary value or equity taken from the previous principal residence, as the residence itself is not, of course, transferred. We conclude that, as *Lyons* put it, "the homestead is not a quantifiable interest; it is a classification of property under state law." *Id.* at 390.

[16] The final term in Section 522(p)(1) that warrants particular attention is "acquired." Black's Law Dictionary defines "acquire" as "[t]o gain possession or control of; to get or obtain." *Black's Law Dictionary* 26 (9th ed.2009). As amici point out, acquiring by gaining possession or control of a property interest usually occurs through a properly executed deed or other instrument of conveyance. The term "acquire" would not be used, in common parlance, to refer to classification of the property as a homestead. [8] Support for this interpretation can also be found in the exception contained in Section 522(p)(2)(B), where the verb "acquired" is used in conjunction with the debtor's previous principal residence. In that context, it appears that Congress intended "acquire" to mean "gaining possession or control" by purchasing or gaining an ownership interest, either legal or equitable.

[17] Based on the foregoing analysis of the terms used in Section 522(p)(1) and their juxtapositions, the most

plausible interpretation of Section 522(p)(1) is that the act of recording a homestead or moving onto the property to establish residency is not an "amount of interest acquired" for purposes of applying the monetary cap in Section 522(p).

***624** The legislative history fully supports this conclusion. During the debate on S. 256, the bill that became the 2005 BAPCPA amendments, Senator Thomas Carper of Delaware told his colleagues:

> [U]nder current law, a wealthy individual in a State such as Florida or Texas can go out, if they are a millionaire, and take those millions of dollars and invest that money in real estate, a huge house, property, and land in the State, file for bankruptcy, and basically protect all of their assets ... With the legislation we have before us, someone has to figure out that 2 1/2 years ahead of time people are going to want to file for bankruptcy and be smart enough to put the money into a home....

151 Cong. Rec. S. 2415 (Mar. 10, 2005).

Similarly, in the House of Representatives, Rep. F. James Sensenbrenner of Wisconsin placed a "Summary of Principal Provisions" of S. 256 into the record, which stated that "S. 256 closes the [mansion] loophole for abuse by requiring a debtor to reside in the state for at least 2 years before he or she can claim the state's homestead exemption ... [and] ... to own the homestead for at least 40 months [1215 days] before he or she can use state exemption law...." 151 Cong. Rec. H.1993, 2049 (Apr. 14, 2005).

And the House Committee Report indicated that: "The bill ... restricts the so-called 'mansion loophole' ... by requiring a debtor to own the homestead for at least 40 months[1215 days] before he or she can use state exemption law; current law imposes no such requirement." H.R.Rep. No. 109–31 (Part I) (2005), U.S.Code Cong. & Admin.News 2005, p. 88 ("If the debtor *owns* the homestead for less than 40 months, the provision imposes a $125,000 homestead cap.") (emphasis added).[9] These accounts of the statute all emphasize a concern with short-term *ownership* of the homestead property, not a conversion of non-residential into residential property or a new declaration of a homestead through formal processes.

We hold that "any amount of interest that was acquired," as used in Section 522(p)(1), means the acquisition of ownership of real property and that the monetary cap in Section 522(p) does not apply to property to which a debtor acquired title more than 1215 days before she or he filed a bankruptcy petition. That language does not include a homestead claim for the underlying property interest, which claim was recorded within the 1215–day period.[10]

***625** **[18]** We further hold that, as the facts here are undisputed with regard to when Greene purchased his Property, Greene's homestead is not subject to the $125,000 cap contained in Section 522(p), because he purchased the underlying property interest more than 1215 days before the bankruptcy filing.

In accordance with the foregoing discussion, we will reverse the district court's order affirming the bankruptcy court's decision that, where a debtor initiates his residency on the property and records a homestead during the 1215–day period prior to filing his bankruptcy petition, Section 522(p) places a monetary cap on the state law homestead even though the debtor purchased the property before the commencement of the 1215–day period.[11]

C. Pre–Petition Appreciation of Exempted Property

Greene further argues that the bankruptcy court erred in failing to provide him an evidentiary hearing as to the amount of "pre-petition appreciation" of the Property before granting the trustee authorization to sell the Property. The Property subsequently sold for $370,000, far more than the $240,000 to $260,000 he estimates the property was worth in 2004. His claim, in essence, is that the bankruptcy court did not determine what portion of this appreciation occurred prior to the filing of his petition in 2005. Any pre-petition appreciation, he argues, properly is exempted from the estate.

We agree with the bankruptcy court that, on Greene's own admissions, no such pre-petition appreciation occurred. In his 2005 Chapter 7 petition, the petition at issue in this appeal, he declared, under penalty of perjury, that the value of the

Property was $240,000. If the value of the property in 2005 when he filed the petition was $240,000, the subsequent sale of the property for a higher amount necessarily captures only post-petition appreciation. Greene does not argue that any such post-petition appreciation is exempt. Indeed, his claim is that the bankruptcy court failed to conduct a hearing to determine how to divide the appreciation pre- and post-petition, so that the pre-petition appreciation would be exempted.

[19] As the bankruptcy court correctly held, no evidentiary hearing is necessary to resolve this question on these facts. [12] If Greene's claim is that his 2005 petition incorrectly declared the value of the Property, the proper course of action would be for him to amend his petition pursuant to FED. R. BANKR. P. 1009(a), in which "[a] voluntary petition, list, schedule, or statement may be amended by the debtor as a matter of course at any time before the ***626** case is closed." We note that a court may disallow the amendment only upon "a showing of bad faith or prejudice to third parties," *Arnold v. Gill (In re Arnold),* 252 B.R. 778, 784 (9th Cir.BAP2000) (quoting *Magallanes v. Williams (In re Magallanes),* 96 B.R. 253, 256 (9th Cir.BAP1988)), but take no position as to whether bad faith or prejudice exists in this case.

[20] We therefore hold that, absent any proper amendment to the petition, the bankruptcy estate is entitled to retain all of the appreciation in the value of the Property; that is, any value in excess of $240,000.

III.

DISPOSITION

AFFIRMED, in part; REVERSED, in part; and REMANDED for proceedings consistent with this opinion.

Each party shall bear his or her own costs on appeal.

All Citations

583 F.3d 614, 62 Collier Bankr.Cas.2d 829, Bankr. L. Rep. P 81,596, 09 Cal. Daily Op. Serv. 12,414, 2009 Daily Journal D.A.R. 14,427

Footnotes

* The Honorable Robert J. Timlin, United States District Judge for the Central District of California, sitting by designation.

1 Nevada is an opt-out state. *E.g., In re Kane,* 336 B.R. 477, 480 (Bankr.D.Nev.2006).

2 The dollar amount was adjusted by the Judicial Conference of the United States from $125,000 to $136,875 in 2007 to reflect the change in the Consumer Price Index published by the Department of Labor, pursuant to 11 U.S.C. § 104.

3 Pub.L. No. 109–8, 119 Stat. 23 (2005) (codified as amended in scattered sections of 11 U.S.C.).

4 Other states' homestead exemptions have been similarly characterized. For example, a bankruptcy court applying Florida law explained:

> Homestead is simply a status, constitutionally defined, which exempts certain property from execution.... It is not a property interest. When a Florida resident's property acquires homestead status, the owner does not acquire any of the rights traditionally associated with property interests: the right to possession, the right to use, the right to transfer—the owner already holds whatever of those he has. Accordingly, homestead

status in Florida is not properly conceptualized as a stick in the bundle; rather, it is a protective safe in which the bundle is put.

Venn v. Reinhard (*In re Reinhard*), 377 B.R. 315, 319–20 (Bankr.N.D.Fla.2007).

5 Nev.Rev.Stat. § 115.020 generally requires that a party seeking to record a homestead must file a written declaration explaining that he or she is a householder; is residing on the premises; and that he or she intends to use the property as a homestead.

6 *Wallace* held that the term "interest" as used in Section 522(p)(1) refers to vested economic interests, such as title and equity, that a debtor acquires in homestead property during the 1215 day period preceding the date a debtor files a petition for bankruptcy. It further held that a homestead exemption is not a separate interest in property but rather is the status of a withdrawn interest in property that was acquired prior to bankruptcy. "Thus a homestead interest established within the statutory period, without more, does not fall within the purview of Section 522(p)(1)." *Wallace,* 513 F.3d at 224.

7 Cases analyzing the appreciation in value issue with regard to Section 522(p) support our reliance on the terms "interest" and "acquired." *See* *In re Sainlar,* 344 B.R. 669, 674 (Bankr.M.D.Fla.2006) ("Both a reading of the plain, unambiguous language of § 522(p)(1) and the statute's legislative history lead to the same result: the monetary cap of § 522(p) is inapplicable to property purchased by a debtor more than 1,215 days before the petition date."); *see also* *In re Blair,* 334 B.R. 374 (Bankr.N.D.Tex.2005). Both cases emphasize the use of the terms "interest" and "acquired" in the statute and hold that the phrase " 'interest that was acquired' as used in § 522(p)(1) means the acquisition of ownership of real property." *In re Sainlar,* 344 B.R. at 673.

8 Notably, the exception for new residences contained in Section 522(p)(2)(B), also uses the verb "acquired," in conjunction with the debtor's previous principal residence. In that context as well, it appears that Congress intended "acquire" to mean "gaining possession or control" by purchasing or gaining an ownership interest, either legal or equitable.

9 From an equitable perspective, it might seem illogical for Congress to have targeted those people who convert cash or other non-exempt assets into the purchase of a home to shield themselves from creditors, but not be concerned with people such as Greene, who convert their non-residential property into a homestead immediately before filing a bankruptcy petition. We are bound, however, by Congress's decision, whether it is thoroughly logical or not. We note that there are other avenues in the Bankruptcy Code for addressing bad faith claims by a debtor. *See, e.g.,* 11 U.S.C. § 727(a)(4)(B) (authorizing denial of discharge for presenting fraudulent claims). Consequently, concerns about such bad faith claims should not impact the interpretation of Section 522(p).

10 Other courts have also considered the applicability of Section 522(p)(1) when a debtor purchased the property outside the 1215–day window and have held that the date of ownership or acquisition of the property is the date of significance for purposes of determining the applicability of Section 522(p)(1). *See* *In re Virissimo,* 332 B.R. 201, 207 (Bankr.D.Nev.2005) ("Because the debtors acquired their homes within the 1215 days before the filing, they are limited to the $125,000 homestead set forth in that § [section 522(p)] notwithstanding that the Nevada homestead is higher."); *In re McNabb,* 326 B.R. at 788 ("Code §

522(p), as added by BAPCPA, applies a $125,000 cap on a homestead if it was acquired by the debtor within 1215 days prepetition....").

11 Greene does not argue that the value of the Property increased because he initiated his residence there by moving the trailer and tent onto the land. We do not decide, therefore, whether the monetary cap would apply to the value of improvements to homestead property effected during the 1215 days preceding the petition.

12 The bankruptcy court also declined to allow Greene to present evidence of pre-petition appreciation, stating that there was no point for Greene to do so because he was only entitled to an exemption of $125,000, the amount of the monetary cap. Specifically, the court said, "it doesn't matter what the value of the property is because it's never going to be more than $125,000 on the date of the filing of the petition. So the value of the property itself doesn't matter...." Given our holding above with respect to the Section 522(p)(1) monetary cap, the value of the Property at the time of the petition *is* material, because Greene's exemption is not limited to $125,000. On the record before the bankruptcy court, however, there was no bona fide dispute as to the value of the Property at the time of the petition, given Greene's signed declaration and his failure to make any effort to file an amended schedule declaring a higher value.

End of Document

566 B.R. 102
United States Bankruptcy Court, D. Massachusetts.

IN RE Armen D. MEGUERDITCHIAN, Debtor

Case No. 15–13288–FJB
|
Signed March 28, 2017

Synopsis

Background: Trustee, joined by creditors, objected to Massachusetts state law homestead exemption claimed by Chapter 13 debtor in residential property acquired less than 1,215 days prepetition.

Holdings: The Bankruptcy Court, Frank J. Bailey, J., held that:

[1] term "interest," as used in bankruptcy statute purporting to cap state law homestead exemption available to debtor for "any amount of interest that was acquired" during the 1215 day period preceding petition date, and also as used in statutory exception to cap, referred to equity and not title;

[2] exemption claim was plausible on its face; and

[3] fact that debtor had not filed a Massachusetts declaration of homestead for prior residential property, proceeds from sale of which were used to pay down loan used to acquire current residence, did not mean that exception to statutory homestead cap did not apply.

So ordered.

West Headnotes (10)

[1] Bankruptcy Waiver or Loss of Exemption

Statutory cap on debtor's state law homestead exemption applies only to such "amount of interest" in homestead property as debtor acquired during the 1,215 days immediately preceding petition date, not to any amount of interest in the same property that debtor may have acquired before the start of this 1215-day period. 11 U.S.C.A. § 522(p)(1).

1 Cases that cite this headnote

[2] Bankruptcy Proceedings

While burden of proof was on parties objecting to state law homestead exemption claimed by debtor, on ground that his exemption rights were subject to statutory cap because Chapter 13 debtor acquired his interest in homestead property less than 1,215 days prepetition, debtor bore burden of showing that exception to statutory cap applied, because he acquired his interest in his current residence with proceeds from sale of prior residence that he had acquired more than 1,215 days prepetition, and that was located in same state. 11 U.S.C.A. § 522(p)(1), (p)(2)(B); Fed. R. Bankr. P. 4003(c).

[3] Bankruptcy Waiver or Loss of Exemption

Term "interest," as used in bankruptcy statute purporting to cap state law homestead exemption available to debtor for "any amount of interest that was acquired" during the 1215 day period preceding petition date, and also as used in statutory exception to cap, which provides that amount of such interest will not include any interest acquired with proceeds from sale of earlier home located in same state and acquired more than 1,215 days prepetition, referred to equity and not title, so that mere fact that Chapter 13 debtor acquired title to current residence, in which he claimed Massachusetts homestead exemption, prior to sale of his previous home did not mean that exception did not apply, if proceeds from sale of former Massachusetts home, acquired outside this 1,215-day period, were used to pay down loan used to purchase current residence. 11 U.S.C.A. § 522(p)(1), (p)(2)(B).

[4] Statutes Language

Statutes Absence of Ambiguity; Application of Clear or Unambiguous Statute or Language

Starting point for court on questions of statutory interpretation is the words of statute at issue, and if statutory language, considered as a whole, is clear and unambiguous, then court's inquiry is at an end.

[5] **Statutes** Similarity or difference

Normal rule of statutory interpretation is that identical words used in different parts of same statute are generally presumed to have the same meaning.

[6] **Bankruptcy** Proceedings

Chapter 13 debtor's claim of Massachusetts' homestead exemption in his current residence, in amount of the $500,000 that he used from sale of previous residence, located in same state and acquired more than 1,215 days prepetition, to pay down loan used to acquire current residence, at time when title to current residence was in trust of which debtor and his wife were alleged to be sole beneficiaries, and prior to transfer of title from trust to debtor and his wife as tenants by the entirety, was plausible on its face, and could not be disallowed, pursuant to statutory cap on debtor's state law homestead exemption rights, prior to hearing, inter alia, on nature of trust and whether debtor and his wife were in fact the sole beneficiaries. 11 U.S.C.A. § 522(p)(1), (p)(2)(B).

[7] **Bankruptcy** Waiver or Loss of Exemption

Simple change in form of title to the equity that a debtor already possesses, when title to homestead property is transferred from trust of which debtor is beneficiary to debtor individually, is not an acquisition of "any amount of interest" in homestead property, within meaning of statutory cap on debtor's state law homestead exemption rights. 11 U.S.C.A. § 522(p)(1).

1 Cases that cite this headnote

[8] **Bankruptcy** Waiver or Loss of Exemption

In order for Chapter 13 debtor's pay down of loan used to acquire his current residence to constitute an acquisition of "any amount of interest" therein, for purposes of statutory cap on his state law homestead exemption rights and exception thereto, that loan must have been secured by an existing mortgage at the time; however, mortgage did not need to have been recorded. 11 U.S.C.A. § 522(p)(1), (p)(2)(B).

[9] **Mortgages and Deeds of Trust** Acceptance of delivery

Mortgages and Deeds of Trust Necessity and Effect as Between Parties to Transaction

Mortgages and Deeds of Trust Record and notice, effect on nonparties in general

Under Massachusetts law, recording of mortgage perfects the mortgagee's rights against certain third parties, such as subsequent purchasers from the mortgagor, but adds nothing to mortgagee's rights against mortgagor; as between mortgagor and mortgagee, mortgage is effective upon delivery and acceptance.

[10] **Bankruptcy** Waiver or Loss of Exemption

Exception to statutory cap on debtor's state law homestead exemption rights for "any amount of interest that was acquired" during the 1215 day period preceding petition date, pursuant to which the amount of such interest shall not include equity acquired with proceeds from sale of another residence located in same state and acquired more than 1,215 days prepetition, contained no requirement that the equity transferred from the prior residence to the current residence have been exempt or even exemptible at time of transfer, so that mere fact that Chapter 13 debtor had not filed a Massachusetts declaration of homestead for prior residential property that he sold did not mean that

exception did not apply. 11 U.S.C.A. § 522(p)(1), (p)(2)(B).

Attorneys and Law Firms

***103** Laurel E. Bretta, Bretta Law Advisors, P.C., Medford, MA, for Debtor.

***104** Joshua Grossman, Davis Malm & D'Agostine, P.C., Boston, MA, Colin Hagan, Shlansky Law Group L.L.P., Chelsea, MA, Justin Kesselman, Adam J. Ruttenberg, Posternak Blankstein & Lund L.L.P., Boston, MA, for Creditor.

MEMORANDUM OF DECISION ON OBJECTIONS TO CLAIM OF HOMESTEAD EXEMPTION

Frank J. Bailey, United States Bankruptcy Judge

In his case under chapter 13 of the Bankruptcy Code, the debtor has claimed a Massachusetts homestead exemption in the amount of $500,000, and the chapter 13 trustee and two creditors have now objected to that exemption, arguing that 11 U.S.C. § 522(p)(1) limits the available exemption to $155,675 because, as the debtor concedes, he acquired all his interest in the exempted property, his principal residence, during the 1215–day period before he filed his bankruptcy petition. The debtor argues that the (p)(1) limitation does not apply because his interest in the property is sheltered to the extent of $500,000 by the "roll-over" safe harbor in § 522(p)(2)(B) by virtue of his having used $500,000 of the proceeds from sale of his previous residence, which was acquired prior to the beginning of the 1215–day period, to pay down the bridge loan that he used to fund purchase of the current residence. The objecting parties argue that the safe harbor is unavailable because (i) it applies only to acquisitions of title and not to acquisitions of equity by paydown of an encumbering mortgage and (ii) in any event, when that paydown occurred, the property was owned by a trust of which the debtor and his wife were beneficiaries, not, as at present, by the debtor and his wife by virtue of an eve-of-bankruptcy conveyance from the trust. For the reasons set forth below, the Court holds that the debtor has not failed to state a claim on which relief can be granted.

PROCEDURAL HISTORY

On August 21, 2015, Armen D. Meguerditchian ("the Debtor") filed a petition for relief under chapter 13 of the Bankruptcy Code. In the case thereby commenced, he filed a schedule of claims of exemption and thereby claimed as exempt to the extent of $500,000 his interest in the real property in Winchester, Massachusetts that is his principal residence. The chapter 13 trustee, Carolyn Bankowski ("the Trustee"), objected to so much of this claim as exceeds $155,675 on the basis that 11 U.S.C. § 522(p)(1)(A) caps a homestead exemption at this amount when, as here, the debtor acquired his interest in the property within the 1,215 days prior to the date of filing of the bankruptcy petition. Creditors Outcome Referrals, Inc. ("Outcome") and David R. Kraus ("Kraus") (Outcome and Kraus jointly, "ORI") then joined in the Trustee's objection, relying without elaboration on the reasons articulated by the Trustee in her objection. In a response, the Debtor conceded that he had acquired all his interest in the property within the 1,215 days prior to the date of filing of the bankruptcy petition, but he contended that subsection (p)(2)(B) excluded his interest in the property from operation of the (p)(1) cap because he had transferred in excess of $500,000 of his interest from his previous principal residence into the current principal residence, the previous principal residence was acquired prior to 1,215 days preceding the petition date, and the previous and current principal residences are located in the same state. In so stating, the Debtor essentially recited the elements of subsection (p)(2)(B), but he did not also specify the facts by which he contended these elements were satisfied.

At a preliminary hearing on their objections to the claim of exemption, the Trustee ***105** and ORI disputed the availability of the safe-harbor of § 522(p)(2)(B) to the Debtor on several grounds, among them (i) that proceeds from sale of the previous residence could not have funded the initial purchase of the current residence because the previous residence was not sold until almost two months after the current residence was purchased and (ii) by the time the previous residence was sold, the current residence had been transferred to, and was owned by, a trust. The Debtor conceded these facts and clarified that the transfer of interest from the previous residence to the current did not occur upon his and his wife's initial acquisition of the current residence. Rather, it occurred later, upon sale of the previous residence, when sale in the amount of $500,000 were used to pay down a bridge loan from the Debtor's father, which loan was secured by a mortgage on the current residence and had served to

facilitate the acquisition of the current residence before sale of the previous. The Debtor argued that nothing in subsection (p)(2)(B) requires that the sale of the old residence precede the purchase of the new. Nor does anything in subsection (p)(2)(B) preclude its satisfaction by payment of a mortgage loan that encumbers the new property and was used to fund its acquisition. Regarding the fact that title to the property was at the time held in a trust, the Debtor stated that the trust in question was a Massachusetts nominee trust, of which he and his wife were beneficiaries, and therefore he and his wife were at all relevant times the owners of the property under Massachusetts law. In light of these developments in the Debtor's articulation of his position, the Court ordered the parties to file briefs setting forth more clearly their respective positions.

In its brief, ORI argued that, by virtue of certain facts on which the Debtor relies and that are not in dispute, the Debtor cannot prevail. First, subsection (p)(2)(B) cannot apply because its focus is on the interest that the Debtor held at the time he filed. He acquired that interest when the trust transferred the property back to him and his wife, and that transaction involved no proceeds from the previous residence. Second, subsection (p)(2)(B) cannot apply for the further reason that the increase in equity that results from payment of a mortgage debt is not an acquisition of an interest within the meaning of § 522(p). In her brief, the Trustee also articulated the first of these arguments, and she further argued that the proceeds from the previous residence could not have gone to pay down the mortgage on the current residence because the mortgage had not yet been recorded at the time of the sale.

Upon receipt of these briefs, the Court held a further non-evidentiary hearing, then ordered the parties to file a stipulation as to the agreed facts, upon receipt of which the Court would determine whether an evidentiary hearing was necessary. The parties did file a joint statement in which they identified the facts as to which there is no dispute and identified other facts that the Debtor alleges but that the Trustee and ORI dispute. In the same statement, the Trustee and ORI stated that they believe the disputed facts are not material to determination of their objections to the claim of exemption.

FACTS

Except where otherwise indicated, the following facts are not in dispute.

1. By deed dated December 16, 2000, the Debtor and his wife, as tenants by the entirety, took title to certain real property in Arlington, Massachusetts ("the Arlington Property"). From on or about December 16, 2000 until "sometime prior to December 8, 2014," the Arlington Property ***106** was the principal residence of the Debtor and his wife. [1]

2. By deed dated October 14, 2000, the Debtor and his wife, as tenants by the entirety, took title to certain real property in Winchester, Massachusetts ("the Winchester Property"). The purchase price for the Winchester Property was $1,185,000.00.

3. The Debtor and his wife borrowed the sum of $800,000.00 from the Debtor's father, Dikran Meguerditchian ("Dikran"), by promissory note and mortgage dated October 14, 2014. By this mortgage ("the Meguerditchian Mortgage"), the Debtor and his wife granted a mortgage on the Winchester Property to Dikran Meguerditchian to secure repayment of the promissory note. The Debtor and his wife were jointly and severally liable for repayment of the promissory note to Dikran.

4. The Debtor asserts, but the Trustee and ORI do not concede, that Dikran funded the $800,000 loan with funds he obtained by drawing on a line of credit he had at Patriot Bank.

5. The Debtor asserts, but the Trustee and ORI do not concede, that he and his wife borrowed the $800,000 from the Debtor's father in order to purchase the Winchester Property.

6. The Debtor asserts, but the Trustee and ORI do not concede, that also on October 14, 2014, he and his wife established a trust known as the GAR–SAR Realty Trust ("the Trust").

7. By deed dated October 14, 2014, the Debtor and his wife conveyed the Winchester Property to the Trust.

8. The Debtor asserts, but the Trustee and ORI do not concede, that the Trust was a nominee trust under Massachusetts law and that he and his wife were the beneficiaries of the Trust.

9. The trustee of the Trust never recorded a declaration of homestead for the Winchester Property.

10. On December 8, 2014, the Debtor and his wife sold the Arlington Property and, from the sale, received net proceeds of $517,754.65.

11. The Debtor asserts, but the Trustee and ORI do not concede, that with the net proceeds from sale of the Arlington Property, he and his wife repaid some of the funds that had been advanced against Dikran's line of credit at Patriot Bank to fund the $800,000 loan, and that, on account of this payment, the balance due on the Meguerditchian Mortgage was reduced by the same amount. In the joint statement of undisputed facts, the parties do not indicate when this payment occurred or the amount of the payment. Elsewhere, the Debtor asserts, but the Trustee and ORI do not concede, that the payment was made a few days after December 8, 2014 and that the amount of the payment was $500,000. A true copy of the check evidencing this payment was attached to the joint statement of undisputed facts. It is dated December 15, 2014 and made out to Patriot Community Bank in the amount of $500,000. [2]

***107** 12. On December 23, 2014, the Meguerditchian Mortgage was recorded at the Middlesex South Registry of Deeds.

13. Also on December 23, 2014, the deed by which the Debtor and his wife had conveyed the Winchester Property to the Trust was recorded at the Middlesex South Registry of Deeds.

14. By deed dated August 20, 2015, the trustee of the Trust conveyed the Winchester Property to the Debtor and his wife, as tenants by the entirety. This deed was recorded in the Middlesex South Registry of Deeds on August 21, 2015. When this deed was recorded, the Meguerditchian Mortgage was of record and encumbered the Winchester Property.

15. Also on August 21, 2015, the Debtor and his wife filed a joint declaration of homestead, dated August 20, 2015, regarding the Winchester Property.

16. Also on August 21, 2015, the Debtor filed his petition for relief under chapter 13 of the Bankruptcy Code.

JURISDICTION

The matters before the court are objections under 11 U.S.C. § 522(p) to a debtor's claim of exemption under § 522(b). The objections arise under the Bankruptcy Code and in a bankruptcy case and therefore fall within the jurisdiction given the district court in 28 U.S.C. § 1334(b) and, by standing order of reference (codified in the district court's local rules at L.R. 201, D. Mass.), referred to the bankruptcy court pursuant to 28 U.S.C. § 157(a). They are core proceedings within the meaning of 28 U.S.C. § 157(b)(1). 28 U.S.C. § 157(b)(2)(B) (core proceedings include allowance or disallowance of exemptions from property of the estate). The bankruptcy court accordingly has authority to enter final orders as to the objections.

ANALYSIS

[1] The Objecting Parties' sole basis of objection to the Debtor's homestead exemption is 11 U.S.C. § 522(p)(1). In relevant part, it limits the amount of recently-acquired interest in a residence that a debtor can claim as exempt under a state homestead exemption. In structure, § 522(p) sets forth a general rule in subsection (p)(1) and then exceptions to it in subsection (p)(2). The general rule is as follows:

> (1) Except as provided in paragraph (2) of this subsection and sections 544 and 548, 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 interest that was acquired by the debtor during the 1215–day period preceding the date of the filing of the petition that exceeds in the aggregate $155,675 [3] in value in—
>
> (A) real or personal property that the debtor or a dependent of the debtor uses as a residence; ... or
>
> (D) real or personal property that the debtor or dependent of the debtor claims as a homestead.

11 U.S.C. § 522(p)(1). This rule applies where, as here, a debtor (i) elects under § 522(b)(3)(A) to exempt property under state or local law [4] and (ii) under such state ***108** or local law claims as exempt an "amount of interest that was acquired by the debtor during the 1215–day period preceding the date of the filing of the petition." Subject to certain exceptions, it limits the amount of such interest that may be claimed as exempt to $155,675. The cap applies only to such "amount of interest" as the debtor acquired during the 1215–day period, not to any amount of interest in the same property that the debtor may have acquired *before* the 1215–day period. *In re Welch*, 486 B.R. 1, 4–5 (Bankr. D. Mass. 2013) (cap in § 522(p)(1) applied only to value of portion of debtor's interest that was acquired in the 1,215 day period). In this instance, it is undisputed that the Debtor acquired *all* his interest in the homestead property during the 1215–day

period and therefore that, if it applies, the cap limits the whole of his homestead exemption.

The general rule is subject to the two exceptions in § 522(p)(2). The Debtor invokes the exception in subsection (p)(2)(B), which states:

> For purposes of paragraph (1), any amount of such interest does not include any interest transferred from a debtor's previous principal residence (which was acquired prior to the beginning of such 1215–day period) into the debtor's current principal residence, if the debtor's previous and current residences are located in the same State.

11 U.S.C. § 522(p)(2)(B). This exception applies where (i) the debtor's previous principal residence was acquired prior to the beginning of the 1215–day period preceding the date of the filing of the bankruptcy petition, (ii) the previous principal residence is located in the same state as the current principal residence, and (iii) there was a transfer of interest from the previous principal residence into the current principal residence. When these three requirements are met, the exception excludes from the cap any such transferred interest.

[2] A party in interest may file an objection to a claim of exemption, Fed. R. Bankr. P. 4003(b)(1), and in any hearing on such an objection, the objecting party has the burden of proving that the exemption is not properly claimed. Fed. R. Bankr. P. 4003(c). In this instance, however, the Debtor concedes that he acquired his entire interest in the exempted property within the 1,215 days prior to the date of filing of the bankruptcy petition. The burden of the Objecting Parties under § 522(p)(1) is thus satisfied. To escape the limitation to which this fact would give rise under § 522(p)(1), the Debtor invokes subsection (p)(2)(B), which amounts to an affirmative defense. Because it is an affirmative defense, the burden of establishing its applicability falls on the Debtor.

The Objecting Parties concede that the first two requirements of the (p)(2)(B) exception are satisfied but maintain that, on the agreed facts, the third cannot be satisfied and therefore that they are entitled to an order sustaining their objections as a matter of law. In essence, the Objecting Parties argue that the Debtor fails to state ***109** a claim on which relief under subsection (p)(2)(B) can be granted. To survive a motion to dismiss for failure to state a claim, "a complaint must contain sufficient factual matter, accepted as true, to 'state a claim to relief that is plausible on its face.' " *Ashcroft v. Iqbal*, 556 U.S. 662, 678, 129 S.Ct. 1937, 173 L.Ed.2d 868 (2009) (quoting *Bell Atlantic Corp. v. Twombly*, 550 U.S. 544, 570, 127 S.Ct. 1955, 167 L.Ed.2d 929 (2007)). I must accordingly determine whether, on the facts alleged —both those to which the parties have stipulated and those remaining to be proven—the Debtor has stated a plausible claim of entitlement to the benefit of the subsection (p)(2)(B) exception. The Court may not "attempt to forecast a plaintiff's likelihood of success on the merits; 'a well-pleaded complaint may proceed even if ... a recovery is very remote and unlikely.' " *Ocasio–Hernandez v. Fortuño–Burset*, 640 F.3d 1, 13 (1st Cir. 2011) (citing *Twombly*, 550 U.S. at 556, 127 S.Ct. 1955). The relevant inquiry, therefore, "focuses on the reasonableness of the inference of liability that the plaintiff is asking the court to draw from the facts alleged in the complaint." *Id.*

a. No Use of Sale Proceeds for Initial Acquisition

The first basis on which the Trustee argued that subsection (p)(2)(B) affords no shelter to the Debtor is that, because the Debtor acquired his current principal residence before he sold the previous principal residence, no interest from the previous can have been used to purchase the current. The Debtor has since clarified that he does not contend that proceeds from the previous residence were used in his and his wife's initial acquisition of the current residence in August 2014. Rather, he contends that the requisite transfer occurred later, just after sale of the previous residence, when (he alleges) proceeds of that sale were used to pay down his father's mortgage on the current residence. This basis of objection is accordingly moot.

b. Equity or Title?

[3] ORI argues that the Debtor cannot prevail because a payment on a mortgage loan that encumbers the current principal residence, resulting in an increase in the owner's equity in the property, is not an acquisition of an interest

within the meaning of § 522(p). It is ORI's position that "interest," as that term is used under both subsection (p)(1) and subsection (p)(2)(B), means title only, not equity. ORI contends that this construction is in keeping with dictionary and state law definitions of "interest" and "acquired," principles of statutory construction, the legislative history of and intent behind § 522(p), and the case law on point. The Debtor responds that a transfer of equity, not title, from one residence to another is precisely what subsection (p)(2)(B) contemplates, and the case law is in accord. He points out that § 522(p) speaks not just of interest but of "*amount of* interest."

[4] The question is one of statutory interpretation. The starting point is the words of the statute. If the statutory language, considered as a whole, is clear, not ambiguous, the inquiry ends there. I therefore begin by examining the words of the statute.

The word "interest" appears in both relevant subsections, (p)(1) and (p)(2)(B). It is not expressly defined, either in § 522 or elsewhere in the Bankruptcy Code, except that § 541(a)(1) makes clear that the "interests of the debtor in property" that comprise the bankruptcy estate, from which property is exempted under § 522, can be solely equitable in nature. 11 U.S.C. § 541(a)(1) ("The commencement of a case under section 301, 302, or 303 of this title creates an estate. Such estate is comprised ***110** of all the following property, wherever located and by whomever held: (1) Except as provided in subsections (b) and (c)(2) of this section, all legal or equitable interests of the debtor in property as of the commencement of the case.").

Subsection (p)(1) states: "a debtor may not exempt any amount of interest that was acquired by the debtor during the 1215–day period preceding the date of the filing of the petition that exceeds in the aggregate $155,675 in value in" certain real or personal property. What this subsection prohibits a debtor from claiming as exempt is not an interest but "any amount of interest" that "exceeds in the aggregate $155,675 in value." The focus is not the sole word interest but "any amount of interest." It suggests something quantifiable. In combination with the limit of "$155,675 in value," the clear focus is on quantifiable economic value. All of this is consistent with equity. Equity has—indeed it *is*—quantifiable economic value; and there is nothing unusual in speaking of an "amount of" equity. Title, too, can have quantifiable economic value, because title is a right to the equity in the property to which the title attaches. On the other hand, it would be strange to speak of someone having an "amount of" title, so title sits uneasily with subsection (p)(1), at least in this respect.

Subsection (p)(2)(B), which creates an exception, does so by limiting the meaning of the phrase "any amount of interest": "For purposes of paragraph (1), any amount of such interest does not include any interest transferred from a debtor's previous principal residence ... into the debtor's current principal residence." This subsection removes from the meaning of "any amount of interest" a particular amount of interest that, but for this exclusion, would be included in it. In doing so, subsection (p)(2)(B) makes clear that the common subject of both subsections, "any amount of interest," is something that can be transferred from one residence into another. This rules out any definition of "amount of interest" that reduces it to title. Equity in one residence can be transferred to another, but title in one residence cannot be transferred into another residence. It makes no sense to speak of transferring title from one property to another. Title is always property-specific, specifying the relationship of the title-holder to the property. The conclusion is clear and unavoidable: in subsection (p)(2)(B), "amount of interest" means equity.

[5] The normal rule of statutory interpretation is that "identical words used in different parts of the same statute are generally presumed to have the same meaning." *IBP, Inc. v. Alvarez,* 546 U.S. 21, 34, 126 S.Ct. 514, 523, 163 L.Ed.2d 288 (2005). Here that presumption is confirmed because subsection (p)(2)(B) is expressly a limitation of what subsection (p)(1) means by the very same phrase, "amount of interest." It begins: "For purposes of paragraph (1), any amount of such interest does not include ... [.]" But for this limitation, subsection (p)(1) would apply to what subsection (p)(2)(B) excludes. It follows that, in subsection (p)(1) as in subsection (p)(2)(B), "amount of interest" means equity.

This reasoning and conclusion is consistent with the majority of courts that have addressed this issue. In *Soule v. Willcut (In re Willcut)*, 472 B.R. 88, at 93–97 (10th Cir. BAP 2012), the bankruptcy appellate panel held that "interest" as used in 11 U.S.C. § 522(o), providing for reduction of the value of a debtor's interest in homestead property to the extent that such value is attributable to fraudulent conversion of nonexempt assets within ten years of bankruptcy, refers to

equity, not title. In reaching this conclusion, the panel ***111** placed heavy reliance on use of the same word, "interest," in neighboring subsection 522(p). There, the panel concluded, a title definition would render nonsensical both the phrase "any amount of interest" (because equity is quantitative but title is not) and the transferability of interest that is presumed in subsection (p)(2)(B) (because equity is transferable but title is not). *Id.* at 96–97. The panel concluded that in § 522(p), interest plainly means equity, and therefore interest must also mean equity in § 522(o).

In *Parks v. Anderson*, 406 B.R. 79, 88–95 (D. Kansas 2009), when asked to determine whether the cap in subsection (p)(1) applied to a debtor's acquisition of equity, by use of non-exempt cash to pay down a mortgage, the court ruled that "interest" in (p)(1) referred to equity, not title, and therefore that the debtor had acquired an amount of interest by the paydown. The court reasoned that "amount," in the phrase "any amount of interest," implies value, and that if Congress had intended to restrict "interest" to title, it would have done so by excluding the phrase "any amount of" preceding the term. *Id.* at 94. The statutory language shows that "interest" refers to "a quantitative or monetary value—a concept consistent with equity." *Id.* The court also noted that a title definition would make subsection (p)(2)(B) incomprehensible: "a person does not transfer title from one residence to another, but instead, transfers equity." *Id.*

In *In re Rasmussen*, 349 B.R. 747, 756–758 (Bankr. M.D. Fla. 2006), the court was called upon to determine whether "interest" acquired in subsection (p)(1)'s 1215–day look-back period included equity that accrued by virtue of appreciation during that period. The Court determined that interest means equity in the property, not merely ownership interest or title, but also that it does not include such equity as is acquired passively, by appreciation. Regarding the holding that interest means equity, the Court found the language of the statute dispositive. First, "interest" used in conjunction with "amount" is a quantitative term that can be used in a commonsense and straightforward manner of equity but not of title. *Id.* at 756. "A homeowner may be thought of as having an amount of equity in a home. It would be unusual to refer to a homeowner having an amount of fee simple ownership in a home." *Id.* Second, "section 522(p)(2)(B) defines 'interest' through usage to mean the debtor's equity in the property—not the debtor's fee simple interest. While one may roll equity from one property to another, one does not roll a fee simple property ownership interest from one property to another." *Id.*

The same reasoning and conclusion were followed and dispositive in three other cases that approached the issue from another direction. In these cases, the courts were asked to determine whether a debtor's acquisition of homestead status, and the benefits of that status under state law, for a long-owned residence constituted an acquisition of an amount of interest for purposes of § 522(p)(1). Each held that the designation or acquisition of homestead status was not an acquisition of an amount of interest for purposes of § 522(p)(1). In *In re Rogers*, 354 B.R. 792, 798 (N.D. Tex. 2006), *aff'd on other grounds* (taking no position on whether interest includes equity or just title), 513 F.3d 212 (5th Cir. 2008), the Court reasoned that the meaning of "interest" in § 522(p) is unambiguous, requires a quantitative, monetary measure, and, like equity, must be capable of being rolled over from one home to another. Likewise, in *In re Reinhard*, 377 B.R. 315, at 320 (Bankr. N.D. Fla. 2007), the court, citing *Rogers*, found that that there were "several indications in the text of § 522(p) that Congress intended the ***112** term 'interest' to refer a quantitative or monetary value in property." Likewise, in *In re Lyons*, 355 B.R. 387, 390–91 (Bankr. D. Mass. 2006), Judge Rosenthal followed *Rogers* in holding that because "the term 'interest' refers to some quantitative amount of legal or equitable value," the classification of property as a homestead is not an acquisition of interest within the meaning of § 522(o) or (p).

Two courts have held that "interest" in § 522(p) means only title and not equity. In *In re Blair*, 334 B.R. 374 (Bankr. N.D. Tex. 2005), the court held that the debtors' increased equity in their residence, which resulted from their making regular mortgage payments on their home during the 1, 215–day before the filing of their bankruptcy petition, was not an "interest acquired" within the meaning of § 522(p)(1). The court based its decision on the meaning of "acquire," stating that "one does not actually 'acquire' equity in a home. One acquires title." *Id.* at 376. For several reasons, *Blair* is not persuasive. First, the court supplied no definition for "acquire" and did not explain why equity

cannot be acquired. Second, the court did not grapple with the language in § 522(p) that speaks of "amount of" interest and of its "value" "in the aggregate" and contemplates its being transferred from one property to another. Third, the court expressly acknowledged that "[subsection (p)(2)(B)] allows for rollover by debtors of *the equity* in one home to another home located in the same state," *id.* at 377 (emphasis added), yet failed to appreciate or address the difficulty this posed for its construal of "interest" in subsection (p)(1) as title, not equity.

Blair's reasoning was followed in *In re Sainlar*, 344 B.R. 669 (Bankr. M.D. Fla. 2006). In *Sainlar*, the court decided whether the debtors' interest in their homestead, which they acquired four years prepetition but which appreciated considerably in the 1210–day period, causing considerable growth in their equity, was, to the extent of the appreciation in that period, an "interest" or "amount of interest" they acquired in that period. The court held that "interest" in § 522(p) means only title and not equity, and therefore the growth in the debtors' equity from appreciation was not subject to the cap in subsection (p)(1). As in *Blair*, the court based its decision on the meaning of acquire: "Title to real property is acquired, equity is not." *Id.* at 673. *Sainlar* is unpersuasive for the same reasons as is *Blair*. Though the court supplies broad dictionary definitions of acquire and interest,[5] the court does not explain—nor is it evident—why interest so defined cannot include equity, much less why equity cannot be acquired, say by paying down one's mortgage. Also, as in *Blair*, *Sainlar* elided all consideration of the language in § 522(p) that speaks of interest in terms of quantitative economic value, capable of being transferred from one property to another.

ORI contends that the case of *Bankowski v. Aroesty (In re Aroesty)*, 385 B.R. 1 (1st Cir. BAP 2008), too, stands for the proposition that interest means title as opposed to equity. In *Aroesty*, the bankruptcy appellate panel was called upon to decide whether the cap in subsection (p)(1) applied to the debtor's interest in her home, where she had acquired title to that home within the 1,215–day look-back period from a Massachusetts nominee trust that had owned it for the previous seven ***113** years, during all of which she had been the trust's sole beneficiary. Without discussion, the panel construed interest in § 522(p) to mean " 'some legal or equitable interest that can be quantified by a monetary figure,' ... or simply as 'equity in the homestead.' " *Id.* at 7. The panel then stated that because the debtor had obtained "title interest" within the look-back period, and this interest had a value of $406,512, the amount of the debtor's equity in the property, the "title interest" is an interest within the meaning of subsection (p)(1) and therefore subject to the subsection (p)(1) cap. This decision cannot stand for the proposition that interest means title because the definition it employed stated that interest means "equity in the homestead."[6] In any event, the panel was not called upon to apply or construe subsection (p)(2)(B) or its bearing on the meaning of interest in (p)(1). Moreover, the statement of facts in *Aroesty* does not indicate whether the equity that the debtor acquired when she obtained legal title was equity she also had as beneficiary of the trust just prior to the transfer from the trust to her. If, in obtaining legal title, the debtor obtained equity of $406,512 in which she had not previously had an equitable interest as beneficiary, *Aroesty* would have a different meaning than if the acquisition of title was merely a change in the nature of an interest in equity that already existed. For these reasons, I find little guidance in *Aroesty*.

I am satisfied that the majority position is by far the more persuasive, that "interest" in § 522(p) is plain in meaning and can only mean equity. ORI advances three further arguments why I should resist that conclusion.

First, it argues that equity is not something that one can acquire; that is, "acquire" as used in § 522(p)(1) is compatible only with title, not equity. I disagree. As ORI concedes, the verb "to acquire" is not defined in the Bankruptcy Code. The Supreme Court has stated that the plain import of acquired is "obtained as ones' own." *Helvering v. San Joaquin Fruit & Investment Co.*, 297 U.S. 496, 499, 56 S.Ct. 569, 80 L.Ed. 824 (1936). Likewise, Black's Law Dictionary defines acquire as "[t]o gain possession or control of; to get or obtain." Black's Law Dictionary 24 (7th ed. 1999). The use of the word acquire, so defined, is wholly in keeping with these definitions. Equity is that portion of the value of a property that exceeds the mortgages and other encumbrances on the property, the owner's share of its value. The extent of equity varies with two factors: the value of the property and the amount of the debt encumbering it. One acquires equity

by paying down a mortgage or other encumbrance (provided that, after the payment, the value exceeds the remaining encumbrances). As the *Sainlar* court noted, equity "is not a constant, but fluctuates based upon market conditions and when mortgage principal is paid." *In re Sainlar*, 344 B.R. at 673. The fact that equity fluctuates, and does not have the fixity of title, is not reason to conclude that it cannot be acquired. As the court held in *Rasmussen,* a debtor may "acquire" equity within the meaning of § 522(p)(1) by, among other means, making a down payment and paying down the mortgage. *In re Rasmussen,* 349 B.R. at 757.

Second, ORI argues that if the cap in subsection (p)(1) is deemed to apply to mortgage payments that increase equity, it will produce mischievous results. ORI poses ***114** the hypothetical case of a debtor that made a $200,000 balloon payment at the end of a 15–year mortgage within three years of the debtor's bankruptcy filing. The short answer is that where, as here, the language of the statute is clear, the court is not free to consider what Congress may have intended by way of policy results. Much less is a court ever free to construe the statute according to its own appraisal of the policy pros and cons. In any event, § 522(p)(1) allows equity acquired in the 1,215 days to be claimed as exempt to the extent of $155,675. One may safely observe that the cases in which debtors file a bankruptcy petition after having acquired equity in excess of this amount by virtue of ordinary mortgage payments in the previous 1,215 days are exceedingly rare. And few debtors who are capable of funding a $200,000 balloon payment find themselves needing bankruptcy relief within 1,215 days of that payment.

Third, ORI argues that if the cap in § 522(p) applies to mortgage payments that increase equity, then § 522(p) comes "very close" to covering what the Bankruptcy Code already covers in § 522(o), which would render § 522(p) redundant. Section 522(o) states:

> (o) For purposes of subsection (b)(3)(A), and notwithstanding subsection (a), the value of an interest in—
>
> (1) real or personal property that the debtor or a dependent of the debtor uses as a residence;
>
> (2) a cooperative that owns property that the debtor or a dependent of the debtor uses as a residence;
>
> (3) a burial plot for the debtor or a dependent of the debtor; or
>
> (4) real or personal property that the debtor or a dependent of the debtor claims as a homestead;
>
> shall be reduced to the extent that such value is attributable to any portion of any property that the debtor disposed of in the 10–year period ending on the date of the filing of the petition with the intent to hinder, delay, or defraud a creditor and that the debtor could not exempt, or that portion that the debtor could not exempt, under subsection (b), if on such date the debtor had held the property so disposed of.

11 U.S.C. § 522(o). Subsection (o) prevents a debtor from claiming as exempt so much of the value of the four listed types of assets, mostly homestead property, as is attributable to the disposition of non-exempt, or non-exemptible, assets within ten years before the bankruptcy filing with intent to hinder, delay, or defraud a creditor. Its concern is with conversion of non-exempt assets, primarily cash, into exempt homestead property. To be sure, there will be instances in which transfers that trigger the limit in § 522(p)(1) will also trigger the reduction in an otherwise available homestead exemption by operation of § 522(o), but the existence of overlap does not make § 522(p) redundant. Subsection (o) has a ten-year look back, requires proof of intent to hinder, delay, or defraud a creditor, and reduces the otherwise available exemption only by the value of the property disposed of. Subsection (p) has a look-back of only 1,215 days, applies regardless of intent, and, even where it applies, allows the exemption of the acquired interest to the extent of $155,675 plus such further amount as the debtor may qualify for under subsection (p)(2)(B). More to the point, the overlap of these two subsections would exist regardless of whether payment on a mortgage, resulting in an increase in equity, were deemed the acquisition of an interest in subsection (p). Both subsections could still apply to, among other things, the use of non-exempt funds to make the down-payment on a new exemptible homestead. The reach of subsection (o) presents ***115** no cause for treating the acquisition of equity by paydown of a mortgage any differently. Accord, *Parks v. Anderson*, 406 B.R. at 95 (finding no conflict between § 522(o) and § 522(p) in defining "interest" as equity).

For these reasons, I conclude that interest in § 522(p) means equity, including such as is acquired by payment of a mortgage encumbering the homestead.

c. Focus on Most Recent Title Only?

[6] ORI also argues that "[t]he homestead cap imposed by § 522(p)(1) is triggered by the temporal event of the debtor's acquisition of his present interest in the property," and that the language in § 522(p)(2)(B), creating the exception to that cap, is likewise "tied explicitly to the interest acquisition event referenced in § 522(p)(1)." In other words, ORI contends, the exception contemplates a scenario in which a debtor acquires his *present* title through a contemporaneous transfer—or "rollover"—of the proceeds from the sale of a previous residence. Accordingly, "the dispositive acquisition event for the Debtor was his acceptance and recordation of the deed from the Trust the day before the Petition Date," and any alleged rollover by the Debtor occurred well in advance of his acquisition of the Winchester Property and increased the equity position of the trust, not of the Debtor.

The Trustee takes this same position, albeit with less elaboration, arguing that the safe harbor in subsection (p)(2)(B) is unavailable because the proceeds from the previous residence were not used to acquire the title that the debtor held when he filed his bankruptcy petition, the "interest" he now seeks to claim as exempt.

In response, the Debtor argues that "interest" means equity, not title, that he first acquired the equity in question with the proceeds from sale of the previous residence (by virtue of the mortgage paydown), and that the change in the form of his title, which effected no change in the extent of his equity in the property, was therefore insignificant for purposes of subsection (p)(2)(B). He held the same equity—and therefore the same amount of interest—continuously, albeit in two different forms, from the time of the mortgage paydown through the date of the bankruptcy filing. The Debtor also emphasizes that the abuses that § 522(p)(1) was designed to prevent simply do not exist here: his transfer of equity from the previous residence to the current did not increase the extent to which the equity in the former residence could be claimed as exempt.

In considering this issue, I emphasize that this matter is before me as if on a motion to dismiss for failure to state a claim on which relief can be granted. The question is whether the Debtor has pled facts on which he might plausibly be entitled, under subsection (p)(2)(B), to except his "interest" in the homestead property from the cap in subsection (p)(1). At this juncture, I do not know what the evidence will show about the nature of the trust that held title to the property when the transfer in question was made, or about the extent of the debtor's beneficial interest in and control over that trust during the relevant period. For present purposes, I must accept as true what the Debtor has alleged: that, from the date on which he and his wife used proceeds from sale of the previous residence to pay down the mortgage on the current residence, he and his wife were at all times the only beneficiaries of the trust, and that the subsequent conveyance from the trust to him and his wife as tenants by the entirety did not increase the extent of his equity in the property.

***116** My starting point is again with the words of the statute, and specifically with my holding above that, in § 522(p), interest means equity. On the facts alleged, the Debtor acquired his interest, his equity, by paydown of the mortgage. At that time, he had a beneficial interest in the trust that owned the property, and he had equity in the property by virtue of that beneficial interest in the trust. When the trust later conveyed the property to the Debtor and his wife as tenants by the entirety, his title changed, but the extent of his equity did not. That is, the conveyance was not an event by which equity was acquired. It effected a change only in the manner in which the Debtor held equity that he had acquired earlier.

Nothing in subsection (p)(1) or (p)(2)(B) compels a focus on events that follow the acquisition of equity and affect only the manner in which previously acquired equity is held. Subsection (p)(1) looks only for "any amount of interest that was acquired by the debtor ... in real or personal property that the debtor or a dependent of the debtor uses as a residence" or "claims as a homestead." 11 U.S.C. § 522(p)(1)(A) and (D). And subsection (p)(2)(B) excludes from the (p)(1) cap such "amount of interest"—that is, of equity—as was "transferred from a debtor's previous principal residence into the debtor's current principal residence." 11 U.S.C. § 522(p)(2)(B). Notably, this subsection requires only a transfer "into the debtor's current principal residence"; it does not require that the transfer have funded the acquisition of the current form of title of the current principle residence. The argument advanced here by ORI and the Trustee require that

I read into § 522(p)(2)(B) a requirement that simply is not there.

Nor should this be surprising. As the Debtor points out, the abuses that § 522(p)(1) was designed to prevent simply do not exist here. In the transfer at issue, the Debtor did not convert non-exempt assets into exemptible form. Rather, equity in the prior residence became equity in a new residence in the same state, precisely the kind of transfer that subsection (p)(2)(B) was designed to protect. This transfer did not improve the Debtor's position vis-à-vis his creditors. I do not rely on this legislative history to resolve ambiguity in the statute; the statute is clear that interest means equity and that the focus of the statute is on events by which a debtor acquires equity. The legislative intent merely shows that there is no reason to read into the statute a requirement that is not in the statutory language.

[7] To my knowledge, this issue has been dealt with in only one other case—as it happens, a case from this district.[7] In *In re Welch*, 486 B.R. 1 (Bankr. D. Mass. 2013), the court was faced with a debtor who, long before commencement of the 1,215–day look-back period, first acquired ***117** title to her homestead in her own name. Within the look-back period, however, she transferred the property to a trust, a Massachusetts nominee trust, of which she was both trustee and holder of ninety-nine percent of the beneficial interest. Her minor son held the remaining one percent. Then, approximately three months before the bankruptcy filing, the Debtor caused her son to transfer his beneficial interest to her, which consolidated all legal and beneficial interest in her. In her bankruptcy case, she claimed her equity in the homestead, some $294,916, as fully exempt. The trustee objected, arguing that the exemption was limited by § 522(p)(1) to $146,450[8] because, under Massachusetts law, the son's transfer of his interest to the debtor effected a merger of all legal and equitable interest that terminated the trust by operation of law and effected a transfer of title to the property from the trust to the debtor on the date of merger, resulting in the debtor's "acquisition" of her entire "interest" in the Andover property within the lookback period.[9] In material part, Judge Hoffman held that even if the merger effected an "acquisition" by the debtor within the meaning of subsection (p)(1), the "interest" so acquired would have been only the one percent of beneficial interest in the property that she had not previously held.

> Before the transfer the value of the trust res would have been shared by Ms. Welch and her son 99% and 1% respectively. With the transfer of the 1% Ms. Welch did not suddenly see the value of her interest increase from 0% to 100% but rather from 99% to 100%.

In re Welch, 486 B.R. at 4–5. Judge Hoffman went on to find that the value of this one percent of total equity in the property was much less than the statutory limit, and he consequently concluded that subsection (p)(1) required no disallowance of any portion of the claimed exemption. The case thus stands for the proposition that a simple change in the form of title to equity that a debtor already owns is not an acquisition of interest within the meaning of subsection (p)(1).

The same issue was raised on appeal in *Khan v. Bankowski*, 375 B.R. 5 (1st Cir. BAP 2007), where the property was held for nine years in a family trust of which debtor and his brother were trustees and the only beneficiaries, then transferred by the trust to the debtor and his brother as joint tenants within 1,215 days of bankruptcy filing. The evidence below did not include the trust or indicate the proportion of the debtor's interest in it or that it was a nominee trust. The bankruptcy appellate panel ruled that, because the debtor had not made the argument below (that the title he acquired upon transfer from the trust did not result in acquisition of any new interest in the property), he could not make it on appeal, and that where he had submitted no evidence of the nature and extent of his interest in the trust, the bankruptcy court had properly concluded that he had acquired his interest upon transfer from the trust. The *Khan* panel was therefore not required to, and did not, consider whether a mere change in the form of title to equity that a debtor already owns is not an acquisition of interest within the meaning of subsection (p)(1). However, *Khan* at least stands for the proposition that a debtor advancing this argument—that an acquisition of title did not constitute an acquisition of interest because the debtor already held that interest ***118** in a different form—bears the burden of proving the nature and extent of the interest he or she held at the time—and I agree.

The three acquisition-of-homestead cases, all discussed above, though not squarely on point, are nonetheless helpful.

In re Rogers, 354 B.R. 792, 798 (N.D. Tex. 2006); *In re Reinhard*, 377 B.R. 315, at 320 (Bankr. N.D. Fla. 2007); and *In re Lyons*, 355 B.R. 387, 390–91 (Bankr. D. Mass. 2006). In each, the court held that a debtor's acquisition of homestead protection for his or her property under state law was not an acquisition of interest within the meaning of subsection (p)(1). These courts reasoned that "interest" is concerned with the quantitative and monetary value in property to the debtor. The courts were not blind to the fact that, under the state law pertinent to each case, "homestead" status added to the bundle of sticks that define a debtor's title to the property, but each court held that the modification in property rights, the new sticks in the bundle, added nothing to the value of the property to the debtor and therefore was not an acquisition of new interest under § 522(p). Of course, the acquisition of a fee interest, when one has had no interest, *does* add to the value of the property to the debtor in a way that the addition of homestead status does not. However, when the debtor previously had equity in the property under one form of title (whether legal or equitable) and then acquired a new form of title to the same equity, the new title carries with it no more new interest than does the addition of homestead status (indeed sometimes less). I therefore find support in these cases for the proposition that a change in title that does not increase a debtor's equity is not an acquisition of interest within the meaning of § 522(p)(1).

In the facts pled by the Debtor, he acquired equity as a beneficiary of the trust when he used proceeds from the previous residence to pay down the debt on the current residence; and the later conveyance effected no change in the extent of his equity. I hold that, on these facts, the later conveyance would not disqualify the Debtor from relief under subsection (p)(2)(B), and therefore that the Debtor has pled a plausible basis for relief under that subsection.

d. Other Arguments

[8] **[9]** The parties have also advanced other arguments that can be more quickly addressed. First, the Trustee has argued that the proceeds from the previous residence could not have paid down the mortgage on the current residence because the mortgage had not yet been recorded at the time of the payment. The Trustee is inferring that, because the mortgage had not been recorded at the time of the payment, the mortgage was not then in existence. I agree with the premise of the Trustee's argument: that in order for the paydown of the loan from Dikran to have constituted an acquisition of equity, the loan needs to have been secured by an existing mortgage at the time, the mortgage being, in essence, a grant of title to secure payment of the loan. However, I disagree with the Trustee that, in order for the mortgage to have come into being, it needed to have been recorded. Recording perfects the mortgagee's rights against certain third parties (such as subsequent purchasers from the mortgagor) but adds nothing to the mortgagee's rights against the mortgagor. As between mortgagor and mortgagee, a mortgage is effective upon delivery and acceptance.

[10] Second, the Trustee suggests that the safe harbor of subsection (p)(2)(B) cannot shelter the equity acquired by the paydown because, at no time prior to the eve of bankruptcy was either the prior ***119** residence or the current residence protected by a Massachusetts homestead exemption greater than $125,000 in value; an exemption in the amount of $500,000 would have required the recording of a declaration of homestead, and, the Trustee maintains, no declaration of homestead was filed as to either residence until the eve of bankruptcy, after the property had been conveyed by the Trust to the debtor and his wife. This argument, which the Trustee never fully develops, lacks merit because subsection (p)(2)(B) includes no requirement that the equity transferred from the prior residence to the current residence have been exempt or even exemptible at the time of the transfer.

Third, ORI has suggested that the safe harbor of subsection (p)(2)(B) should be unavailable to the Debtor because the Debtor and his wife held their current residence, including their equity in it, in a trust for a time. ORI argued that the Congressional intent behind § 522(p)(1) was to guard against the "shenanigans" of a debtor's transferring property into a trust and then back to the debtor again. When asked, however, ORI was unable to point to evidence in the legislative history that concern for transfers of this kind informed the enactment § 522(p)(1). I am aware of no such purpose and see no reason in the language of subsection (p)(2)(B) to make its benefits unavailable to debtors who have held their "amount of interest" through a trust. [10]

Fourth, the Debtor has argued that, even if the Debtor were not entitled to the full $500,000 exemption, his wife would separately be able to shelter that full amount for the benefit of her family. That argument, whatever its merits, is presently irrelevant. The Trustee is not at present seeking to liquidate this property for the benefit of creditors. Rather, the purpose of the present objection is simply to determine the extent to

which the Debtor's equity in the current residence is, by the Debtor's claim of exemption, excluded from the bankruptcy estate. [11]

CONCLUSION

For the reasons set forth above, the Debtor's recourse to subsection (p)(2)(B) is not barred as a matter of law. The Court will schedule an evidentiary hearing on the matter.

All Citations

566 B.R. 102

Footnotes

1 The parties' joint statement of undisputed facts identifies the end of the period indeterminately, as "sometime prior to December 8, 2014." I understand this choice of words to indicate uncertainty about only the precise date on which the Debtor and his wife moved from the Arlington Property to their current principal residence. No one contends that the Debtor and his wife had another principal residence between the time that they occupied the Arlington Property in 2000 and the time that they moved into their current principal residence.

2 I understand that the Trustee and ORI concede the fact of the transfer effected by this check but do not concede (i) that the funds it transferred were proceeds from sale of the Arlington Property or (ii) that the payment was made to pay down the $800,000 loan by which Dikran had enabled the Debtor and his wife to purchase the Winchester Property.

3 This dollar amount is adjusted every three years by the Judicial Conference of the United States. On April 1, 2016, the dollar amount increased to $160,375. This case was commenced on August 21, 2015 and, as of that date, the dollar amount was $155,675. This case is governed by the limit in place on the date of its commencement.

4 It does not apply to property exempted under § 522(b)(3)(B), which permits a debtor to exempt, in addition to the property specified in subsection (b)(3)(A), "any interest in property in which the debtor had, immediately before the commencement of the case, an interest as a tenant by the entirety or joint tenant to the extent that such interest as a tenant by the entirety or joint tenant is exempt from process under applicable nonbankruptcy law[.]" Here, it is uncontroverted that the Debtor had, immediately before the commencement of the case, an interest in his principal residence as a tenant by the entirety. However, he did not cite the tenancy by the entirety as a basis for his claim of exemption; he has invoked only the Massachusetts homestead statute. I express no opinion on the extent to which the tenancy by the entirety may afford him an alternate or additional basis for exempting the same property.

5 "The plain import of the word [acquired] is "obtained as one's own." Black's Law Dictionary sets forth "acquire" means: "[t]o gain possession or control of; to get or obtain." "Interest" is defined as "[a] legal share in something; all or part of a legal or equitable claim to or right in property."" *In re Sainlar*, 344 B.R. at 672–73.

6 In fact, the "definition" was two definitions, and the other used the word it defined in the definition. The panel did not indicate how it reconciled its decision with the intricacies of its double definition.

7 It appears that this argument was not made in the *Aroesty* case, discussed above, though the facts would have lent themselves to it. The debtor had acquired title to her home within the 1,215–day look-back period from a Massachusetts nominee trust that had owned it for the previous seven years, during all of which time she had been the trust's sole beneficiary. The bankruptcy appellate panel held that by the transfer from

the trust, the debtor had acquired "title interest," and this triggered application of the § 522(p)(1) cap. The Debtor had argued that an individual who owns a beneficial interest in the subject property beyond the 1,215–day period and later becomes the title owner, does not acquire an "interest" by recording a declaration of homestead during the requisite period. The Debtor had apparently not argued, and the panel did not address (at least not expressly), whether, because she had had beneficial interest in property through the trust until she acquired legal title, the acquisition of title was not an acquisition of interest within the meaning of subsection (p)(1).

8 This was the limit imposed by subsection (p)(1) at the time.

9 The bankruptcy trustee evidently did not argue, and the court certainly did not address, whether and to what extent the earlier transfer from the debtor to the trust, within the look-back period, triggered the § 522(p)(1) cap.

10 To be clear, ORI does not contend that the decisions by the Debtor and his wife to hold their current property in a trust and then to convey it back to themselves were nefarious in any way, only (apparently) that the statute was drafted to limit the exemptibility of property so held and transferred regardless of actual intent.

11 The parties expect that this issue will be pertinent to the ability of the Debtor to propose a plan that satisfies the requirement in 11 U.S.C. § 1325(a)(4), the so-called "best interest of creditors test." I make no determination about the extent of rights of the Debtor's wife or of the relevance of those rights to the § 1325(a)(4) inquiry.

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KeyCite Yellow Flag - Negative Treatment
Disagreed With by In re Nestlen, 10th Cir.BAP (Okla.), December 21, 2010

349 B.R. 747
United States Bankruptcy Court,
M.D. Florida,
Tampa Division.

In re Alfred Thomas RASMUSSEN
and Billie Jo Rasmussen, Debtors.

No. 8:05–bk–20277–MGW.
|
Sept. 8, 2006.

Synopsis

Background: Chapter 7 trustee objected to debtors' claim of homestead exemption.

Holdings: The Bankruptcy Court, Michael G. Williamson, J., held that:

[1] Bankruptcy Code provision imposing cap on homestead exemption claimed by debtor in property acquired during 1215-day prepetition period applies in Florida;

[2] debtors had total homestead exemption of $250,000;

[3] as used in bankruptcy statute imposing homestead exemption cap, term "interest" means equity in the homestead acquired by debtor during 1215–day period; and

[4] for purposes of exemption cap, "amount of interest that was acquired" by debtors in their residence during 1215-day prepetition period did not include appreciation that occurred during such time.

Objection overruled.

West Headnotes (20)

[1] **Bankruptcy** Validity and effect of opt-out legislation

Bankruptcy Waiver or Loss of Exemption

Bankruptcy Code provision imposing cap on homestead exemption claimed by debtor in property acquired during 1215-day prepetition period applies in Florida, notwithstanding that, in Florida, an individual has no right to elect between federal and state exemptions under Florida law. 11 U.S.C.A. § 522(p); West's F.S.A. Const. Art. 10, § 4; West's F.S.A. § 222.20.

[2] **Bankruptcy** Waiver or Loss of Exemption

Effect of bankruptcy statute imposing cap on homestead exemption claimed by debtor in property acquired during 1215-day prepetition period is that value of homestead derived from any money in excess of $125,000 cap which is put into relatively recently acquired homestead will not be exempt in debtor's bankruptcy case. 11 U.S.C.A. § 522(p).

[3] **Bankruptcy** Waiver or Loss of Exemption

Under bankruptcy statute imposing cap on homestead exemption claimed by debtor in property acquired during 1215-day prepetition period, homestead value acquired by debtor from money derived from sale of exempt assets, other than a prior homestead, is not exempt. 11 U.S.C.A. § 522(p).

[4] **Exemptions** Debtors or defendants

Under Florida law, each debtor gets to claim exemptions separately.

[5] **Bankruptcy** Validity and effect of opt-out legislation

"Stacking" of federal exemptions on top of state exemptions by joint debtors is not permitted under Bankruptcy Code. 11 U.S.C.A. § 522(b)(1).

3 Cases that cite this headnote

[6] **Bankruptcy** Validity and effect of opt-out legislation

Bankruptcy Waiver or Loss of Exemption

Whether, in case involving joint petition, only one debtor may claim homestead exemption or whether both debtors may do so separately, and thus whether, for purposes of Bankruptcy Code's homestead exemption cap, "a debtor" is to be considered in the singular or plural, is a matter of state exemption law in opt-out states. 11 U.S.C.A. §§ 102(7), 522(p); Fed.Rules Bankr.Proc.Rule 1015, 11 U.S.C.A.

1 Cases that cite this headnote

[7] **Homestead** Existence of more than one homestead

Homestead Debtors or defendants

Florida allows joint debtors to both claim homestead exemptions.

4 Cases that cite this headnote

[8] **Bankruptcy** Joint debtor's election

Bankruptcy Co-debtors; stacking

In the case of non-opt-out states, the rights of individual debtors who are spouses to claim their exemptions separately is protected through Bankruptcy Code provision indicating that, generally, bankruptcy exemption statute applied separately with respect to each debtor in a joint case. 11 U.S.C.A. § 522(m).

5 Cases that cite this headnote

[9] **Bankruptcy** Co-debtors; stacking

Provision of Bankruptcy Code's exemption statute indicating that statute applies separately with respect to each debtor in joint case does not create any rights under state laws that do not otherwise exist. 11 U.S.C.A. § 522(m).

5 Cases that cite this headnote

[10] **Homestead** Existence of more than one homestead

Homestead Family relation in general

Under Florida law, married spouses residing in separate residences may claim a homestead for each residence only if they legitimately live apart in separate residences. West's F.S.A. Const. Art. 10, § 4.

1 Cases that cite this headnote

[11] **Bankruptcy** Co-debtors; stacking

Bankruptcy Waiver or Loss of Exemption

Provision of Bankruptcy Code's exemption statute indicating that statute applied separately with respect to each debtor in joint case applied to same statute's provision imposing cap on homestead exemption claimed by debtor in property acquired during 1215-day prepetition period, such that joint debtors' homestead exemption, which was unlimited as to value under Florida law, was limited to $125,000 as to each debtor for property acquired in 1215-day prepetition period, resulting in total exemption for joint debtors in amount of $250,000. 11 U.S.C.A. § 522(m, p); West's F.S.A. Const. Art. 10, § 4.

8 Cases that cite this headnote

[12] **Bankruptcy** Waiver or Loss of Exemption

As used in provision of Bankruptcy Code's exemption statute imposing limit on debtor's exemption of interest in homestead property acquired by debtor during 1215-day prepetition period, term "interest" means equity in the homestead acquired by debtor during 1,215–day period. 11 U.S.C.A. § 522(p)(1), (p)(2)(B).

7 Cases that cite this headnote

[13] **Statutes** Defined terms; definitional provisions

Common rule of statutory construction is that a single definition of common words must be used in the same section of the same enactment.

[14] **Statutes** Wisdom, practicality, and common sense

Statutes should be read in a straightforward and commonsense manner.

[15] **Statutes** Superfluousness

Courts generally disfavor statutory interpretations that render language superfluous.

[16] **Bankruptcy** Waiver or Loss of Exemption

Monthly principal amortization constituting the acquisition of equity within the 1215–day prepetition period counts against permitted $125,000 homestead exemption for individual debtor under bankruptcy statute imposing limit on debtor's exemption of interest in homestead property acquired by debtor during 1215-day prepetition period. 11 U.S.C.A. § 522(p).

4 Cases that cite this headnote

[17] **Bankruptcy** Proceedings

In deciding whether appreciation of Chapter 7 debtors' residence that occurred within 1215-day prepetition period qualified as interest acquired by debtors for purposes of bankruptcy statute capping homestead exemption for interests in property acquired by debtor during 1215-day prepetition period, bankruptcy court would take judicial notice of the fact that, for a conventional 30–year mortgage at an interest rate of seven percent to exceed a principal pay down of more than $125,000 over a 1215–day period, the principal amount of the mortgage would have to be approximately $3,400,000, requiring payments of more than $22,000 per month. 11 U.S.C.A. § 522(p).

8 Cases that cite this headnote

[18] **Bankruptcy** Waiver or Loss of Exemption

For purposes of bankruptcy statute imposing cap on homestead exemption claimed by debtor in interest in property acquired during 1215-day prepetition period, "amount of interest that was acquired" by Chapter 7 debtors in their residence during 1215-day prepetition period did not include appreciation that occurred during such time period, which did not result from any act of debtors; rather, pertinent interest in property acquired by debtors consisted of equity resulting from rollover of equity derived from sale of prior homestead and cash paid at closing of sale. 11 U.S.C.A. § 522(p).

10 Cases that cite this headnote

[19] **Bankruptcy** Waiver or Loss of Exemption

That debtor's homestead may have appreciated substantially in value during 1215–day prepetition period does not constitute the acquisition of an interest in debtor's homestead for purposes of bankruptcy statute imposing cap on homestead exemption claimed by debtor in interest in property acquired during 1215-day prepetition period. 11 U.S.C.A. § 522(p).

12 Cases that cite this headnote

[20] **Statutes** Purpose and intent; determination thereof

Statutes Plain, literal, or clear meaning; ambiguity

Although, as a general proposition, a court should not resort to legislative history when statutory text is clear, when a statute is vague or ambiguous an examination of the act's purpose and of its legislative history is appropriate.

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MEMORANDUM DECISION AND ORDER OVERRULING TRUSTEE'S OBJECTION TO DEBTORS' HOMESTEAD EXEMPTION

MICHAEL G. WILLIAMSON, Bankruptcy Judge.

Under Florida law, debtors have an unlimited homestead exemption. However, new section 522(p) of the Bankruptcy Code[1] now caps the amount of a homestead exemption at $125,000 if a debtor acquires an interest in a homestead within 1,215 days of filing for bankruptcy. The debtors in this case acquired their homestead within 1,215 days of the date they filed their joint petition for bankruptcy. The chapter 7 trustee ("Trustee") objected to the debtors' claim of a homestead exemption based on section 522(p). Section 522(m) provides that the provisions of section 522, which includes section 522(p), shall apply separately with respect to each debtor in a joint case. Accordingly, each Debtor in this joint case may separately claim a homestead exemption of $125,000 for a total exemption of $250,000. Because the Debtors' equity in their homestead was less than $250,000 on the date of the petition, the Trustee's objection is overruled.

In addition, to the extent that equity in the homestead at the time of the petition resulted from appreciation, such appreciation does not constitute an interest that was acquired by the debtor within the meaning of section 522(p). Because the Trustee's objection depends on a construction of section 522(p) that would include appreciation as part of the interest acquired within the 1,215–day period, the Trustee's objection is overruled on that ground as well.

I. *Factual Background*

The debtors in this joint chapter 7 case, Alfred Thomas Rasmussen and Billie Jo Rasmussen ("Debtors"), claimed their homestead in Sarasota, Florida ("Homestead") as exempt under article X, section 4 of the Florida Constitution. The Debtors purchased their Homestead for approximately $350,000 on June 7, 2002, and filed their petition on September 28, 2006—1,210 days after acquiring their homestead. The Debtors funded the purchase by using approximately $35,000 rolled over from the sale of Mr. Rasmussen's previous homestead located in Longboat Key, Florida, additional cash of approximately $1,800, and a $320,300 loan from a bank.

According to the Debtors' Schedule A, the Homestead had a value of $750,000 as of the petition date, reflecting appreciation of approximately $400,000 since its purchase. Schedule D lists mortgage debts in the aggregate amount of approximately $575,000 secured by the Homestead. There is no dispute that as of the petition ***751** date the Debtors' equity in their Homestead was approximately $175,000.

The Trustee filed an objection to the Debtors' homestead exemption (Doc. No. 11)("Objection") relying upon new section 522(p) of the Bankruptcy Code, which applies to a homestead acquired during the 1,215–day period preceding the date of filing of a bankruptcy petition. Based on this provision, the Trustee contends that the Debtors are allowed to claim only a single $125,000 exemption of their Homestead plus any amount rolled over from a previous homestead. Thus, under the Trustee's theory, after deducting the mortgage debt, the amount rolled over from Mr. Rasmussen's previous homestead, and the $125,000 allowed under section 522(p), at least $13,000 would be property of the estate. However, the Debtors argue that each spouse may claim the $125,000 exemption, allowing for a "stacked" exemption of $250,000, which would leave nothing for the estate. Alternatively, the Debtors contend that equity appreciation is not an interest that was acquired by them during the 1,215–day period, and, therefore, section 522(p) provides no remedy to the Trustee in this case.

II. *Issues*

The issues raised by the Objection and the Debtors' response are: 1) whether the Debtors may "stack" the $125,000 exemption under section 522(p) and receive a total joint exemption of $250,000; and 2) whether the increase in value of the Homestead attributable to appreciation falls within the section 522(p) cap.

III. *Jurisdiction*

This court has jurisdiction of this matter under 28 U.S.C. sections 157 and 1334(b). This is a core proceeding pursuant to 28 U.S.C. section 157(b)(2)(B).

IV. *Conclusions of Law*

A. Operation of Section 522(p)

On April 20, 2005, Congress enacted the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ("BAPCPA"). Although the bulk of BAPCPA went into effect on October 17, 2005, new section 522(p)—the section at issue here—became effective immediately. Because the Debtors filed their petition on September 28, 2005, section 522(p) applies to this case.

Section 522(p) provides that "a debtor may not exempt any amount of interest [in homestead property] that was acquired by the debtor during the 1215–day period preceding the date of filing of the petition that exceeds in the aggregate $125,000 in value...." By its terms, this provision becomes applicable "as a result of electing ... to exempt property under State ... law...." In this regard, section 522(b)(1) provides to an individual debtor an election under which the debtor may exempt property either under the federal exemptions set forth in section 522(d) or under the applicable state and non-bankruptcy federal exemptions. 11 U.S.C. §§ 522(b)(2), 522(b)(3)(2005). [2]

***752** A debtor's right to elect the federal exemptions set forth in section 522(d) is, however, subject to an important limitation. The choice of federal exemptions under section 522(d) is not available to debtors in states where "State law ... specifically does not so authorize."

Florida law provides that Florida residents "shall not be entitled to federal exemptions in § 522(d)...." Fla. Stat. Ann. § 222.20 (West 2006). This is commonly referred to as the "opt-out" provision. The result of Florida's opt-out is that Florida residents do not have an election to use the federal exemptions under subsection (b)(3)(A). Rather, they are restricted to state law exemptions by subsection (b)(2), which authorizes states to opt out, and the Florida "opt-out" provision. The lack of an election to choose between federal and state exemptions in opt-out states led at least one court to conclude that section 522(p) does not apply to residents of opt-out states such as Florida because it is predicated on the exercise of an "election" that Florida residents do not have. *In re McNabb,* 326 B.R. 785, 789–790 (Bankr.D.Ariz.2005). The issue of the applicability of subsection (p) of section 522 in opt-out states such as Florida has been considered by a number of courts since the decision in *McNabb.* These courts have generally rejected the rationale and holding of McNabb. *See, e.g., In re Kane,* 336 B.R. 477, 481–482 (Bankr.D.Nev.2006)(holding that section 522(p) was designed to close "the 'millionaire's mansion' loophole in the current bankruptcy code that permits corporate criminals to shield their multi-million dollar homesteads"); *In re Virissimo,* 332 B.R. 201, 207 (Bankr.D.Nev.2005).

[1] Florida courts considering the issue have uniformly rejected *McNabb. See In re Buonopane,* 344 B.R. 675, 677 (Bankr.M.D.Fla.2006); *In re Landahl,* 338 B.R. 920, 921 (Bankr.M.D.Fla.2006); *In re Wagstaff,* 2006 WL 1075382 *2 (Bankr.S.D.Fla. Mar.17, 2006); *In re Wayrynen,* 332 B.R. 479, 484 (Bankr.S.D.Fla.2005); *In re Kaplan,* 331 B.R. 483, 484 (Bankr.S.D.Fla.2005). This Court is in full agreement with the analysis contained in the Florida decisions dealing with this issue and concludes that subsection 522(p) applies in Florida, notwithstanding the fact that, in Florida, an individual has no right to elect between federal and state exemptions by virtue of Florida Statutes section 222.20.

Turning then to the terms of section 522(p)—as an initial observation, it is clear ***753** that a debtor's intent to shield property from creditors is not a factor. In fact, in light of section 522(*o*), which deals with such intent, section 522(p) is not designed to deal with fraudulent conversions of property at all. It is simply a cap to be applied in cases in which a debtor happens to have acquired an interest in a homestead within the three years and four months prior to filing bankruptcy.

[2] [3] Simply stated, the effect of section 522(p) is that the value of the homestead derived from any money in excess of $125,000 that is put into a relatively recently acquired homestead will not be exempt in the debtor's bankruptcy. The only exception to the $125,000 cap is for money derived and rolled over from the sale of a prior homestead within the state of Florida. 11 U.S.C. § 522(p)(2)(B)(2005). Thus, homestead value acquired by the debtor from money derived from the sale of even exempt assets, other than a prior homestead, is also not exempt.

While the operation of this provision seems straightforward, left unclear are the issues in this case: (1) whether both spouses in a joint case have the right to each exempt $125,000 of equity in a homestead, and (2) whether appreciation that occurred during the 1,215–day period counts toward the $125,000 cap.

> Prior to entering an order the court shall give consideration to protecting creditors of different estates against potential conflicts of interest. An order directing joint administration of individual cases of a husband and wife shall, if one spouse has elected the exemptions under section 522(b)(1) [federal exemptions under section 522(d)] and the other has elected the exemptions under section 522(b)(2)[state exemptions], fix a reasonable time within which either may amend the election so that both shall have elected the same exemptions.

B. Stacking of the Homestead Exemption

[4] The concept of joint debtors "stacking" the $125,000 exemption for each spouse may initially seem contrary to the much-publicized $125,000 cap set forth in revised section 522 and discussed in the legislative history. It is not, however, inconsistent with current practice under Florida law and the Bankruptcy Code governing other exemptions. In this respect, it is clear under Florida law that each debtor gets to claim exemptions separately. For example, each spouse is entitled to the constitutional exemption for $1,000 of personal property even though the personalty is jointly owned, resulting in an aggregate exemption of $2,000. Fla. Const. art. X, § 4(a)(2); *In re Howe,* 241 B.R. 242, 245 (Bankr.M.D.Fla.1999); *In re Moody,* 241 B.R. 238, 241 (Bankr.M.D.Fla.1999). Likewise, each spouse is entitled to a $1,000 exemption for an automobile. Fla. Stat. § 222.25(1) (2006).

The separateness of the husband and wife for bankruptcy purposes is recognized in section 302, "Joint Cases," which, while allowing a joint petition, provides that "[a]fter the commencement of a joint case, the court shall determine the extent, if any, to which the debtors' estates shall be consolidated." This section is implemented by Rule 1015, Federal Rules of Bankruptcy Procedure, which provides that if a joint petition is pending by a husband and wife, the court may order a joint administration of the estates. Rule 1015 provides in pertinent part as follows:

Fed. R. Bankr.P. 1015(b).

[5] This rule recognizes that each spouse has the right to choose the available exemptions with the only restriction that the spouses must agree to either the federal exemptions or the state exemptions; that is, "stacking" of federal exemptions ***754** on top of state exemptions is not permitted. 11 U.S.C. § 522(b)(1). In this district, Rule 1015 is implemented by Local Rule 1015–1, which provides that if a joint petition is filed by a husband and wife, the trustee shall administer their estates jointly without order of the court subject to the right of a party to move for an order of separate administration.

[6] [7] There is nothing in the language of section 522(p) that would indicate a contrary result. That section clearly says "a" debtor is subject to the cap. Although section 102(7) provides that "the singular includes the plural," whether only one debtor may claim the exemption or whether both debtors may do so separately—and thus whether a debtor is to be considered in the singular or plural—is a matter of state exemption law in opt-out states. *First Nat'l. Bank of Mobile v. Norris,* 701 F.2d 902, 905 (11th Cir.1983). In this case, as discussed above, Florida allows both debtors to claim homestead exemptions.

Interestingly, for most of its history, Florida law provided otherwise. That is, Florida used to restrict the homestead exemption to the head of a household. This archaic practice was repealed in a 1985 amendment to the Florida Constitution. Now each spouse, regardless of head of household status, may claim a homestead. *See, e.g.,* *Snyder v. Davis,* 699 So.2d 999, 1002 (Fla.1997); *Public Health Trust of Dade County v. Lopez,* 531 So.2d 946, 948 (Fla.1988).

[8] In the case of non-opt-out states, the rights of individual debtors who are spouses to claim their exemptions separately is protected through the application of section 522(m). This provision provides that "[s]ubject to the limitation in subsection (b), this section shall apply separately with respect to each debtor in a joint case." 11 U.S.C. § 522(m). Section 522(m) is, by its terms, subject to the limitation imposed by subsection (b), but that limitation simply prohibits the stacking that could otherwise occur in non-opt-out states if one spouse were to choose the section 522(d) exemptions provided by the Bankruptcy Code and the other were to choose the state exemptions and federal exemptions available outside section 522(d).

[9] The Eleventh Circuit has concluded that the reference in section 522(m) to "this section" means to section 522, which includes the federal exemptions in section 522(d), and thus applies to debtors claiming federal exemptions in non-opt-out states. *Norris,* 701 F.2d at 905 ("[b]ecause section 522(m) applies only to 'this section,' 11 U.S.C. § 522, it neither applies to Alabama exemptions nor conflicts with the Alabama provision allowing only one homestead exemption to joint debtors."). Accordingly, section 522(m) does not create any rights under state laws that do not otherwise exist. For example, in *Norris* the Eleventh Circuit held that applicable Alabama law limiting debtors to a single $2,000 homestead exemption would apply in bankruptcy and not be controlled by section 522(m)(which is restricted by its terms to the provisions contained in section 522). *Norris,* 701 F.2d at 905.

[10] But, unlike Alabama law, Florida law contains no specific limitation as to the right of either spouse to claim a homestead exemption in an unlimited amount under article X, section 4 of the Florida Constitution and, indeed, provides an express entitlement to each. That is not to say that Florida law contains no restrictions on the availability of its unlimited homestead exemption. For example, married spouses residing in separate residences may claim a homestead for each residence only if they legitimately live apart in separate residences. ***755** *In re Colwell,* 196 F.3d 1225, 1226 (11th Cir.1999); *Law v. Law,* 738 So.2d 522, 524 (Fla. 4th DCA 1999). Further, although there is no Florida authority for each spouse to separately claim 160 acres in the same parcel for a total of 320 acres, other states dealing with this issue have generally rejected debtors' attempts to double up on acreage. *See, e.g.,* *In re Arnold,* 73 P.3d 861, 865 (Okla.2003); *Commerce Bank of Kansas City v. Odell,* 16 Kan.App.2d 704, 827 P.2d 1205, 1209 (1992).

The Trustee's argument in this case is premised in large part on how courts generally have viewed debtors' attempts to double up on limited homestead monetary exemptions. A number of states restrict the right of debtors to double up on the value of a homestead either by statute[3] or by case law.[4] And just as in *Norris,* because of the limitation of section 522(m)'s reference to "this section"—referring to section 522 and thus making it inapplicable to state law exemptions—section 522(m) is not available to alter the outcome under state law.

The Trustee's attempt to extend the logic of these cases to this case is not persuasive, however, because unlike the states referenced above that have limitations in the value of a homestead for exemption purposes, Florida's homestead exemption is unlimited in amount. Importantly, the only limitation to the right of a Florida debtor to exempt an unlimited amount of homestead in value is found in section 522(p).

[11] Accordingly, section 522(m)'s reference to "this section" makes clear that section 522(m) applies to new section 522(p), the provision limiting the homestead exemption. Thus, under section 522(m), section 522(p) "shall apply separately with respect to each debtor in a joint case." And while Florida residents each have a homestead exemption unlimited as to value under applicable Florida

law, that value is limited to $125,000 by section 522(p) applied "separately with respect to each debtor in a joint case." 11. U.S.C. § 522(m)U.S.C. § 522(m); *see also* 4 Collier on Bankruptcy ¶ 522.13[4], at 522–102.8–522–102.9 (rev. 15th ed.2006)(noting the "absence in the 2005 Act of any express or implied limitation on section 522(m)section 522(m)" in reference to its application to 522(p)); 2 Norton Bankr.L. & Prac.2d § 46:4 (2006). In this case, the result of applying section 522(p)section 522(p) separately to each debtor is to limit the homestead exemption for each to a separate $125,000 for a total exemption for the joint debtors in the amount of $250,000.

C. Appreciation Does Not Count Toward the $125,000 Cap

The Trustee contends that the interest in the Homestead that the Debtors acquired during the 1,215–days prior to the petition includes appreciation. Consideration of this argument requires an interpretation of the wording of the following phrase found in section 522(p)(1)section 522(p)(1): "... a ***756** debtor may not exempt *any amount of interest* that was *acquired by the debtor* during 1,215–day period ... that exceeds in the *aggregate $125,000 in value ...*" (emphasis added). For purposes of analysis, the sentence can be divided into three component parts:

(1) "any amount of interest,"

(2) "acquired by the debtor," and

(3) "aggregate $125,000 in value."

[12] Recent decisions interpreting section 522(p)section 522(p) appear to define "interest" as the fee simple interest acquired by the debtor upon purchase of the home. *In re Sainlar,* 344 B.R. 669, 672 (Bankr.M.D.Fla.2006); *In re Blair,* 334 B.R. 374, 376 (Bankr.N.D.Tex.2005). Both of these cases dealt with homesteads acquired before the 1,215–day period and both concluded that an increase in value due to appreciation during the 1,215–day period was not an interest acquired within the meaning of section 522(p)section 522(p). This Court is in agreement with the ultimate holdings in both these cases. However, the Court does not agree that the "interest" that is acquired by a debtor is ownership interest in the homestead. Rather, for the reasons discussed below, the Court concludes that the term "interest" means equity in the homestead acquired by a debtor during the 1,215–day period.

This conclusion is buttressed by the use of the same phrase "any amount of interest" immediately after section 522(p)(1)section 522(p)(1) in section 522(p)(2)(B)section 522(p)(2)(B): "For purposes of paragraph (1), *any amount of such interest* does not include any interest transferred from a debtor's previous principal residence ... into the debtor's current principal residence...." 11 U.S.C. § 522(p)(2)(B)(emphasis added). This second use of the term "interest" can only refer to the equity in the prior residence that is rolled into the current homestead. *See Blair,* 334 B.R. at 377 ("[e]ssentially, [section 522(p)(2)(B)] allows for rollover by debtors of equity in one home to another home located in the same state"); *see also In re Summers,* 344 B.R. 108, 113 (Bankr.D.Ariz.2006) (allowing debtors to claim "rolled over equity" from previous Arizona homestead); *In re Wayrynen,* 332 B.R. at 486 (same). Thus, it is clear that section 522(p)(2)(B) defines "interest" through usage to mean the debtor's equity in the property—not the debtor's fee simple interest. While one may roll equity from one property to another, one does not roll a fee simple property ownership interest from one property to another.

[13] Moreover, a common rule of statutory construction is that a single definition of common words must be used in the same section of the same enactment. *Union Bank v. Wolas,* 502 U.S. 151, 163, 112 S.Ct. 527, 116 L.Ed.2d 514 (1991) (Scalia concurring); *Bray v. Alexandria Women's Health Clinic,* 506 U.S. 263, 283, 113 S.Ct. 753, 122 L.Ed.2d 34 (1993). Given this rule of statutory construction, the Court must conclude that "amount of interest" in section 522(p)(1) means amount of equity in the homestead just as it means equity in a prior homestead when referenced in section 522(p)(2).

[14] This interpretation also makes sense in light of the term "interest" being used in conjunction with "amount." Amount is a quantitative term. A homeowner may be thought of as having an amount of equity in a home. It would be unusual to refer to a homeowner having an amount of fee simple ownership in a home. In this regard, statutes should be "read in a 'straightforward' and 'commonsense' manner...." *Andersson v. Sec. Fed. Sav. & Loan of Cleveland (In re Andersson),* 209 B.R. 76, 78 (6th Cir. BAP 1997) (citing *Rogers v. Laurain (In re Laurain),* 113 F.3d 595 (6th Cir.1997)).

***757** We next turn to the interpretation of the term, "acquired by the debtor." As stated in *Sainlar,* "[t]he plain import of the word [acquired] is 'obtained as one's own.' " *Sainlar,* 344 B.R. at 672–673. In this regard, a debtor may acquire or obtain equity either by making a down payment, by paying down the mortgage, or by appreciation due to market conditions. The first two methods of acquiring equity require active conduct on the part of the debtor—payment of money. The third, appreciation, is passive, requiring no active conduct.

This presents a question of grammatical construction. From the standpoint of statutory language, it would have been sufficient for capturing all methods of acquisition, active or passive, if the statute had provided "any amount of interest that was acquired during the 1215–period...." This presents the question of the effect to be given by the addition of the phrase "by the debtor" after and modifying "acquired."

[15] Courts generally disfavor interpretations that render language superfluous. *U.S. v. DBB, Inc.,* 180 F.3d 1277, 1285 (11th Cir.1999). Therefore, the addition of "by the debtor" must qualify "acquired" in some manner if it is not to be considered mere surplusage. As a matter of grammatical construction, "by the debtor" is a restrictive clause. John C. Hodges & Mary E. Whitten, Harbrace College Handbook 138, 553 (Harcourt Brace Jovanovich, Inc. 9th ed.1982). Restrictive clauses and phrases follow and limit the words they modify. They are essential to the meaning of the main clause. *Id.* It appears, therefore, that in this context, the addition of the clause "by the debtor" after "acquires" implies more than a passive acquisition—such as by appreciation; it implies an active acquisition of equity such as by an affirmative act of a down payment or mortgage pay down.

[16] **[17]** Finally, we have the phrase "aggregate of $125,000 in value." Use of the phrase "in the aggregate" implies that successive acquisitions of equity by the debtor are to be aggregated. If the aggregate amount of these acquisitions during the 1,215–day period exceeds in value $125,000, the excess will not be exempt. For example, if a debtor within the 1,215–day period purchased a home for $750,000, paying $100,000 down and financing the balance by a bank mortgage and then a month after the purchase paid off the $650,000 mortgage, the amount of equity acquired by the debtor's affirmative acts of paying $100,000 down at the time of purchase and then paying off the $650,000 mortgage would be aggregated. In this example, the debtor's permitted exemption of $125,000 will have been exceeded by $625,000. [5]

[18] **[19]** In this case, the "amount of interest that was acquired" by the Debtors was equity resulting from the rollover of equity derived from the sale of the prior homestead of approximately $35,000 and cash of approximately $1,800 paid at closing of the sale. While appreciation did ***758** occur, it did not occur due to any act of the Debtors and accordingly it is not an interest "acquired *by the debtor"* during the 1,215–day period. The fact that the Homestead may have appreciated substantially in value during the 1,215–day period does not constitute the acquisition of an interest in the Debtors' homestead for purposes of section 522(p).

[20] This conclusion is consistent with the legislative history of section 522(p). [6] In this regard, the legislative history contains no suggestion that a debtor's passive acquisition of appreciation by a debtor within the 1,215–day period was intended to be capped by section 522(p). Rather, the House Report accompanying BAPCPA refers to the problem of debtors who relocate to states such as Florida to take advantage of the "mansion loophole." H.R.Rep. No. 109–31 pt. I 109th Cong., 1st Sess., 15–16 (2005), U.S.Code Cong. & Admin.News 2005, pp, 88, 102. Or, as summarized in the Congressional Record,

> "[u]nder current law, a wealthy individual in a State such as Florida ... can go out ... and invest that money in ... a huge house, file for bankruptcy, and basically protect all of their assets.... With the legislation we have before us, someone has to figure out that 2 1/2 years ahead of time people are going to want to file for bankruptcy and be smart enough to put the money into a home ...."
> 151 Cong. Rec. S2415–02 (2005). Passive appreciation in a homestead was not the target of the legislation; rather, the active acquisition of equity in an exempt homestead shortly before filing for bankruptcy was the focus of the new provision.

V. *Conclusion*

In this case, the Trustee has objected to the Debtors' claim of exemptions because the amount of appreciation that has occurred since the purchase of the Homestead less than 1,215 days before the petition exceeds $125,000. For the reasons set forth above, the Court concludes that as a result

of the application of section 522(m) to new section 522(p), each Debtor in this joint case may separately claim $125,000 of the Homestead for a total exemption in their joint case of $250,000. In addition, to the extent that equity in the Homestead at the time of the petition resulted from appreciation, such appreciation does not constitute an interest acquired by the Debtors within the meaning of section 522(p). Because the Debtors' equity in their Homestead was less than $250,000, and because the Objection is premised on an interpretation of section 522(p) that would include appreciation as part of the equity, the Trustee's objection is overruled.

Accordingly, it is

ORDERED that the Trustee's objection to the Debtors' claim of exemption as to their Homestead is overruled.

DONE and ORDERED.

All Citations

349 B.R. 747, 19 Fla. L. Weekly Fed. B 395

Footnotes

1 All references herein to "section" shall mean a section of Title 11 of the United States Code, also known as the Bankruptcy Code.

2 Sections 522(b) and 522(p) provide in pertinent part:

> **(b)**
>
> **(1)** ... [A]n individual debtor may exempt from property of the estate the property listed in either paragraph (2) or, in the alternative, paragraph (3) of this subsection. In joint cases filed under section 302 of this title and individual cases filed under section 301 or 303 of this title by or against debtors who are husband and wife, and whose estates are ordered to be jointly administered under Rule 1015(b) of the federal Rules of Bankruptcy Procedure, one debtor may not elect to exempt property listed in paragraph (1) and the other debtor elect to exempt property listed in paragraph (3) of this subsection. If the parties cannot agree on the alternative to be elected, they shall be deemed to elect paragraph (2), where such election is permitted under the law of the jurisdiction where the case is filed.
>
> **(2)** Property listed in this paragraph is property that is specified under subsection (d) unless the State law that is applicable to the debtor under paragraph (3)(A) specifically does not so authorize.
>
> **(3)** Property listed in this paragraph is—
>
> **(A)** subject to subsections (*o*) and (p), any property that is exempt under federal law, other than subsection (d) of this section, or State or local law that is applicable on the date of the filing of the petition....
>
> * * *
>
> **(p)**
>
> **(1)** Except as provided in paragraph (2) of this subsection and sections 544 and 548, 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 interest that was acquired by the debtor during the 1215–day period preceding the date of the filing of the petition that exceeds in the aggregate $125,000 in value in—

(A) real or personal property that the debtor or a dependent of the debtor uses as a residence;

* * *

(2) (B) For purposes of paragraph (1), any amount of such interest does not include any interest transferred from a debtor's previous principal residence (which was acquired prior to the beginning of such 1215–day period) into the debtor's current principal residence, if the debtor's previous and current residences are located in the same State.

3 Alaska Stat. § 09.38.010; Ariz.Rev.Stat. Ann. § 33–1101(B); Cal.Civ.Proc.Code § 703.110(a); Haw.Rev.Stat. § 651–92(a)(2); Ky.Rev.Stat. Ann. § 132.810(2)(e); Mass. Gen. Laws ch. 188, § 1; Minn. Stat § 510.02; Mo.Rev.Stat. § 513.475(1); Mont.Code. Ann. §§ 70–32–103, 70–32–104; R.I. Gen. Laws § 9–26–4.1(b); Wis. Stat. § 815.20(1).

4 *Joe T. Dehmer Distributors, Inc. v. Temple,* 826 F.2d 1463, 1469 (5th Cir.1987) (applying Mississippi law); *In re Lindstrom,* 331 B.R. 267, 271 (Bankr.E.D.Mich.2005) (Michigan law); *In re Foulk,* 134 B.R. 929, 930–931 (Bankr.D.Neb.1991) (Nebraska law); *In re Lenox,* 58 B.R. 104, 106 (Bankr.D.Nev.1986) (Nevada law); *In re Reisnour,* 56 B.R. 225, 227 (D.N.D.1985) (North Dakota law); *D'Avignon v. Palmisano,* 34 B.R. 796 (D.Vt.1982) (Vermont law).

5 This interpretation of the applicability of section 522(p) would also result in monthly principal amortization constituting the acquisition of equity within the 1,215–day period and counting against the permitted $125,000 exemption for an individual debtor. However, this in itself will rarely if ever be sufficiently significant in amount to exceed the cap. The Court takes judicial notice of the fact that in order for a conventional 30–year mortgage at an interest rate of 7 percent to exceed a principal pay down of more than $125,000 over a 1,215–day period, the principal amount of the mortgage would have to be approximately $3,400,000, requiring payments of over $22,000 per month. Such a case would no doubt raise other issues—such as the debtor's bad faith under section 707(b)(3).

6 While, as a general proposition, a court should not resort to legislative history when statutory text is clear, when a statute is vague or ambiguous an examination of the act's purpose and of its legislative history is appropriate. *Midrash Sephardi, Inc. v. Town of Surfside,* 366 F.3d 1214, 1226 (11th Cir.2004), *U.S. v. Pringle,* 350 F.3d 1172, 1180 n. 11 (11th Cir.2003). Here, there may be some ambiguity in the statute—as the terms can be read as this Court has done or as interpreted by *Blair* and *Sainlar.* *In re Blair,* 334 B.R. 374, 376 (Bankr.N.D.Tex.2005); *In re Sainlar,* 344 B.R. 669, 672 (Bankr.M.D.Fla.2006).

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377 B.R. 315
United States Bankruptcy Court,
N.D. Florida,
Panama City Division.

In re Don Warner REINHARD, Debtor.
John E. Venn, Jr., Trustee, Plaintiff,
v.
Don Warner Reinhard & Sarah A. Reinhard, Defendants.

Bankruptcy No. 06–50298–LMK.
|
Adversary No. 07–05006–LMK.
|
Oct. 16, 2007.

Synopsis

Background: Chapter 7 trustee challenged debtor's right to unlimited Florida homestead exemption in real property which, while owned by debtor and his wife for more than a decade prior to petition date, was designated as their homestead less than 1,215 days prepetition. Dispute arose as to whether debtor and his wife, by designating real property as their homestead within this 1,215-day lookback period, thereby acquired "any amount of interest" in this property, so as to trigger statutory limitation on debtor's state law homestead exemption under Code provision added by the Bankruptcy Abuse Prevention and Consumer Protection Act (BAPCPA).

[Holding:] The Bankruptcy Court, Lewis M. Killian, Jr., J., held that debtor and his nondebtor-wife, simply by designating as their homestead less than 1,215 days prior to petition date Florida real estate that they had owned for more than a decade prepetition, did not thereby acquire "any amount of interest" in this property, and did not trigger statutory cap on debtor's state law homestead exemption rights.

Debtors' motion to dismiss granted.

Procedural Posture(s): On Appeal; Motion for Summary Judgment.

West Headnotes (15)

[1] Bankruptcy Waiver or Loss of Exemption

Whether Chapter 7 debtor and his nondebtor-wife, when they designated as their homestead less than 1,215 days prepetition certain Florida real estate which they had owned for more than a decade prior to petition date, thereby acquired "any amount of interest" in this property, so as to trigger statutory limitation on debtor's state law homestead exemption rights, was question of federal law primarily depending upon Florida homestead law; bankruptcy court first had to look to state law to determine what debtor acquired when he and his wife designated this property as their homestead, and then had to look to federal law to determine whether what the debtor acquired under Florida law qualified as "any amount of interest," within the meaning of statutory cap on his homestead exemption rights.

11 U.S.C.A. § 522(p).

1 Cases that cite this headnote

[2] Bankruptcy Waiver or Loss of Exemption

In deciding whether the recently acquired homestead status of real property that Chapter 7 debtor had owned for more than 1,215 days prepetition was "any amount of interest" in property, so as to trigger statutory limitation on debtor's state law homestead exemption rights, bankruptcy court had to be mindful of the substance of the rights that state law provided upon designation of property as homestead, not merely of labels that state gave these rights or the conclusions which it drew from them. 11 U.S.C.A. § 522(p).

2 Cases that cite this headnote

[3] Bankruptcy Waiver or Loss of Exemption

While rights and limitations created by Florida homestead exemption were matter of state law, whether those rights and limitations constituted "any amount of interest" in property, within

meaning of statutory cap on debtor's state law homestead exemption rights, was determined by federal bankruptcy law. 11 U.S.C.A. § 522(p).

[4] **Homestead** Construction of homestead laws in general

Florida homestead exemption is liberally construed in order to protect debtor's property from creditors. West's F.S.A. Const. Art. 10, § 4(a).

[5] **Homestead** Nature of estate or right

Homestead property in Florida is exempt from execution for most types of unpaid debts. West's F.S.A. Const. Art. 10, § 4(a).

[6] **Homestead** Power to transfer or incumber in general

Under Florida law, homestead status is not only an exemption from forced sale under process of court, but is also limitation on alienation of homestead property. West's F.S.A. Const. Art. 10, § 4(a).

[7] **Homestead** Consent of husband or wife

Homestead Devise or other testamentary disposition

Under Florida law, testamentary transfers of homestead property by owners with minor children are ineffective, and married owner who desires to transfer homestead property must do so with his or her spouse. West's F.S.A. Const. Art. 10, § 4(a).

[8] **Homestead** Ownership, estate, or interest in property in general

Homestead Liabilities existing before establishment of homestead

While, under Florida law, any beneficial interest in land may support a claim of homestead, property must acquire homestead status prior to attachment of creditor's lien in order for exemption to apply. West's F.S.A. Const. Art. 10, § 4(a).

[9] **Homestead** Acquisition and selection of property in general

Homestead Time of acquisition of homestead exemption

Under Florida law, the acquisition of interest in property and property's acquisition of homestead status are distinctly different; homestead status attaches to protect property after it is first acquired by homesteader. West's F.S.A. Const. Art. 10, § 4(a).

4 Cases that cite this headnote

[10] **Homestead** Nature and extent of right created

Under Florida law, acquisition of homestead status does not confer any additional property interest or rights in property. West's F.S.A. Const. Art. 10, § 4(a).

4 Cases that cite this headnote

[11] **Homestead** Nature of estate or right

Under Florida law, homestead is simply a status, constitutionally defined, which exempts certain property from execution and limits its alienability, and is not property interest; homestead status in Florida is not properly conceptualized as stick in bundle of property rights, but as protective safe in which the bundle is put. West's F.S.A. Const. Art. 10, § 4(a).

7 Cases that cite this headnote

[12] **Bankruptcy** Waiver or Loss of Exemption

Chapter 7 debtor and his nondebtor-wife, simply by designating as their homestead less than 1,215 days prior to petition date Florida real estate that they had owned for more than a decade prepetition, did not thereby acquire "any

amount of interest" in this property, and did not trigger statutory cap on debtor's state law homestead exemption rights, where there was no suggestion that debtor had transferred any equity from previous residence to this Florida real estate within this statutory 1,215-day lookback period.

11 U.S.C.A. § 522(p).

2 Cases that cite this headnote

[13] Statutes Language

Starting point of statutory construction is language of statute itself.

[14] Statutes Plain Language; Plain, Ordinary, or Common Meaning

Words in statutes should be given their common, ordinary meanings, unless Congress provides otherwise.

[15] Statutes Prior or existing law in general

Congress is presumed to know the legal background against which it legislates.

Attorneys and Law Firms

***317** John E. Venn, Jr., Esq., John E. Venn, Jr., P.A., Pensacola, FL, for Plaintiff.

J. Steven Ford, Esq., Wilson, Harrell, Farrington, Pensacola, FL, for Defendants.

ORDER GRANTING MOTION TO DISMISS

LEWIS M. KILLIAN, JR., Bankruptcy Judge.

THIS MATTER is before the Court on the Motion to Dismiss filed by Don Reinhard (the "Motion," Doc. 9). The parties have agreed to treat Mr. Reinhard's Motion as a motion for partial summary judgment as to Count I of the complaint, which alleges that the Debtor is limited to exempting $125,000 in his homestead real property pursuant to 11 U.S.C. § 522(p) (2006). The issue presented is whether or not the $125,000 cap applies where a residence owned for more than 1215 days before the filing of the petition acquires homestead status within the 1215 days. There being no genuine issues of material fact, and the Defendants being entitled to judgment as a matter of law, the Motion will be granted for the reasons more fully explained herein. This is a core proceeding over which the Court has jurisdiction pursuant to 28 U.S.C. §§ 151, 157(b)(2)(B), 1334, and 1408.

Facts

For purposes of the Motion, the facts are accepted as undisputed. The Debtor and his wife acquired title to 1976 Scenic Highway 30A, Seaside, Florida (the "Seaside Property") on February 24, 1995. However, they resided in Tallahassee, Florida until on or around June 30, 2005. During the 1215–day period in § 522(p), the Debtor and his wife moved into the Seaside Property and designated it their homestead. When the Debtor filed his voluntary Chapter 7 petition on November 3, 2006, the Seaside Property was worth approximately $4,500,000 and was encumbered by approximately $2,050,000 of debt. There has been no suggestion that any equity was transferred from the prior residence in Tallahassee to the Seaside Property during the 1215–day period. The question is whether, within the meaning of § 522(p), the Debtor acquired any amount of interest in value in the Seaside Property when it acquired homestead status under Florida law.

Applicable Law

[1] [2] [3] Determining whether the acquisition of Florida homestead status falls within § 522(p) raises issues of both federal and state law. Such interwoven questions are not unfamiliar to federal courts. For example, in *United States v. Craft,* 535 U.S. 274, 122 S.Ct. 1414, 152 L.Ed.2d 437 (2002), the U.S. Supreme Court was presented with the question whether a tenant by the entirety under state law possesses "property" or "rights to property" within the meaning of § 6321 of the federal Tax Code. The Court determined this was a question of federal law which was

largely dependent upon state law. *Id.* at 278, 122 S.Ct. 1414. Similarly, whether the Debtor in this case acquired "any amount of interest" when he designated the Seaside Property as his homestead is a question of federal law which primarily depends upon Florida homestead law. Following the analysis laid out in *Craft,* I must look initially to state law to determine what the Debtor acquired when he designated the Seaside Property as his homestead, then to federal law to determine whether that constitutes "any amount of interest" within the ambit of § 522(p). I am mindful that I should "consider the substance of the rights state law provides, not merely the labels the State gives these rights or the conclusions it draws from them," as such ***318** state-law labels "are irrelevant to the federal question of which bundles of rights constitute" any amount of interest. *Id.* Accordingly, the rights and limitations created by Florida's homestead exemption are a matter of state law, but whether those rights and limitations constitute "any amount of interest" within the meaning of § 522(p) is determined by federal bankruptcy law. *See also Butner v. U.S.,* 440 U.S. 48, 54–55, 99 S.Ct. 914, 59 L.Ed.2d 136 (1979).

Florida Homestead

[4] Though similar concepts existed at common law, homestead legislation is uniquely American. George L. Haskins, *Homestead Exemptions,* 63 HARV. L. REV.. 1289 (1950). The purpose of Florida's homestead provision—to preserve the family's interest in the family home—is a strongly held public policy, and the provision is liberally construed in order to protect the debtor's property from creditors. *See Snyder v. Davis,* 699 So.2d 999, 1002 (Fla.1997); *Olesky v. Nicholas,* 82 So.2d 510, 512 (Fla.1955).

[5] Florida homestead status carries with it an exemption from forced sale. Section 4(a) of Article X of the Constitution of the State of Florida provides in part that

> SECTION 4. Homestead; exemptions.—
>
> (a) There shall be exempt from forced sale under process of any court, and no judgment, decree or execution shall be a lien thereon, except for the payment of taxes and assessments thereon, obligations contracted for the purchase, improvement or repair thereof, or obligations contracted for house, field or other labor performed on the realty, [a homestead] owned by a natural person.

Fla. Const. art. X, § 4(a). Thus, homestead property in Florida is exempt from execution for most types of unpaid debts. *See Butterworth v. Caggiano,* 605 So.2d 56, 60 (Fla.1992).

[6] **[7]** Homestead status is not only an exemption from forced sale under process of a court, but it is also a limitation on alienation of the homestead property, as provided in § 4(c) of Article X:

> (c) The homestead shall not be subject to devise if the owner is survived by spouse or minor child, except the homestead may be devised to the owner's spouse if there be no minor child. The owner of homestead real estate, joined by the spouse if married, may alienate the homestead by mortgage, sale or gift and, if married, may by deed transfer the title to an estate by the entirety with the spouse. If the owner or spouse is incompetent, the method of alienation or encumbrance shall be as provided by law.

Fla. Const. art. X, § 4(c). Testamentary transfers of homestead property by owners who have minor children are ineffective, and a married owner who desires to transfer the homestead property must do so with his or her spouse. *See Johns v. Bowden,* 68 Fla. 32, 66 So. 155 (1914); *In re Estate of Melisi,* 440 So.2d 584 (4th Fla.Dist.Ct.App.1983).

[8] **[9]** Though any beneficial interest in land may support a claim of homestead, the property must acquire homestead status prior to the attachment of the creditor's lien in order for the exemption to apply. *See Bessemer v. Gamble,* 158 Fla. 38, 27 So.2d 832, 833 (1946); *see also Callava v. Feinberg,* 864 So.2d 429, 431 (3rd Fla. Dist.Ct.App.2003). Thus, the claimant must have some existing property interest to which

homestead status can attach. *Cf.* ***319** *Pasco v. Harley,* 73 Fla. 819, 75 So. 30, 33 (1917) (stating that "[t]he Constitution does not contemplate that the exemptions allowed shall extend to any title, right, or interest in property that is not owned by the head of a family residing in this state.... [T]he right of exemption is no greater than his title and interest in the property"). The acquisition of an interest in property and the acquisition of homestead status are therefore distinctly different. Homestead status attaches to protect property after it is acquired by the homesteader.

[10] The acquisition of homestead status does not confer any additional property interest or rights in property. In *Johns v. Bowden,* 68 Fla. 32, 66 So. 155 (1914), a child challenged his father's testamentary disposition of homestead property on the ground that the transfer was prohibited by the Florida Constitution's limitations on alienation. The Florida Supreme Court found that the conveyance was, in effect, a will attempting an end run around the alienability limitations, and it concluded that such conveyances are not effective when the owner of the homestead leaves a wife or child. *Johns,* 66 So. at 155. In discussing the nature of the homestead, the Florida Supreme Court explained that it is a status of, not an interest in, property:

> The ***status*** of a homestead which the Constitution impresses upon property under certain circumstances ***does not change the nature of the estate*** in the property owned by the head of a family residing in this state, but merely exempts such property from certain liabilities to which it would otherwise be subject, and limits the owner's inherent power of alienation, by making such property exempt from forced sale under process of any court, and by making the real estate inalienable without the joint consent of the husband and wife, when that relation exists.

Id. at 159 (internal quotations omitted and emphasis added).

[11] Homestead is simply a status, constitutionally defined, which exempts certain property from execution and limits its alienability. It is not a property interest. When a Florida resident's property acquires homestead status, the owner does not acquire any of the rights traditionally associated with property interests: the right to possession, the right to use, the right to transfer—the owner already holds whatever of these he has. Accordingly, homestead status in Florida is not properly conceptualized as a stick in the bundle; rather, it is a protective safe in which the bundle is put.

11 U.S.C. § 522(p) (2006)

[12] I next turn to the question whether the acquisition of Florida homestead status alone falls within the ambit of § 522(p). Section 522(p) limits to $125,000 [1] the exemption a debtor may claim on any amount of interest in value in four types of property that the debtor acquires within 1215 days of the filing of the bankruptcy petition. In order for the § 522(p)(1)(D) limit to apply (1) the debtor must acquire; (2) an amount of interest; (3) during the 1215–day period; (4) exceeding in the aggregate $125,000 in value; (4) in real or personal property that is claimed as a homestead.

What Congress meant in § 522(p) is not entirely clear in this situation. At least one court has held that the phrase encompasses ***320** the acquisition of a "homestead interest," *In re Greene,* 346 B.R. 835 (Bankr.D.Nev.2006), while other courts disagree, *Wallace v. Rogers (In re Rogers),* 354 B.R. 792 (N.D.Tex.2006); *In re Lyons,* 355 B.R. 387 (Bankr.D.Mass.2006). There is enough ambiguity to require the statute to be construed.

[13] The starting point of statutory construction is the language itself. *See* *Watt v. Alaska,* 451 U.S. 259, 265–66, 101 S.Ct. 1673, 68 L.Ed.2d 80 (1981). The text of § 522(p)(1)(D) provides in relevant part that "a debtor may not exempt any amount of interest that was acquired by the debtor during the 1215–day period preceding the date of filing of the petition that exceeds in the aggregate $125,000 in value in ... real or personal property that the debtor or a dependant of the debtor claims as a homestead" (emphasis added).

There are several indications in the text of § 522(p) that Congress intended the term "interest" to refer a quantitative or

monetary value in property. The statute refers to "any ***amount*** of interest." § 522(p)(1) (emphasis added). A debtor is limited to an "aggregate $125,000 in ***value*** in" certain types of property. *Id.* (emphasis added). The use of the words "amount," "value," as well as the dollar figure of $125,000, indicate that Congress intended to convey a monetary meaning in connection with "interest." *See* *Rogers,* 354 B.R. at 796; *Lyons,* 355 B.R. at 390–91; *In re Rasmussen,* 349 B.R. 747, 756 (Bankr.M.D.Fla.2006). In addition, § 522(p)(1)(D) refers to the acquisition of an amount of interest in value in "real or personal ***property.***"

[14] **[15]** There are also extra-textual sources which shed some light on the meaning of § 522(p). *See* *Dolan v. U.S. Postal Service,* 546 U.S. 481, 486, 126 S.Ct. 1252, 163 L.Ed.2d 1079 (2006) (indicating that the use of aids to statutory construction other than the text of a statute can inform the analysis). The term "interest" is not defined in the Bankruptcy Code. However, words in statutes should be given their common, ordinary meanings unless Congress provides otherwise, *see* *C.I.R. v. Brown,* 380 U.S. 563, 570–71, 85 S.Ct. 1162, 14 L.Ed.2d 75 (1965), and Congress is presumed to know the legal background against which it legislates, *see* *U.S. v. U.S. Gypsum Co.,* 438 U.S. 422, 437, 98 S.Ct. 2864, 57 L.Ed.2d 854 (1978). Therefore, courts have often used legal dictionaries to ascertain the meaning of words in legislation, *see, e.g.,* *Shaw v. Delta Air Lines, Inc.,* 463 U.S. 85, 97–98 n. 16, 103 S.Ct. 2890, 77 L.Ed.2d 490 (1983). According to Black's Law Dictionary (8th ed.2004), an interest is "[a] legal share in something; all or part of a legal or equitable claim to or right in ***property*** " (emphasis added), which indicates that the debtor must acquire some amount of interest in the value of one of the four types of property listed during the 1215–day period in order for the cap to apply.

The legislative history of § 522(p) also provides some insight. The House Report states that § 522 was amended

> to impose an aggregate monetary limitation of $125,000, subject to Bankruptcy Code sections 544 and 548, on the value of property that the debtor may claim as exempt under State or local law pursuant to section 522(b)(3)(A) under certain circumstances. The monetary cap applies if the debtor acquired such property within the 1,215–day period preceding the filing of the petition and the property consists of any of the following: (1) real or personal property of the debtor or that a dependent of the debtor uses as a residence; (2) an interest in a cooperative that owns property, which the debtor or the debtor's dependent uses as a residence; (3) a burial plot for the ***321** debtor or the debtor's dependent; or (4) real or personal property that the debtor or dependent of the debtor claims as a homestead.

H.R.Rep. No. 109–31 pt. 1, at 81 (2005), *reprinted in* 2005 U.S.C.C.A.N. 88, 148. The acquisition of homestead status is not listed as one of the types of property to which the monetary limit applies. In debating BAPCPA, some members of Congress indicated that § 522(p) was intended to close the "mansion loophole":

> The legislation will also bring to an end other abuses that occur under the current bankruptcy system. For example, it closes the "mansion loophole," which allows opportunistic debtors to avoid paying their creditors by buying a house in a State with an unlimited or extremely generous homestead exemption, and then declaring bankruptcy.

151 CONG. REC. S1726–01, S1779 (daily ed. February 28, 2005) (statement of Sen. Specter). The "mansion loophole" permitted debtors to flee to states with generous homestead exemption laws on the eve of the filing of the petition and then transfer non-exempt assets into an exempt homestead in order to keep those assets from creditors. This is not such a case. Here, the Debtor, a long-time resident of Florida, has owned the Seaside Property since 1995. He did not transfer

any non-exempt assets into the exempt homestead during the 1215–day period, and he moved to the Seaside Property from within the same state.

One might argue that "any amount of interest" refers to a more expansive notion, incorporating every conceivable interest that the debtor has, including the legal interest the debtor has in having his or her constitutional rights enforced. But Congress did not reach that far. Congress could have defined all debtors' exemptions to be whatever they would have been 1215 days before the filing of the petition. Instead, Congress defined the cap more narrowly.

Finally, assuming that homestead status is an amount of interest within the meaning of § 522(p), any such interest arguably would not be included in the $125,000 limit pursuant to § 522(p)(2)(B) in this case. The Debtor transferred his homestead interest, whatever it was, from his prior residence to the Seaside Property, which are both in Florida. The amount of interest limited by the $125,000 cap does not include any interest transferred from a debtor's previous principal residence to the current principal residence when both are located in the same state. § 522(p)(2)(B).

Conclusion

The acquisition of Florida homestead status alone does not fall within the limits on exemptions imposed by § 522(p). Homestead status under Florida law is not a property interest. The homesteader's legal or equitable claim to or right in the homestead property arises prior to and independently of the acquisition of homestead status. Homestead status simply exempts the homesteader's existing share in the property from forced sale and limits its alienability. Therefore, the Debtor did not acquire any amount of interest in value in the Seaside Property when it acquired homestead status.

For the foregoing reasons, the Debtor's claim of exemptions with respect to his homestead shall not be limited by § 522(p). Accordingly, it is hereby

ORDERED and ADJUDGED that the Debtor–Defendant's Motion to Dismiss (Doc. 9) is GRANTED as to Count I of the Complaint.

DONE and ORDERED.

All Citations

377 B.R. 315, 21 Fla. L. Weekly Fed. B 52

Footnotes

1 The Judicial Conference of the United States adjusted the dollar amount in § 522(p) to $136,875 by notice dated February 14, 2007 pursuant to 11 U.S.C. § 104. *See* 72 F.R. 7082.

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KeyCite Yellow Flag - Negative Treatment
Declined to Extend by In re Odes Ho Kim, 5th Cir.(Tex.), April 9, 2014

513 F.3d 212
United States Court of Appeals,
Fifth Circuit.

In the matter of: Sarah K. ROGERS, Debtor.
Jack C. Wallace, Appellant,
v.
Sarah K. Rogers, Appellee.

No. 06–11263.
|
Jan. 4, 2008.

Synopsis
Background: Chapter 7 debtor claimed $359,000.00 state-law homestead exemption in real property which she inherited more than 1,215 days prepetition, but which she did not begin to occupy as a homestead until a time within this 1,215-day "lookback" period. Judgment creditor objected, asserting that the exemption was limited to the $125,000.00 cap established by the Bankruptcy Abuse Prevention and Consumer Protection Act (BAPCPA). The United States Bankruptcy Court for the Northern District of Texas entered order overruling objection, and judgment creditor appealed. The District Court, A. Joe Fish, Chief Judge, 354 B.R. 792, affirmed, and judgment creditor appealed.

[Holding:] Addressing a question of apparent first impression in the circuit, the Court of Appeals, DeMoss, Circuit Judge, held that the term "interest," as used in the section of the Bankruptcy Code setting forth the homestead exemption cap established by the BAPCPA, refers to vested economic interests in the homestead property that a debtor acquires during the 1,215-day period preceding the filing of the bankruptcy petition, and so a homestead interest established within the statutory period, without more, does not fall within the purview of the cap.

Affirmed.

Procedural Posture(s): On Appeal.

West Headnotes (27)

[1] **Bankruptcy** Scope of review in general

On appeal of a district court's review of a bankruptcy court decision, the Court of Appeals reviews the decision of the district court by applying the same standard to the bankruptcy court's findings of fact and conclusions of law as the district court applied.

2 Cases that cite this headnote

[2] **Bankruptcy** Conclusions of law; de novo review

Bankruptcy Clear error

Bankruptcy court's findings of fact are subject to clearly erroneous review, while its conclusions of law are reviewed de novo.

1 Cases that cite this headnote

[3] **Bankruptcy** Exemptions

Bankruptcy Operation and effect

"Exemption" is an interest withdrawn from the bankruptcy estate, and hence from the creditors, for the benefit of the debtor.

1 Cases that cite this headnote

[4] **Bankruptcy** Waiver or Loss of Exemption

Section of the Bankruptcy Code setting forth the homestead exemption cap became effective immediately upon enactment of the Bankruptcy Abuse Prevention and Consumer Protection Act (BAPCPA) on April 20, 2005. 11 U.S.C.A. § 522(p).

[5] **Bankruptcy** Waiver or Loss of Exemption

Section of the Bankruptcy Code setting forth the homestead exemption cap prevents the debtor from exempting certain interests from the bankruptcy estate if they were acquired by the debtor during the statutory period and

their aggregate value exceeds a certain dollar threshold. 11 U.S.C.A. § 522(p)(1).

2 Cases that cite this headnote

[6] **Homestead** Amount or Extent

Homestead Ownership, estate, or interest in property in general

In Nevada, the homestead exemption extends to the claimant's equity in the homestead property up to a maximum of $350,000.00. West's NRSA 115.010(2).

5 Cases that cite this headnote

[7] **Homestead** Nature of estate or right

Homestead interest is not the equivalent of title or equity.

3 Cases that cite this headnote

[8] **Divorce** Distribution of separate property in general

Trial court in Texas has no discretion to divest title to separate property and award that property to the other spouse in a divorce.

[9] **Bankruptcy** Waiver or Loss of Exemption

Term "interest," as used in the section of the Bankruptcy Code setting forth the homestead exemption cap established by the Bankruptcy Abuse Prevention and Consumer Protection Act (BAPCPA), which prevents a debtor from exempting "any amount of interest that was acquired by the debtor during the 1215-day period preceding the date of the filing of the petition that exceeds in the aggregate $125,000 in value," refers to vested economic interests in the homestead property that a debtor acquires during the subject 1,215-day period; accordingly, a homestead interest established within the statutory period, without more, does not fall within the purview of the cap. 11 U.S.C.A. § 522(p)(1).

11 Cases that cite this headnote

[10] **Homestead** Intent in acquisition and occupancy

Homestead Character and mode of occupancy

To establish homestead rights under Texas law, the claimant must show a combination of both overt acts of homestead usage and the intention on the part of the owner to claim the land as a homestead. Vernon's Ann.Texas Const. Art. 16, § 50; V.T.C.A., Property Code §§ 41.001–41.002.

4 Cases that cite this headnote

[11] **Homestead** Intent in acquisition and occupancy

Homestead Character and mode of occupancy

Homestead Recording

Under Texas law, a "homestead interest" is established when two elements are satisfied, namely, the claimant shows both overt acts of homestead usage and the intention on the part of the owner to claim the land as a homestead; in contrast, a "homestead designation" refers to the ministerial act of recording a notice in the county deed records. Vernon's Ann.Texas Const. Art. 16, § 50; V.T.C.A., Property Code §§ 41.001, 41.002, 41.005.

4 Cases that cite this headnote

[12] **Bankruptcy** Waiver or Loss of Exemption

Homestead exemption cap established by the Bankruptcy Abuse Prevention and Consumer Protection Act (BAPCPA) would have been inapplicable if Chapter 7 debtor had established her homestead rights in the property outside the 1,215-day period preceding the filing of her bankruptcy petition and then filed her Texas homestead designation within the statutory period. 11 U.S.C.A. § 522(p)(1).

1 Cases that cite this headnote

[13] **Bankruptcy** Waiver or Loss of Exemption

In determining the applicability of the homestead exemption cap established by the Bankruptcy Abuse Prevention and Consumer Protection Act (BAPCPA), the court would look initially to state law to determine what rights the debtor had in the subject property pursuant to state homestead law, then to federal law to determine whether the debtor's "state-delineated rights" qualified as an "interest" within the compass of the homestead exemption cap. 11 U.S.C.A. § 522(p)(1).

2 Cases that cite this headnote

[14] **Homestead** Nature of estate or right

Homestead Exceptions from exemptions in general

Under Texas law, the homestead interest is a legal interest created by the constitution that provides prophylactic protection from all but a few types of constitutionally permitted liens against homesteads. Vernon's Ann.Texas Const. Art. 16, § 50.

3 Cases that cite this headnote

[15] **Homestead** Exceptions from exemptions in general

Under Texas law, homesteads are protected from forced sale for the payment of debts, except for those debts specifically enumerated in the constitution, including debts incurred for purchase money on the homestead, taxes thereon, work or services performed thereon, certain extensions of credit, and certain reverse mortgages. Vernon's Ann.Texas Const. Art. 16, § 50.

[16] **Bankruptcy** Waiver or Loss of Exemption

In determining the applicability of the homestead exemption cap established by the Bankruptcy Abuse Prevention and Consumer Protection Act (BAPCPA), the court would look beyond the label given the homestead interest by state courts and consider the substance of the right conferred by state law. 11 U.S.C.A. § 522(p)(1).

1 Cases that cite this headnote

[17] **Bankruptcy** Waiver or Loss of Exemption

Term "value," as used in the section of the Bankruptcy Code setting forth the homestead exemption cap established by the Bankruptcy Abuse Prevention and Consumer Protection Act (BAPCPA), which prevents a debtor from exempting "any amount of interest that was acquired by the debtor during the 1215-day period preceding the date of the filing of the petition that exceeds in the aggregate $125,000 in value," refers to the economic value of the property interests acquired within the statutory period, not the value of the exemption claimed by the debtor. 11 U.S.C.A. § 522(p)(1).

7 Cases that cite this headnote

[18] **Statutes** Undefined terms

One fundamental canon of statutory construction instructs that in the absence of a statutory definition, courts give terms their ordinary meaning.

5 Cases that cite this headnote

[19] **Bankruptcy** Waiver or Loss of Exemption

For purposes of federal bankruptcy law, the homestead exemption is not a separate interest but, rather, the status of a withdrawn interest in property that was acquired prior to bankruptcy.

2 Cases that cite this headnote

[20] **Bankruptcy** Waiver or Loss of Exemption

Homestead interest simply gives "protective legal security" to those vested economic interests in property that were acquired by the debtor before the filing of the bankruptcy petition.

9 Cases that cite this headnote

[21] **Bankruptcy** Operation and effect

Bankruptcy Waiver or Loss of Exemption

"Homestead exemption" and the property interest impressed with that exemption are discrete concepts: the former is the debtor's legal right to exempt certain property interests from the bankruptcy estate, the latter is the debtor's vested economic interests in the property itself.

7 Cases that cite this headnote

[22] **Statutes** Language and intent, will, purpose, or policy

Starting point in discerning congressional intent is the existing statutory text.

1 Cases that cite this headnote

[23] **Statutes** Plain Language; Plain, Ordinary, or Common Meaning

Statutes Relation to plain, literal, or clear meaning; ambiguity

When a statute's language is plain, the sole function of the courts, at least where the disposition required by the text is not absurd, is to enforce it according to its terms.

5 Cases that cite this headnote

[24] **Statutes** Plain, literal, or clear meaning; ambiguity

Only after application of the principles of statutory construction, including the canons of construction, and after a conclusion that the statute is ambiguous may the court turn to the statute's legislative history.

3 Cases that cite this headnote

[25] **Statutes** What constitutes ambiguity; how determined

For the language of a statute to be considered "ambiguous," it must be susceptible to more than one reasonable interpretation or more than one accepted meaning.

6 Cases that cite this headnote

[26] **Statutes** What constitutes ambiguity; how determined

Statute is not "ambiguous" simply because it is inartfully drafted.

1 Cases that cite this headnote

[27] **Statutes** Extrinsic Aids to Construction

Extrinsic materials have a role in statutory interpretation only to the extent they shed a reliable light on the enacting legislature's understanding of otherwise ambiguous terms.

Attorneys and Law Firms

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

Before DeMOSS, DENNIS and OWEN, Circuit Judges.

Opinion

DeMOSS, Circuit Judge:

This case involves a question of first impression in this circuit: the statutory interpretation of the newly enacted homestead exemption cap, 11 U.S.C. § 522(p)(1), found in the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ("BAPCPA"). The issue is whether the homestead exemption cap applies to a homestead interest established within the 1,215–day period preceding the filing of the bankruptcy petition despite the fact that the debtor acquired title to the property before that statutory period. The bankruptcy court answered this question in the negative, and the district court ***216** affirmed. For the reasons discussed below, we affirm.

I. Factual & Procedural Background

On January 17, 1994, the Appellee, Sarah K. Rogers ("Rogers" or "debtor"), inherited a 72.5 acre tract of real property known as 14849 Kelly Road, Forney, Texas ("Forney Property"). Rogers was single when she inherited the Forney Property from her mother. Subsequently, Rogers married George E. Rogers, and they purchased a 5.1 acre tract of real property known as 8644 South F.M. 549, Rockwall, Texas ("Rockwall Property"). Rogers and her husband constructed a residence on the Rockwall Property and claimed it as their homestead. In January 2004, Rogers separated from her husband, moved into a mobile home on the Forney Property, and claimed the Forney Property as her homestead. On April 6, 2004, Rogers and her husband divorced. Pursuant to the divorce decree, Rogers was divested of all right, title and interest in the Rockwall Property, and no equity from the Rockwall Property was rolled-over into the Forney Property. The divorce decree awarded the Forney Property to Rogers, but this award simply affirmed the reality that the Forney Property was her separate property because she inherited it from her mother before marriage.

Prior to 2004, Rogers and her husband had borrowed money from the Appellant, Jack C. Wallace, to embark on an ultimately unsuccessful business venture. Wallace eventually sued to recover the unpaid loan balance, and on April 19, 2004, he obtained a state-court judgment against both the debtor and her then ex-husband, for the total principal amount of $316,180.95, in addition to court costs and post-judgment interest.

On September 28, 2005, the debtor filed for relief under Chapter 7 of the Bankruptcy Code. The debtor elected state law exemptions in accordance with the provisions of 11 U.S.C. § 522(b). In her Schedule C, the debtor claimed her homestead exemption on the Forney Property in the amount of $359,000. Wallace filed a timely objection to the debtor's claimed homestead exemption, arguing that 11 U.S.C. § 522(p)(1) capped the debtor's homestead exemption at the federal statutory amount of $125,000 because the debtor acquired her homestead interest in the Forney Property within the 1,215–day period preceding the filing of her bankruptcy petition.

The bankruptcy court orally denied Wallace's objection at a hearing held on January 18, 2006, and this ruling was memorialized by written order dated February 7, 2006. On October 16, 2006, the district court affirmed the bankruptcy court's order overruling Wallace's objection to the claimed homestead exemption. Wallace then perfected this timely appeal.

II. Analysis

A. Standard of Review

[1] **[2]** We have jurisdiction over this appeal pursuant to 28 U.S.C. § 1291. "We review the decision of the district court by applying the same standard to the bankruptcy court's findings of fact and conclusions of law as the district court applied." *Total Minatome Corp. v. Jack/Wade Drilling, Inc. (In re Jack/Wade Drilling, Inc.),* 258 F.3d 385, 387 (5th Cir.2001). The bankruptcy court's findings of fact are subject to clearly erroneous review, while its conclusions of law are reviewed de novo. *Id.*

B. The debtor is entitled to her full homestead exemption.

1. 11 U.S.C. § 522(p)(1)

[3] The bankruptcy estate is comprised of "all legal or equitable interests of the ***217** debtor in property as of the commencement of the case." 11 U.S.C. § 541(a)(1); *Owen v. Owen,* 500 U.S. 305, 308, 111 S.Ct. 1833, 114 L.Ed.2d 350 (1991). Rogers elected to exempt the Forney Property as her homestead under Texas state law. *See* 11 U.S.C. § 522(b); *see also* TEX. CONST. art. XVI, § 50; *see also* TEX. PROP.CODE §§ 41.001–.002. " 'An exemption is an interest withdrawn from the estate (and hence from the creditors) for the benefit of the debtor.' " *Norris v. Thomas (In re Norris),* 413 F.3d 526, 527 (5th Cir.2005) (quoting *Owen,* 500 U.S. at 308, 111 S.Ct. 1833).

[4] **[5]** Enacted as part of BAPCPA, 11 U.S.C. § 522(p)(1) limits the state law homestead exemption under certain circumstances. [1] Section 522(p)(1) prevents the debtor from exempting certain interests from the bankruptcy estate if they were acquired by the debtor during the statutory period and their aggregate value exceeds a certain dollar threshold. The statute reads, in relevant part:

> [A]s a result of electing ... to exempt property under State or local law, a debtor may not exempt any amount of interest that was acquired by the debtor during the 1215–day period preceding the date of the filing of the petition that exceeds in the aggregate [$125,000][2] in value in—real or personal property that the debtor or dependent of the debtor claims as a homestead.

11 U.S.C. § 522(p)(1)(D). The statute further states that "any amount of such interest does not include any interest transferred from a debtor's previous principal residence (which was acquired prior to the beginning of such 1215–day period) into the debtor's current principal residence, if the debtor's previous and current residences are located in the same State." *Id.* § 522(p)(2)(B).

2. The bankruptcy court held that the term "interest" refers to title, and the district court held that the term "interest" refers to equity.

Both the bankruptcy court and the district court held that Rogers was entitled to her homestead exemption, but they gave different reasons for this holding. The bankruptcy court predominantly focused on construing the relationship between different phrases in § 522(p)(1)(D) while the district court focused on interpreting the meaning of the term "interest." Ultimately, the two courts interpreted the term "interest" differently: the bankruptcy court interpreted it to mean an unquantifiable "property interest," which presumably refers to title or fee ownership, and the district court interpreted it to mean "some legal or equitable interest that can be quantified by a monetary figure," which presumably refers to equity. Both courts reached the same conclusion regarding the applicability of § 522(p)(1)(D) because a homestead interest is not the equivalent of title or equity.

The bankruptcy court construed § 522(p)(1) to mean that a debtor "can't exempt any amount in excess of $125,000 if an interest in property was acquired by the debtor during the 1,215 day period preceding the date of the filing of the petition." Thus, the bankruptcy court ***218** concluded that the phrase "any amount" modifies the phrase "that exceeds in the aggregate $125,000." In the words of the bankruptcy court, "it's got to be the interest that's acquired, not an amount of interest." The bankruptcy court concluded that § 522(p)(1) was inapplicable because Rogers acquired her "property interest" in the Forney Property in 1994, which was outside the statutory period.

Although the Texas Supreme Court has characterized the homestead interest as a "legal interest" created by the Texas Constitution, the bankruptcy court held that this "legal interest" was not the type of "property interest" covered by § 522(p)(1). Although it did not further define the term "property interest," the bankruptcy court's conclusion that the phrase "any amount" does not modify the term "interest" strongly suggests that it equated acquiring a "property interest" with acquiring title to the property. Furthermore, the only case cited by the bankruptcy court at the hearing held that the term "interest" refers to title, not equity. *See* *In re Blair,* 334 B.R. 374, 376 (Bankr.N.D.Tex.2005).

Based on the legislative history, the bankruptcy court concluded that the purpose of the statute was to close the "mansion loophole" and prevent debtors from moving to states with more generous homestead exemptions on the eve of bankruptcy in order to avail themselves of those exemptions. After observing that Rogers did not move to Texas in anticipation of bankruptcy and that her homestead designation of the Forney Property was precipitated by divorce, the bankruptcy judge overruled Wallace's objection and held that Rogers may exempt the entirety of her homestead from the bankruptcy estate.

On appeal, the district court affirmed the bankruptcy court's order. *Wallace v. Rogers (In re Rogers),* 354 B.R. 792, 798 (N.D.Tex.2006). Unlike the bankruptcy court, the district court assumed that the phrase "any amount" modifies the term "interest," so the issue was whether "the characterization of real property as a homestead qualif[ies] as an 'interest' within the phrase 'debtor may not exempt any amount of interest.' " *Id.* at 795. The district court held that the statutory language of § 522(p)(1) was unambiguous and that the term " 'interest' refers to some legal or equitable interest that can be quantified by a monetary figure." *Id.* at 796. In support of its holding that "interest" refers to a quantitative measure, the district court observed that (1) the term "interest" is modified by the term "amount," which is a quantitative term; (2) the statute mandates that the "amount of interest" may not exceed in the aggregate a specified dollar amount; and (3) § 522(p)(2)(B) allows for transfer of any amount of interest from the debtor's previous principal residence that

was acquired before the statutory period. *Id.* at 796–97. Regarding this third point, the district court noted that both § 522(p)(1) and § 522(p)(2)(B) used the term "interest," and it reasoned that only equity, which has a quantitative value, can be rolled-over into a new property, not a homestead interest. *Id.* at 797.

The district court observed that it is impossible "to have a 'quantity' of classification as homestead." *Id.* The district court disagreed with the bankruptcy court's analysis in *In re Greene,* 346 B.R. 835, 843 (Bankr.D.Nev.2006), which held that § 522(p)(1) applied to a homestead interest established within the statutory period despite the fact that the debtor acquired title to the property outside that period. *Rogers,* 354 B.R. at 797. The district court criticized the *Greene* court for ignoring statutory language indicating that the term "interest" refers to a quantitative ***219** measure. *Id.* The district court cited approvingly to the bankruptcy court's analysis in *In re Rasmussen,* 349 B.R. 747, 758 (Bankr.M.D.Fla.2006), which held that the term "interest" referred to equity in the property, not an ownership interest equivalent to a fee simple. *Rogers,* 354 B.R. at 798. The district court refused to consider the legislative history of § 522(p)(1) because it concluded that the statute was unambiguous, and it declined to address the meaning of the term "acquired" because its interpretation of the term "interest" was dispositive of the appeal. *Id.* Thus, the district court affirmed the bankruptcy court, holding that "the term 'interest' does not encompass the classification of real property as a homestead." *Id.*

3. Three other bankruptcy courts have addressed this same legal issue.

Two bankruptcy courts have held that § 522(p)(1) does not apply to a homestead interest established within the 1,215–day period if the debtor acquired title the property before that period. *See* *In re Lyons,* 355 B.R. 387, 390–91 (Bankr.D.Mass.2006); *see also Venn v. Reinhard (In re Reinhard),* 377 B.R. 315, 321 (Bankr.N.D.Fla.2007). One bankruptcy court has held to the contrary. *See* *In re Greene,* 346 B.R. 835, 843 (Bankr.D.Nev.2006). [3]

In *Lyons,* the debtor purchased the property on April 26, 1977 and recorded a homestead declaration on August 12, 2004. 355 B.R. at 389. Two weeks after the debtor recorded the homestead designation, a creditor was granted an attachment on the property in the amount of $50,000. *Id.* Regarding the applicability of § 522(p)(1)(D), the *Lyons* court held the following:

> The plain language of Section 522(p) indicates that the debtor must have acquired an interest in the property within 1,215 days of filing. The term "interest" refers to some quantitative amount of legal or equitable value. *See* *In re Rogers,* 354 B.R. 792, 796 (N.D.Tex.2006) (discussing at length the statutory construction of Section 522(p)). The homestead is not a quantifiable interest; it is a classification of property under state law. *Id.* Here, the Debtor did not acquire his interest in the Property within 1,215 days; rather, the Property "acquired" its classification as a homestead during that time. Thus, the Court finds that [Section 522(p)(1)(D)] do[es] not apply and that Debtor is entitled to the $500,000.00 homestead exemption under Massachusetts law.

355 B.R. at 390–91. Thus, the *Lyons* court adopted the reasoning of the district court in this case.

In *Reinhard,* the debtor and his wife ("the Reinhards") acquired title to a Florida property (the "Seaside Property") on February 24, 1995. 377 B.R. at 317. However, they resided in a different Florida property (the "Tallahassee Property") until June 30, 2005. *Id.* During the 1,215–day period before they filed for bankruptcy, the Reinhards moved into the Seaside Property and designated it as their homestead under Florida law. *Id.* No equity was transferred from the Tallahassee Property to the Seaside Property. *Id.* The Reinhards filed

for bankruptcy on November 3, 2006. *Id.* According to the *Reinhard* court, the issue was whether "the Debtor acquired any amount of interest in value in the Seaside Property when it acquired homestead status under Florida law." *Id.*

***220** The *Reinhard* court asserted that the acquisition of an interest in property and the acquisition of homestead status are distinct concepts because homestead status attaches to protect the property after it is acquired by the debtor. *Id.* at 319. The *Reinhard* court stated the following:

> Homestead is simply a status, constitutionally defined, which exempts certain property from execution and limits its alienability. It is not a property interest. When a Florida resident's property acquires homestead status, the owner does not acquire any of the rights traditionally associated with property interests: the right to possession, the right to use, the right to transfer—the owner already holds whatever of these he has. Accordingly, homestead status in Florida is not properly conceptualized as a stick in the bundle; rather, it is a protective safe in which the bundle is put.

Id. Thus, the *Reinhard* court concurred with the conclusion of *Rogers* and *Lyons* that a homestead is a classification of property, not a "property interest" that implicates § 522(p)(1).

Relying in part on the district court's opinion in this case, the *Reinhard* court held that the term "interest" refers to "a quantitative or monetary value in property." *Id.* at 320. The *Reinhard* court further elaborated on this concept when it stated that "the debtor must acquire some amount of interest in the value of one of the four types of property listed during the 1215–day period in order for the cap to apply." *Id.* According to the *Reinhard* court, § 522(p)(1) refers to the acquisition of monetary value in property, not in an exemption. *Id.* The debtor does not acquire additional monetary value *in the property* when she designates it as her homestead; rather, the designation merely protects the existing monetary value that the debtor acquired in the property before filing for bankruptcy. *See id.* at 321 ("Homestead status simply exempts the homesteader's existing share in the property from forced sale and limits its alienability. Therefore, the Debtor did not acquire any amount of interest in value in the Seaside Property when it acquired homestead status.").

[6] To date, only one bankruptcy court has reached a conclusion contrary to that of *Rogers*, *Lyons*, and *Reinhard*. In *Greene,* the debtor purchased a 67–acre parcel of undeveloped land (the "Sparks Property") in May 1994. 346 B.R. at 838. The debtor admitted that he lived with his girlfriend at another location until early August 2004. *Id.* On August 10, 2004, the debtor moved a travel trailer onto the property, and on August 11, 2004, the debtor designated the property and the travel trailer as his homestead. *Id.* The debtor filed his Chapter 13 petition just 16 days later, on August 27, 2004. *Id.* After the debtor voluntarily dismissed his Chapter 13 petition, the debtor filed his Chapter 7 petition on October 15, 2005. *Id.* A creditor filed a timely objection to the debtor's claimed homestead exemption, arguing that the exempted amount must be reduced from $350,000 to $125,000 pursuant to § 522(p)(1) because the homestead was an interest acquired within 1,215 days of the filing of the petition. [4] *Id.*

In *Greene,* the debtor argued that § 522(p)(1) does not apply because he purchased the property more than 1,215 days before he filed the petition. *Id.* at 840. In rejecting this argument, the *Greene* court stated that the homestead exemption is a "property interest" that "lies dormant and inactive until it is *acquired* by the debtor." *Id.* at 842. In the words of the *Greene* court, "[w]hat must be acquired during the 1,215 day period is the homestead exemption, ***221** not the real property. These are separate interests." *Id.* at 842–43. Although the *Greene* court recognized that the debtor's interest in the property includes title to the property, it insisted that the term "interest" refers to a broader concept. *See id.* at 843 ("Whatever Debtor had in his bundle of rights and interests pertaining to the Property, homestead protection was not one of them."). Thus, the *Greene* court concluded that the debtor's homestead interest "is a property interest acquired within 1,215 days of his bankruptcy petition and is limited to $125,000 pursuant to Section 522(p)." *Id.*

4. Other courts have addressed the meaning of the term "interest" in cases involving different facts.

For purposes of § 522(p)(1), other courts have generally defined "interest" as either title[5] or equity.[6] Those courts adopting the equity definition have been forced to address complex issues regarding passive and active equity appreciation during the 1,215–day period. *See In re Rasmussen,* 349 B.R. at 757–58 (distinguishing between active equity appreciation, which is subject to the cap, and passive equity appreciation, which is not); *see In re Chouinard,* 358 B.R. at 815 (holding that "passive market appreciation" resulting in increased equity is not an interest that a debtor "acquires" during the statutory period). In contrast, those courts adopting the title definition have crafted an easily-applied rule that is arguably in conflict with the statutory language indicating that the term "interest" refers to a quantitative or monetary value.[7] *See In re Sainlar,* 344 B.R. at 669 (holding that § 522(p)(1) "has no applicability to property in which a ***222** debtor obtained an ownership interest more than 1,215 days before the petition date, even if the property's equity increases [through market appreciation or principal debt reduction] during the 1,215–day pre-petition period"); *see In re Blair,* 334 B.R. at 375, 378 (same); *see In re Anderson,* 374 B.R. at 859–60 (same).

5. A homestead interest is not the equivalent of title or equity.

[7] We find it unnecessary at this time to pick a side in the title versus equity debate. A homestead interest is not the equivalent of title or equity. In this case, Rogers acquired title to the property when she inherited it from her mother in 1994, which was outside the statutory period. Those courts adopting the title definition of "interest" would conclude that § 522(p)(1) is inapplicable to Rogers. *See In re Anderson,* 374 B.R. at 861. Rogers acquired most of her equity in the Forney Property at the time she inherited it in 1994. Those courts adopting the equity definition of "interest" would also conclude that § 522(p)(1) is inapplicable to Rogers.[8] She did not actively acquire equity through making a down payment or monthly mortgage payments on the Forney Property during the statutory period. *See In re Rasmussen,* 349 B.R. at 757. Rogers made capital improvements to the Forney Property by spending less than $100,000 of her retirement money to construct a permanent residence, but the aggregate value of those improvements did not exceed $125,000. Rogers presumably benefitted from market appreciation during the statutory period; however, those courts adopting the equity definition of "interest" have concluded that passive equity appreciation is not "acquired" by the debtor and not covered by § 522(p)(1). *Id.* at 757–58.

[8] Wallace argues that Rogers acquired an interest in the Forney Property during the 1,215–day period because the divorce decree divested the debtor's husband of "all right, title, interest, and claim" in the Forney Property and awarded it to the debtor. Recently, a bankruptcy court addressed the issue of whether acquiring an ex-spouse's community property interest in the homestead property is a form of active equity appreciation that is subject to § 522(p)(1). If the Forney Property had constituted the community property of the debtor and her husband, then Wallace's argument might have some merit. *See In re Presto,* 376 B.R. at 576. However, the Forney Property was the debtor's separate property because she inherited it from her mother before marriage. *See* TEX. FAM.CODE § 3.001. A trial court in Texas has no discretion to divest title to separate property and award that property to the other spouse in a divorce. *Cameron v.* ***223** *Cameron,* 641 S.W.2d 210, 219–20 (Tex.1982). In this case, the divorce decree did not increase Rogers's equity share in the Forney Property because she owned it as her separate property. Rogers did not acquire "new value in a homestead through a divorce decree." *See In re Presto,* 376 B.R. at 580.

6. A homestead interest is not covered by § 522(p)(1) because it does not constitute a vested economic interest in property.

[9] [10] [11] [12] [13] Wallace does not appear to quarrel with the proposition that the debtor's acquisition of title or equity during the 1,215–day period can implicate the homestead exemption cap. He is simply advocating a more expansive definition of "interest" that includes a "homestead interest." Although other courts have interpreted the term "interest" more narrowly, we must determine whether the term refers to a broader concept that includes a homestead interest.[9] "The answer to this federal question, however,

largely depends upon state law." *United States v. Craft,* 535 U.S. 274, 278, 122 S.Ct. 1414, 152 L.Ed.2d 437 (2002). Thus, we look initially to state law to determine what rights the debtor had in the Forney Property pursuant to Texas homestead law, then to federal law to determine whether the debtor's "state-delineated rights" qualify as an "interest" within the compass of the homestead exemption cap. *Id.* In *Craft*, which addressed whether property held as a tenant by the entirety constituted "property and rights to property" for purposes of the federal tax lien statute, the Supreme Court stated the following:

> A common idiom describes property as a "bundle of sticks"—a collection of individual rights which, in certain combinations, constitute property. State law determines only which sticks are in a person's bundle. Whether those sticks qualify as "property" for purposes of the federal tax lien statute is a question of federal law. In looking to state law, we must be careful to consider the substance of the rights state law provides, not merely the labels the State gives these rights or the conclusions it draws from them. Such state law labels are irrelevant to the federal question of which bundles of rights constitute property that may be attached by a federal tax lien.

Id. at 278–79, 122 S.Ct. 1414 (internal citations omitted). In *Craft,* the Supreme Court held that "the statutory language authorizing the tax lien is broad and reveals on its face that Congress meant to reach every interest in property that a ***224** taxpayer might have." *Id.* at 283, 122 S.Ct. 1414 (internal quotation marks omitted). Accordingly, the Supreme Court held that the husband's rights in the entireties property fall within this broad statutory language: "all property and rights to property." *Id.*; 26 U.S.C. § 6321. Based on the statutory language of 11 U.S.C. § 522(p)(1), we find that Congress did not intend the scope of the term "interest" to sweep so broadly.

[14] **[15]** **[16]** Under Texas law, "[t]he homestead interest is a legal interest created by the constitution that provides prophylactic protection from all but [a few] types of constitutionally permitted liens against homesteads. This interest ... gives protective legal security rather than vested economic rights."[10] *Heggen v. Pemelton,* 836 S.W.2d 145, 148 (Tex.1992). Although the Texas Supreme Court referred to the homestead interest as a "legal interest" in *Heggen,* we must look beyond that label and consider the substance of the right conferred by state law. *See Craft,* 535 U.S. at 279, 122 S.Ct. 1414. Based on our review of the statutory language, we conclude that the term "interest" as used in § 522(p)(1) refers to vested economic interests that the debtor acquires in the homestead property during the 1,215–day period preceding the filing of the petition. Thus, a homestead interest established within the statutory period, without more, does not fall within the purview of § 522(p)(1).

[17] Unlike a homestead interest, title and equity both constitute vested economic interests in the homestead property that can be acquired during the 1,215–day period preceding the filing of the petition. These interests are vested because they have an ascertainable economic value at the moment they are acquired by the debtor. In contrast, for purposes of federal bankruptcy law, the homestead exemption is valueless until it is claimed in bankruptcy, such that any value attributable to the exemption is not realized by the debtor until *after* the filing of the petition. Wallace essentially argues that "interest" refers to all rights that enhance a debtor's claimed exemption on Schedule C. However, we believe that "interest" refers to property interests acquired within the statutory period that the debtor "may not exempt" from the bankruptcy estate. "Value" as used in § 522(p)(1) refers to the economic value of the property interests acquired within the statutory period, not the value of the exemption claimed by the debtor.

[18] Although we decline to address whether the equity definition of "interest" is correct, we concur with the *Reinhard* court's conclusion that the debtor must acquire vested economic interests *in the homestead property* during the 1,215–day period. A debtor acquires an interest in property, not in an exemption. *See Owen,* 500 U.S. at 311 n. 4, 111 S.Ct. 1833 ("[T]here would be no debtor's interest in the property to which a[n] ... exemption could attach."). "A fundamental canon of statutory construction instructs that in the absence of a statutory definition, we give terms their ordinary meaning." *Hamilton v. United Healthcare of La., Inc.,* 310 F.3d 385, 391 (5th Cir.2002). BLACK'S LAW DICTIONARY 828 (8th ed.2005) defines "interest" as "a legal share in something; all or part of a legal or equitable claim to or right in ***225** property <right, title, and interest>." Similarly, WEBSTER'S THIRD NEW INTERNATIONAL DICTIONARY 1178 (1971) defines "interest" as "right, title, or legal share in something" and "something in which one

has a share of ownership or control." These definitions clearly indicate that one has "interests" in the property itself, not in the exemption that protects those interests.

[19] **[20]** For purposes of federal bankruptcy law, the homestead exemption is not a separate interest, but rather the status of a withdrawn interest in property that was acquired prior to bankruptcy. *See* *Norris v. Thomas,* 215 S.W.3d 851, 856 (Tex.2007) ("[W]e agree that the proper test for whether a residence attains homestead status ...."); *see also* *Owen,* 500 U.S. at 308, 111 S.Ct. 1833 ("An exemption is an interest withdrawn from the estate"). The homestead interest simply gives "protective legal security" to those vested economic interests in property that were acquired by the debtor before the filing of the petition. *Heggen,* 836 S.W.2d at 148; *see* *Laster,* 826 S.W.2d at 131 ("[The party's] homestead interest protects the portion of the property that she owns.").

[21] Our own precedent has recognized that a homestead interest is a legal right vested in the individual to attach an exempt status to existing property interests. *See Perry v. Dearing (In re Perry),* 345 F.3d 303, 314–15 (5th Cir.2003) ("According to the Texas Supreme Court, it is a well-recognized principle of law that one's homestead right in property can never rise any higher than the right, title, or interest that he owns in the property attempted to be *impressed* with a homestead right.") (internal quotation marks and ellipsis omitted) (emphasis added). The homestead exemption and the property interest impressed with that exemption are discrete concepts: the former is the debtor's legal right to exempt certain property interests from the bankruptcy estate, the latter is the debtor's vested economic interests in the property itself.

Although the Texas Supreme Court has characterized the homestead interest as "an estate in land" that is "analogous to a life tenancy," this language merely describes the scope of the protective legal security afforded by the homestead interest. *See* *Laster,* 826 S.W.2d at 129–31 (discussing the analogy and concluding that one spouse's homestead designation did not affect "any property interest *protected* by [the other spouse's] homestead right.") (emphasis added). The homestead interest does not increase the vested economic interests that the debtor holds in the homestead property; rather, it simply protects those vested economic interests in the property that the debtor acquired before the filing of the petition.

Thus, we find that the *Greene* court construed the scope of the term "interest" too broadly. What must be acquired during the statutory period is vested economic interests in the homestead property.

7. Other sections of 11 U.S.C. § 522 indicate that the term "interest" refers to a vested economic interest in property.

[22] **[23]** **[24]** **[25]** **[26]** "The starting point in discerning congressional intent is the existing statutory text." *Lamie v. United States Trustee,* 540 U.S. 526, 534, 124 S.Ct. 1023, 157 L.Ed.2d 1024 (2004). "[W]hen the statute's language is plain, the sole function of the courts—at least where the disposition required by the text is not absurd—is to enforce it according to its terms." *Id.* (internal quotation marks omitted). Only after application of the principles of statutory construction, including the canons of construction, and after a conclusion that the statute is ambiguous ***226** may the court turn to the legislative history. *Carrieri v. Jobs.com, Inc.,* 393 F.3d 508, 518–19 (5th Cir.2004). For the language to be considered ambiguous, however, it must be susceptible to more than one reasonable interpretation or more than one accepted meaning. *Id.* at 519. However, a statute is not ambiguous simply because it is inartfully drafted. *See* *Lamie,* 540 U.S. at 534, 124 S.Ct. 1023 ("The statute is awkward, and even ungrammatical; but that does not make it ambiguous on the point at issue.").

The statute is not ambiguous as to whether a homestead interest is covered by § 522(p)(1). The term "interest" is used in several sections of 11 U.S.C. § 522 and consistently refers to some vested economic interest in property. For example, § 522(b)(3)(B), which addresses state exemptions, characterizes "an interest as a tenant by the entirety or joint tenant" as an "interest in property." Section 522(d)(1), which addresses federal exemptions, states that the debtor may exempt her "aggregate interest, not to exceed $20,200 in value, in real property ... that the debtor ... uses as a residence." Section 522(p)(2)(B) states that "any amount of interest" does not include any interest transferred from a debtor's previous principal

residence that was acquired outside the statutory period. In contrast to "interests," which refer to vested economic interests in property, "exemptions" refer to those interests that are withdrawn from the estate. *See* 11 U.S.C. § 522(b)(1) ("[A]n individual debtor may exempt from property of the estate the property listed in either paragraph (2) [federal exemptions] or, in the alternative, paragraph (3) [state exemptions]."). Section 522(p)(1) prevents the debtor from withdrawing certain vested economic interests in property from the bankruptcy estate if they were acquired by the debtor during the statutory period and their aggregate value exceeds a certain dollar threshold.

8. The legislative history indicates that the term "interest" refers to a vested economic interest in property.

[27] Even assuming that § 522(p)(1) is ambiguous, the legislative history makes clear that the term "interest" refers to some vested economic interest in property acquired during the statutory period, not a homestead interest. "Extrinsic materials have a role in statutory interpretation only to the extent they shed a reliable light on the enacting Legislature's understanding of otherwise ambiguous terms." *Exxon Mobil Corp. v. Allapattah Servs., Inc.*, 545 U.S. 546, 568, 125 S.Ct. 2611, 162 L.Ed.2d 502 (2005). The House Report specifically addressed the meaning of § 522(p):

> Sec. 322. Limitations on Homestead Exemption. Section 322(a) amends section 522 of the Bankruptcy Code to impose an aggregate monetary limitation of $125,000 ... on the value of property that the debtor may claim as exempt under State or local law pursuant to section 522(b)(3)(A) under certain circumstances. The monetary cap applies if the debtor acquired such property within the 1,215–day period preceding the filing of the petition and the property consists of any of the following: (1) real or personal property of the debtor or that a dependent of the debtor uses as a residence ... (4) real or personal property that the debtor or dependent of the debtor claims as a homestead.... In addition, the limitation does not apply to any interest transferred from a debtor's principal residence (which was acquired prior to the beginning of the specified time period) to the debtor's current principal residence, if both the previous and current residences are located in the same State.

H.R.Rep. No. 109–31(I) (2005), *reprinted in* 2005 U.S.C.C.A.N. 88, 148, ***227** 2005 WL 832198, *81. This piece of legislative history has been cited approvingly by those courts adopting the title definition of interest. *See, e.g.*, *In re Sainlar*, at 344 B.R. at 673–74. The legislative history indicates that Congress was concerned with the acquisition of vested economic interests in property during the statutory period.

On March 10, 2005, Senator Carper stated the following:

> Today, under current law, a wealthy individual in a State such as Florida or Texas can go out, if they are a millionaire, and take those millions of dollars and invest that money in real estate, a huge house, property, and land in the State, file for bankruptcy, and basically protect all of their assets which they own because of a provision in Florida and Texas law.

151 Cong. Rec. S2415–02 (daily ed. March 10, 2005), at *S2415–*S2416.

> With the legislation we have before us, someone has to figure out that 2-1/2 years ahead of time people are going to want to file for bankruptcy and be smart enough to put the money into a home, or an estate, or into a trust—not something you can do today—and file for bankruptcy tomorrow; or this year

> and file for bankruptcy next year or the next 2 or 3 years, or 3-1/2 years.

Id. at *S2416. Senator Carper's statement has been cited approvingly by those courts adopting the equity definition of interest. *See, e.g.,* *In re Rasmussen,* 349 B.R. at 758. Senator Carper's statement is also supported by language in the House Report, which states that "[t]he bill also restricts the so-called 'mansion loophole.' Under current bankruptcy law, debtors living in certain states can shield from their creditors virtually all of the equity in their homes. In light of this, some debtors actually relocate to these states just to take advantage of their 'mansion loophole' laws." H.R.Rep. No. 109–31(I) (2005), 2005 WL 832198, *15–*16. In this case, it is undisputed that Rogers did not relocate to Texas to exploit the so-called "mansion loophole."

Wallace cites to the House Report, which states that "[t]he bill further reduces the opportunity for abuse by requiring a debtor to own the homestead for at least 40 months before he or she can use state exemption law." *Id.* at *16. Considering the fact that one "owns" property, not a homestead interest, we do not find this piece of legislative history to be particularly probative of congressional intent.

According to Wallace, BAPCPA was intended to address fraudulent transfers in general, including conversions of non-exempt assets into exempt assets within the statutory period. *Cf.* *In re Kane,* 336 B.R. 477, 481–82 (Bankr.D.Nev.2006). We concur with the *Reinhard* court's observation that "Congress could have defined all [the] debtors' exemptions to be whatever they would have been 1215 days before the filing of the petition. Instead, Congress defined the cap more narrowly." 377 B.R. at 321. We do not believe that Congress was concerned with the timing of the establishment of the homestead when it enacted § 522(p)(1). The statutory text and legislative history indicate that the term "interest" refers to vested economic interests in the property that were acquired by the debtor within the 1,215–day period preceding the filing of the petition. "If Congress enacted into law something different from what it intended, then it should amend the statute to conform it to its intent." *Lamie,* 540 U.S. at 542, 124 S.Ct. 1023. We hold that Rogers is entitled to her full homestead exemption under Texas state law.

AFFIRMED.

All Citations

513 F.3d 212, Bankr. L. Rep. P 81,081

Footnotes

1 Unlike most other provisions of the statute, 11 U.S.C. § 522(p) became effective immediately upon enactment of BAPCPA on April 20, 2005. *See* Pub.L. No. 109–8, § 1501(b)(2), 119 Stat. 23, 216 (2005).

2 In 2007, the Judicial Conference of the United States adjusted the dollar amount from $125,000 to $136,875. *See* 72 Fed.Reg. 7082–01 (Feb. 14, 2007); 11 U.S.C. § 104(b). At the time the bankruptcy petition was filed in this case, the relevant dollar amount was $125,000.

3 The bankruptcy court decision in *Greene* was affirmed by the district court in an unpublished opinion, and the case is currently on appeal before the Ninth Circuit.

4 In Nevada, the homestead exemption extends to the claimant's equity in the homestead property up to a maximum of $350,000. NEV.REV.STAT. § 115.010(2).

5 *See* *In re Anderson,* 374 B.R. 848, 859 (Bankr.D.Kan.2007) (holding that the phrase "interest that was acquired" should be construed as "applying to the actual purchase or acquisition of an ownership or fee

interest in the homestead property"); *see* *In re Sainlar,* 344 B.R. 669, 673 (Bankr.M.D.Fla.2006) ("The phrase 'interest that was acquired' as used in § 522(p)(1) means the acquisition of ownership of real property. Section 522(p), therefore, does not apply to property to which a debtor acquired title more than 1,215 days before a bankruptcy filing."); *see* *In re Blair,* 334 B.R. 374, 376–77 (Bankr.N.D.Tex.2005) (holding that § 522(p)(1) was inapplicable because the debtors "acquired title and fee to their home" before the statutory period); *see* *Khan v. Bankowski (In re Khan),* 375 B.R. 5, 13–14 (B.A.P. 1st Cir.2007) (holding that § 522(p)(1) applied because legal title to the property was transferred from a trust to the debtor within the statutory period); *see also* 4 COLLIER ON BANKRUPTCY 522.13[2] (Alan N. Resnick & Henry J. Sommer eds., 15th ed. rev. 2007) ("[T]he phrase ['interest that was acquired'] should be construed as applying to the actual purchase or acquisition of an ownership or fee interest in the homestead property.")

6 *See* *In re Rasmussen,* 349 B.R. 747, 756 (Bankr.M.D.Fla.2006) (concluding that the term "interest" means "equity in the homestead acquired by a debtor during the 1,215–day period," not title or a fee simple ownership interest); *see* *In re Chouinard,* 358 B.R. 814, 815 (Bankr.M.D.Fla.2006) (concurring with the *Rasmussen* court's holding that the term "interest" refers to equity); *see* *In re Rogers,* 354 B.R. at 798 (holding that interest refers to some legal or equitable interest that can be quantified by a monetary figure and stating that "[t]he court finds *In re Rasmussen* to [be] a better reasoned interpretation of § 522(p)"); *see* *In re Reinhard,* 377 B.R. at 320 (citing *Rogers,* *Lyons*, and *Rasmussen* and holding that the term "interest" refers to "a quantitative or monetary value in property"); *see* *In re Presto,* 376 B.R. 554, 577 (Bankr.S.D.Tex.2007) (adopting the *Rogers* interpretation of the term "interest"); *see also* Shaun Mulreed, Casenote, *In re Blair Misses the Mark: An Alternative Interpretation of the BAPCPA's Homestead Exemption,* 43 SAN DIEGO L.REV. 1071, 1087 (2006) (arguing that the phrase "interest that was acquired" should apply "to all equity acquired within the 1,215 days preceding the filing of a bankruptcy petition").

7 Those courts and commentators adopting the title definition of "interest" have indicated that creditors could challenge fraudulent mortgage payments or capital improvements made during the statutory period through another BAPCPA provision, 11 U.S.C. § 522(*o*). *See* *In re Anderson,* 374 B.R. at 858 ("The Court concludes that accumulation of equity by early payoff or substantially paying down the mortgage against the homestead property, such as debtor's $240,000 one-time lump sum payment during the 1,215 day period here, may be subject to challenge under § 522(*o*)."); *see also* 4 COLLIER ON BANKRUPTCY 522.13[2] (same). Unlike § 522(p)(1), § 522(*o*) requires proof of "intent to hinder, delay, or defraud a creditor." *See* *In re Anderson,* 374 B.R. at 859–60.

8 The date of acquisition of title is irrelevant for purposes of the equity definition; however, if title is acquired during the statutory period, any lump-sum down payment made in connection with closing (*i.e.* the date of acquisition of title) would apply towards the $125,000 equity cap. In this case, Rogers inherited the Forney Property in 1994, so she did not make a down payment during the statutory period that would apply towards the cap.

9 We note the distinction between a homestead interest and a homestead designation. "To establish homestead rights, the claimant must show a combination of both overt acts of homestead usage and the intention on the part of the owner to claim the land as a homestead." *Dominguez v. Castaneda,* 163 S.W.3d 318, 330 (Tex.App.—El Paso 2005, pet. denied). Thus, a homestead interest is established when those two elements

are satisfied. In contrast, a homestead designation refers to the ministerial act of recording a notice in the county deed records. TEX. PROP.CODE § 41.005; *see id.* at § 41.021 (allowing judgment debtors to record a homestead designation under § 41.005 after execution is issued). In this case, the debtor established her homestead rights and recorded her homestead designation within the statutory period. *Cf.* *Laster v. First Huntsville Props. Co.,* 826 S.W.2d 125, 130–32 (Tex.1991) (using the term "homestead right" and "homestead interest" interchangeably). If the debtor had established her homestead rights outside the statutory period and filed her homestead designation within the statutory period, then § 522(p)(1) would also be inapplicable. Even assuming that a homestead interest is "acquired" by the debtor, which we do not decide, we conclude that it is not the type of "interest" covered by § 522(p)(1).

10 "Homesteads are protected from forced sale for the payment of debts, except for those debts specifically enumerated in the constitution, including debts incurred for purchase money on the homestead, taxes thereon, work or services performed thereon, certain extensions of credit, and certain reverse mortgages." *Florey v. Estate of McConnell,* 212 S.W.3d 439, 443 (Tex.App.—Austin 2006, no pet.).

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Disagreed With by Parks v. Anderson, D.Kan., May 19, 2009

344 B.R. 669
United States Bankruptcy Court,
M.D. Florida,
Orlando Division.

In re Thomas William SAINLAR
and Sheryl A. Sainlar, Debtors.

No. 6:05–BK–14070–ABB.
|
March 21, 2006.

Synopsis

Background: Judgment creditor objected to the Florida homestead exemption claimed by Chapter 7 debtors.

[Holding:] The Bankruptcy Court, Arthur B. Briskman, J., held that the term "interest," as used in the section of the Bankruptcy Abuse Prevention and Consumer Protection Act (BAPCPA) applying a $125,000 exemption cap on "any amount of interest that was acquired by the debtor" less than 1,215 days before the petition date, refers to real property purchased or otherwise acquired by a debtor within 1,215 days of the petition date, and it does not encompass the equity gained in property, to which a debtor acquired title more than 1,215 days before the petition date, as a result of appreciation or a decrease in secured debt during the 1,215-day period.

Objection overruled; claim of homestead exemption allowed.

West Headnotes (6)

[1] **Bankruptcy** Validity and effect of opt-out legislation

Federal exemptions are not available to debtors who commence cases in states that have "opted out" of the federal exemptions. 11 U.S.C.A. § 522(d).

[2] **Bankruptcy** Validity and effect of opt-out legislation

Florida has "opted out" of the federal exemptions and provides its own state law exemptions. West's F.S.A. § 222.20.

[3] **Bankruptcy** Validity and effect of opt-out legislation

Debtors filing for bankruptcy protection in Florida are entitled to the Florida state law exemptions. West's F.S.A. § 222.20.

[4] **Bankruptcy** Waiver or Loss of Exemption

Term "interest," as used in the section of the Bankruptcy Abuse Prevention and Consumer Protection Act (BAPCPA) applying a $125,000 homestead exemption cap on "any amount of interest that was acquired by the debtor" less than 1,215 days before the petition date, refers to real property purchased or otherwise acquired by a debtor within 1,215 days of the petition date; it does not encompass the equity gained in property, to which a debtor acquired title more than 1,215 days before the petition date, as a result of appreciation or a decrease in secured debt during the 1,215-day period. 11 U.S.C.A. § 522(p)(1).

16 Cases that cite this headnote

[5] **Property** Acquisition, Transfer, and Disposition of Property in General

Word "acquired" is not a term of art in the law of property, but one in common use, the plain import of which is "obtained as one's own."

9 Cases that cite this headnote

[6] **Mortgages and Deeds of Trust** Scope, Operation, and Effect of Transaction; Rights, Duties, and Liabilities of Parties

"Equity" is the difference between value of real property and debt.

1 Cases that cite this headnote

Attorneys and Law Firms

***670** Robert H. Pflueger, Robert H. Pflueger PA, Altamonte Springs, FL, for Debtors.

ORDER

ARTHUR B. BRISKMAN, Bankruptcy Judge.

This matter came before the Court on the Objection to Debtors' Claim of Exemption [1] ("Objection") filed by Bank One Kentucky, N.A. ("Bank One"). Bank One objects, pursuant to 11 U.S.C. § 522(p), to the homestead exemption claimed by Thomas William Sainlar and Sheryl A. Sainlar (collectively, the "Debtors"). An evidentiary hearing on the Objection was held on January 9, 2006 at which counsel for Bank One and counsel for the Debtors appeared. Bank One and the Debtors filed supporting legal memoranda. [2] An *amicas curiae* brief was filed by the National Association of Consumer Bankruptcy Attorneys in Opposition to Objection to Debtors' Homestead Exemption. [3] After reviewing the pleadings and evidence, hearing argument, and being otherwise fully advised in the premises, the Court finds that the Debtors' claim of exemption in their homestead is proper. The following Findings of Fact and Conclusions of Law are made:

FINDINGS OF FACT

There are no factual issues in dispute. The Debtors purchased a single family home located at 215 Acadia Terrace, Celebration, Florida 34747 (the "Property") on March 6, 2001 for the amount of $783,000. The Property is their homestead. The Debtors filed a joint Chapter 7 bankruptcy case on October 12, 2005 ("Petition Date"). The Debtors, on the Petition Date, owned the Property in excess of 1,215 days. The Debtors list the Property as an asset in Schedule A and claim the Property fully exempt in Schedule C pursuant to Florida ***671** state homestead exemption law. [4] They valued the Property at $809,400 in Schedule A and Schedule D reflects a secured claim encumbering the Property in the amount of $480,094 held by Citicorp Mortgage ("Citicorp"). [5] Citicorp has not filed a proof of claim in this case.

The Debtors now believe the Property's value on the Petition Date was $1,400,000. The Property's value has increased by at least $617,000 since the purchase date and equity of at least $919,906 exists in the Property. [6]

Bank One, the Debtors' largest unsecured creditor, filed a $559,495.50 unsecured claim. [7] The claim arises from a pre-petition judgment obtained by Bank One against the Debtors and another defendant. Bank One contends the Debtors are limited to an exemption of no more than $125,000 in the Property and the creditors are entitled to the appreciation in value in excess of $125,000 pursuant to 11 U.S.C. § 522(p).

CONCLUSIONS OF LAW

The sole issue for determination is the meaning of the word "interest" contained in the phrase "any amount of interest that was acquired by the debtor during the 1,215–day period" of 11 U.S.C. § 522(p)(1). [8] Does "interest" encompass any and all appreciation in a property's value during the 1,215–day pre-petition period, regardless of when a debtor acquired title to the property? Does "interest" relate only to property a debtor acquired title to during the 1,215–day period? The Code does not define what specific interest a debtor must acquire in property during the 1,215–day period to fall within the ambit of § 522(p).

The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ("BAPCPA") was enacted on April 20, 2005. [9] The Debtors filed their bankruptcy case after the enactment date. The new law became generally effective on October 17, 2005, but certain provisions became effective upon enactment. Section 522(p)(1) became effective upon enactment of BAPCPA:

> (1) Except as provided in paragraph (2) of this subsection and sections 544 and 548, 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 interest that was acquired by the debtor during the 1215–day period

preceding the date of the filing of the petition that exceeds in the aggregate $125,000 in value in—

(A) real or personal property that the debtor or a dependent of the debtor uses as a residence;

....

11 U.S.C. § 522(p)(1) (2005). [10]

[1] [2] [3] Section 522(d) of the Bankruptcy Code sets forth federal exemptions that ***672** protect property of individual debtors. Exemption of property is fundamental to a debtor's fresh start. The federal exemptions are not available to debtors who commence cases in states that have "opted out" of the federal exemptions. [11] The majority of states, including Florida, have opted out of the federal exemptions and provide their own state law exemptions. [12] Debtors filing for bankruptcy protection in Florida are entitled to the Florida state law exemptions. The Florida exemptions include a homestead exemption available to qualifying debtors for protection of their Florida homesteads. The exemption provides:

(a) There shall be exempt from forced sale under process of any court, and no judgment, decree or execution shall be a lien thereon, except for the payment of taxes and assessments thereon, obligations contracted for the purchase, improvement or repair thereof, or obligations contracted for house, field or other labor performed on the realty, the following property owned by a natural person:

(1) a homestead, if located outside a municipality, to the extent of one hundred sixty acres of contiguous land and improvements thereon, which shall not be reduced without the owner's consent by reason of subsequent inclusion in a municipality; or if located within a municipality, to the extent of one-half acre of contiguous land, upon which the exemption shall be limited to the residence of the owner's family.

FLA. CONST. art. X, Section 4(a)(1). The Debtors claim the Property as fully exempt in Schedule C pursuant to the Florida homestead exemption and Florida Statutes §§ 222.01, 222.02, and 222.05.

[4] Bank One objects to their homestead exemption claim contending § 522(p) limits the Debtors' homestead exemption to $125,000. Bank One argues the phrase "any amount of interest acquired by the debtor during the 1215–day period" contained in § 522(p) encompasses the equity gained in the Property during the 1,215–day period preceding the Petition Date. The Debtors contend the phrase only applies to property a debtor purchases or acquires an interest in within 1,215 days of the petition date. The Debtors argue they did not acquire "any amount of interest" during the 1,215–day period, since they purchased the Property more than 1,215 days prior to filing for bankruptcy, and § 522(p) does not limit their homestead exemption.

Bank One's reading of § 522(p)(1) would have the statute encompass not only all property purchased or acquired by debtors within the 1,215–day period, but all property purchased prior to the 1,215–day period in which the equity value increased as a result of appreciation in the property's value and/or a decrease of secured debt (a consequence of payments reducing the principal balance of a mortgage). Bank One's reading of § 522(p)(1) is inconsistent with the plain language of the statute and the common definitions of its words.

[5] [6] The Supreme Court explained in *Helvering v. San Joaquin Fruit & Investment Co.*, 297 U.S. 496, 56 S.Ct. 569, 80 L.Ed. 824 (1936): "The word 'acquired' is not a term of art in the law of property but one in common use." The plain import of ***673** the word is "obtained as one's own." [13] Black's Law Dictionary sets forth "acquire" means: "[t]o gain possession or control of; to get or obtain." [14] "Interest" is defined as "[a] legal share in something; all or part of a legal or equitable claim to or right in property." [15] Title to real property is acquired, equity is not. Equity is the difference between value and debt. It is not a constant, but fluctuates based upon market conditions and when mortgage principal is paid. A debtor who holds title to property obtained that property as the debtor's own. The debtor's interest in the property is his legal right in the property.

The phrase "interest that was acquired" as used in § 522(p)(1) means the acquisition of ownership of real property. Section 522(p), therefore, does not apply to property to which a debtor acquired title more than 1,215 days before a bankruptcy filing. The Debtors acquired an interest in the Property through their purchase of the Property in March 2001. The Debtors had owned the Property in excess of 1,215 days when they filed for bankruptcy protection. Section 522(p) does not apply to the Property. The Debtors' homestead

is not subject to the $125,000 cap. The Debtors are entitled to fully exempt the Property pursuant to the Florida homestead exemption.

Legislative History

An analysis of § 522(p)'s legislative history is not required because the statute is unambiguous. The legislative history makes it clear that "interest" in § 522(p) means acquisition of ownership of property within the 1,215–day period, even if one finds the plain language of § 522(p) ambiguous:

> The bill also restricts the so-called "mansion loophole." Under current bankruptcy law, debtors living in certain states can shield from their creditors virtually all the equity in their homes. In light of this, some debtors actually relocated to these states just to take advantage of their "mansion loophole" laws. S.256 closes this loophole for abuse by requiring a debtor to be a domiciliary in the state for at least two years before he or she can claim that state's homestead exemption; the current requirement can be as little as 91 days. The bill further reduces this opportunity for abuse by requiring a debtor to own the homestead for at least 40 months before he or she can use state exemption law; current law imposes no such requirement.

H.R. REP. NO. 109–31(Part I) (2005), *reprinted in* 2005 (June) U.S.C.C.A.N. 102. A footnote further explains:

> If the debtor owns the homestead for less than 40 months, the provision imposes a $125,000 homestead cap. In effect, this provision overrides state exemption law authorizing a homestead exemption in excess of this amount and allows such law to control if it authorizes a homestead exemption in a lesser amount.

Id. at 102 n. 72. The House Report explains § 322(a) of BAPCPA (which is now § 522(p) of the Bankruptcy Code):

> "[This §] amends § 522 of the Bankruptcy Code to impose an aggregate monetary limitation of $125,000 ... on the value of property that the debtor may claim as exempt under State or local law pursuant to § 522(b)(3)(A) *under certain circumstances.* The monetary ***674** cap applies if the debtor *acquired* such property within the 1,215–day period preceding the filing of the petition ...."

Id. at 148 (emphasis added).

Both a reading of the plain, unambiguous language of § 522(p)(1) and the statute's legislative history lead to the same result: the monetary cap of § 522(p) is inapplicable to property purchased by a debtor more than 1,215 days before the petition date.

This conclusion is consistent with the rulings of other bankruptcy courts. The United States Bankruptcy Court for the Northern District of Texas, Dallas Division, held the increase in the value of the equity in the debtors' home was not subject to the $125,000 cap of § 522(p) because they purchased their home outside of the 1,215–day period. "The 'interest' the Debtors acquired was the actual purchase of the home, which was completed well before the 1215–day period." *In re Blair,* 334 B.R. 374, 377 (Bankr.N.D.Tex.2005). The United States Bankruptcy Court for the District of Nevada, in two decisions jointly issued on October 31, 2005, sustained the trustee's objections to the debtors' homestead exemptions and limited the debtors' homestead exemptions to $125,000 because they "acquired

their homes within the 1215 days before the filing...." *In re Virissimo,* 332 B.R. 201, 207 (Bankr.D.Nev.2005). [16] The United States Bankruptcy Court for the District of Arizona held, "Code § 522(p), as added by BAPCPA, applies a $125,000 cap on a homestead if it was acquired by the debtor within 1215 days prepetition...." *In re McNabb,* 326 B.R. 785, 788 (Bankr.D.Ariz.2005). [17]

Conclusion

The $125,000 exemption cap of 11 U.S.C. § 522(p) applies only to real property purchased or otherwise acquired by a debtor within 1,215 days of the petition date. The statute has no applicability to property in which a debtor obtained an ownership interest more than 1,215 days before the petition date, even if the property's equity increases during the 1,215–day pre-petition period. Section § 522(p) is not applicable to the Debtors' Property and does not limit their homestead exemption.

Accordingly, it is

ORDERED, ADJUDGED and DECREED that Bank One's Objection is hereby **OVERRULED;** and it is further

ORDERED, ADJUDGED and DECREED that the Debtors' homestead exemption claim is **ALLOWED** and their home located at 215 Acadia Terrace, Celebration, ***675** Florida 34747 is exempt in its entirety.

All Citations

344 B.R. 669, Bankr. L. Rep. P 80,712

Footnotes

1 Doc. No. 12.

2 Doc. No. 18; Doc. No. 20.

3 Doc. No. 21.

4 Doc. No. 1.

5 Doc. No. 1 (Schedules A and D).

6 A secured priority claim (Claim No. 2) in the amount of $39,520.40 was filed by the Kentucky Department of Revenue. It has not been determined yet whether this claim encumbers the Property and thereby needs to be included in an equity calculation. Even if this claim affects the Property, a substantial amount of equity exists.

7 Claim No. 1.

8 The Court does not address at this time whether § 522(p) is applicable to bankruptcy cases filed in Florida, an opt-out state, and leaves that issue for later determination.

9 Pub.L. No. 109–8, 119 Stat. 23 (2005).

10 11 U.S.C. § 522(p)(1) was added to the Bankruptcy Code by § 322(a) of BAPCPA.

11 11 U.S.C. § 522(b) provides that states can prohibit their citizens from using the federal exemptions and limit them to applicable state law exemptions.

12 FLA. STAT. § 222.20 (1998); 4 COLLIER ON BANKRUPTCY ¶ 522.01, at 522–16 (Alan N. Resnick et al. eds., 15th ed. rev.2005).

13 *Helvering v. San Joaquin Fruit & Investment Co.,* 297 U.S. 496, 499, 56 S.Ct. 569, 80 L.Ed. 824 (1936).

14 *Black's Law Dictionary* 24 (7th ed.1999).

15 *Id.* at 816.

16 The case *In re Heisel* is contained within this decision. Both *In re Virissimo* and *In re Heisel* involve Chapter 7 debtors who had purchased their homesteads less than 1,215 days before the petition date and had equity of more than $125,000 in their homes. They claimed the properties as exempt pursuant to Nevada's homestead exemption (which allows a debtor to exempt $350,000 in a homestead) and the Chapter 7 Trustee objected to the exemptions. The Court's decision on the applicability of § 522(p)'s homestead exemption cap in opt-out states was certified for direct appeal to the Ninth Circuit Court of Appeals in *In re Virissimo,* 332 B.R. 208 (Bankr.D.Nev.2005).

17 *See also* 4 COLLIER ON BANKRUPTCY ¶ 522.13[2], at 522–102.4 (explaining "... section 522(p) should not apply to any amount of interest in the debtor's homestead that is acquired through no affirmative action of the debtor, such as an appreciation in the homestead's value resulting solely from changes in the real estate market during the 1215–day period. Similarly, this provision should not prevent the debtor from claiming as fully exempt any increase in the debtor's equity interest in a homestead attributable to the application of regularly scheduled mortgage payments during the 1215–day period.")

End of Document

466 B.R. 903
United States Bankruptcy Court,
S.D. Texas,
Houston Division.

In re Wendy M. SCHREIBER, Debtor(s).
T.D. Farrell Construction, Inc., Plaintiff(s)
v.
Wendy M. Schreiber, Defendant(s).

Bankruptcy No. 06–30361–H5–7.
|
Adversary No. 06–3681.
|
Jan. 26, 2012.

Synopsis

Background: General contractor for construction project brought adversary proceeding against Chapter 7 debtor, seeking judgment based on debtor's alleged violation of Texas Construction Trust Fund Act and determination that judgment was excepted from discharge, and also objecting to debtor's discharge and claimed exemptions.

Holdings: Following trial, the Bankruptcy Court, Karen K. Brown, J., held that:

[1] general contractor could not assert claim under Act, as trust beneficiary, respecting trust funds that it had paid to subcontractor;

[2] debtor did not misapply trust funds received in violation of Act;

[3] Act did not create type of fiduciary relationship required by discharge exception for fraud or defalcation while acting in fiduciary capacity;

[4] debtor did not convert general contractor's funds under Texas law;

[5] general contractor failed to establish claim under discharge exception for debts for willful and malicious injury;

[6] denial of discharge was not warranted on false oath grounds; and

[7] denial of debtor's discharge was not warranted on ground that she failed to explain loss or deficiencies of assets.

Ruling for debtor.

West Headnotes (22)

[1] **Mechanics' Liens** Payment to Principal Contractor, or to Subcontractor Employing Claimant

General contractor for construction project acted as trustee under Texas Construction Trust Fund Act when it paid its subcontractor for work performed on project, and thus could not assert claim, as trust beneficiary, to trust funds paid to subcontractor. V.T.C.A., Property Code §§ 162.001(a), 162.002, 162.003.

1 Cases that cite this headnote

[2] **Mechanics' Liens** Payment to Principal Contractor, or to Subcontractor Employing Claimant

General contractor for construction project, which had acted as trustee of trust funds pursuant to Texas Construction Trust Fund Act, could not assert claim for alleged violation of Act by downstream recipient of trust funds in place of actual statutory beneficiary by means of assignments from project suppliers. V.T.C.A., Property Code §§ 162.005(a)(1), 162.031(a).

1 Cases that cite this headnote

[3] **Mechanics' Liens** Payment to Principal Contractor, or to Subcontractor Employing Claimant

The Texas Construction Trust Fund Act subjects litigants to civil liability if (1) they breach the duty imposed by the Act, and (2) plaintiffs are within the class of people that Act was designed to protect and have asserted type of injury that Act was intended to prohibit. V.T.C.A., Property Code § 162.001 et seq.

[4] **Assignments** Founded on statute

Where a Texas statute requires a plaintiff to have particular characteristics to obtain the benefit of a protected status, an assignment of the protected status is ineffective.

[5] **Mechanics' Liens** Payments to principal contractor in general

Texas Construction Trust Fund Act was enacted to further the legislative intent of protecting materialmen. V.T.C.A., Property Code § 162.001 et seq.

[6] **Bankruptcy** Construction contracts

Mechanics' Liens Payments to principal contractor in general

Assuming that some suppliers' assignments of their status as trust fund beneficiaries under Texas Construction Trust Fund Act to general contractor for construction project were valid, general contractor did not become "unpaid" or "exposed" contractor on project as a result of its payments to suppliers, and therefore general contractor's claim that other downstream suppliers were not paid did not establish rights under Act or Bankruptcy Code's nondischargeability statute against debtor who was officer and shareholder of sub-subcontractor for project, where general contractor was paid in full for construction project under its original contract and for approved change order requests for increased costs under subcontractor's scope of work, but failed to pay funds due under its contract with subcontractor. 11 U.S.C.A. § 523; V.T.C.A., Property Code § 162.001 et seq.

[7] **Mechanics' Liens** Payment to Principal Contractor, or to Subcontractor Employing Claimant

Sub-subcontractor's officer and shareholder, as trustee of trust funds received in connection with construction project, did not misapply those trust funds in violation of Texas Construction Trust Fund Act where officer-shareholder used all of trust funds received, plus additional funds, to pay those who furnished labor or materials for project and to pay sub-subcontractor's actual expenses directly related to construction or repair of building constructed. V.T.C.A., Property Code §§ 162.005(a)(1), 162.031(a, b).

1 Cases that cite this headnote

[8] **Bankruptcy** Trustees

Texas Construction Trust Fund Act did not impose sufficient trust-like duties on contractors to create fiduciary relationship required to establish nondischargeability of debt under discharge exception for fraud or defalcation while acting in fiduciary capacity. 11 U.S.C.A. § 523(a)(4); V.T.C.A., Property Code § 162.001 et seq.

[9] **Trusts** Transactions between persons in confidential relations

Subcontract between general contractor and subcontractor for construction project, which did not require segregation of payments made under subcontract and provided that subcontract did not create any fiduciary or tort liability on part of contractor or subcontractor for breach of trust, did not create express trust under Texas law.

[10] **Trusts** Certainty

Under Texas law, to create an express trust by a written instrument, the beneficiary, the res, and the trust purpose must be identified.

[11] **Bankruptcy** Trustees

For breach of express trust to give rise to an exception to discharge for fraud or defalcation while acting in fiduciary capacity, purported trustee's duties must arise independent of any contractual obligation, and must have been imposed prior to, rather than by virtue of, any claimed misappropriation or wrong. 11 U.S.C.A. § 523(a)(4).

[12] **Conversion and Civil Theft** Assertion of ownership or control in general

Under Texas law, "conversion" consists of the wrongful exercise of dominion or control over another's property in denial of or inconsistent with the other's rights in that property.

1 Cases that cite this headnote

[13] **Conversion and Civil Theft** Money and commercial paper; debt

Action for conversion of money will lie under Texas law where the money is (1) delivered for safekeeping, (2) intended to be kept segregated, (3) substantially in the form in which it is received or an intact fund, and (4) not the subject of a title claim by the keeper.

1 Cases that cite this headnote

[14] **Conversion and Civil Theft** Money and commercial paper; debt

Officer and shareholder of sub-subcontractor for construction project did not convert funds of project's general contractor under Texas law where general contractor delivered no funds to officer-shareholder or to sub-subcontractor, funds received by sub-subcontractor from subcontractor were used to pay suppliers for construction project and sub-subcontractor's operating expenses, and no funds were delivered to sub-subcontractor or officer-shareholder to be kept in intact fund or in substantially same form as received, or to be kept segregated or for safekeeping.

[15] **Bankruptcy** Conversion and civil theft

Chapter 7 debtor, as officer and shareholder of sub-subcontractor for construction project, did not take money belonging to project's general contractor to injure general contractor or its property without general contractor's knowledge or consent and without justification or excuse, and therefore alleged debt did not fall within discharge exception for debts for willful and malicious injury. 11 U.S.C.A. § 523(a)(6).

[16] **Bankruptcy** Grounds for Denial of Discharge

Bankruptcy Fraudulent or Preferential Transfer

Bankruptcy Concealment of Property

Chapter 7 debtor did not transfer, remove, destroy, mutilate, or conceal estate property postpetition with intent to hinder, delay, or defraud creditors, and therefore denial of discharge was not warranted on such grounds, where debtor produced all of her personal financial records, including tax return, bank records, her personnel records from business for which she had been officer and minority shareholder, and her records of loans made to and repayments made by that business, debtor contacted business's corporate accountant and obtained and produced business's tax returns, and debtor also obtained production of some of business's corporate records, which she then produced to purported creditor. 11 U.S.C.A. § 727(a)(2)(B).

[17] **Bankruptcy** Sufficiency of records

Chapter 7 debtor produced all of her personal records, which were adequate to explain satisfactorily her financial transactions, and therefore denial of discharge was not warranted for failure to maintain adequate records. 11 U.S.C.A. § 727(a)(3).

[18] **Bankruptcy** Errors on and omissions from schedules

Chapter 7 debtor did not falsely swear to value of her real property in her bankruptcy schedules, and therefore denial of discharge was not warranted on false oath grounds, where debtor's valuation of her homestead matched property's appraisal by local taxing authority and debtor testified credibly as to source of funds

used to purchase home. 11 U.S.C.A. § 727(a)(4)(A).

[19] **Bankruptcy** Errors on and omissions from schedules

Chapter 7 debtor's inadvertent failure to schedule, in her bankruptcy schedules, two short-term business ventures and her short-term ownership of stock in another company did not warrant denial of discharge on false oath grounds. 11 U.S.C.A. § 727(a)(4)(A).

[20] **Bankruptcy** False Oath or Account

Chapter 7 debtor's inability to respond to impromptu demand during deposition by construction project's general contractor that she name exact purpose of every check written while sub-subcontractor for which she was officer and shareholder performed work on construction project was not knowing and fraudulent false oath or account warranting denial of discharge. 11 U.S.C.A. § 727(a)(4)(A).

[21] **Bankruptcy** Failure to explain loss or deficiency

Chapter 7 debtor explained satisfactorily any loss of assets or deficiencies of assets to meet her liabilities and liabilities of company for which she had been officer and minority shareholder, and therefore denial of debtor's discharge was not warranted on ground that she failed to explain adequately loss or deficiencies of assets, particularly given evidence that failure of construction project's general contractor to pay subcontractor on its contract for project, and subcontractor's consequent failure to pay debtor's company, as sub-subcontractor, contributed to company's financial demise. 11 U.S.C.A. § 727(a)(5).

[22] **Bankruptcy** Waiver or Loss of Exemption

Amount of interest that Chapter 7 debtor acquired in her homestead within statutory lookback period did not exceed statutory cap, and therefore debtor's claim of exemption of her equity in homestead did not violate exemption caps, regardless of amount for which debtor had listed property for sale. 11 U.S.C.A. § 522(p, q).

Attorneys and Law Firms

***907** Brad L. Sklencar, Jay K. Farwell, William W. Sommers, The Gardner Law Firm, San Antonio, TX, for Plaintiff.

John Norman Manicom, Law Office of John Manicom, Austin, TX, for Defendant.

MEMORANDUM OPINION

KAREN K. BROWN, Bankruptcy Judge.

Before the Court is the complaint of T.D. Farrell Construction, Inc. (Plaintiff Farrell), a Georgia company authorized to do business in Texas, seeking a judgment against debtor, Wendy Schreiber.

This case arose in connection with Farrell's construction of Home Depot store # 6584 in Corpus Christi, Texas in 2002–2003. Farrell contracted with Monitor Trust to perform site preparation and utilities work for the building. Monitor Trust (Monitor) subcontracted with Town & Country Excavation, Inc. (Town & Country) to excavate and improve the real property selected for the project.

Specifically, Farrell seeks a judgment against debtor contending that she violated the Tex. Prop.Code § 162.001 et seq. (violation of the Texas Construction Trust Fund Act) and a determination that the judgment is not dischargeable under 11 U.S.C. § 523(a)(4) (defalcation in a fiduciary capacity) or § 523(a)(6) (willful and malicious injury to property of another). In addition, Farrell objects to debtor's discharge under 11 U.S.C. § 727(a)(2)(B) (concealment of property of the estate after the filing of the petition with intent to hinder, delay or defraud); (a)(3) (failure to keep or preserve recorded information from which debtor's financial condition could be ascertained), (a)(4)(A) (knowingly and fraudulently making a false oath or account), (a)(5) (failure to explain satisfactorily

any loss of assets), and (a)(7)(committing acts in violation of § 727(a)(2), (3), (4), (5), or (6) on or within one year before the date of the petition, or during the case, in connection with another case, under the Bankruptcy Code or the Bankruptcy Act, concerning an insider.) In addition, Farrell objects to debtor's exemptions.

In response, debtor agrees that she was a minority shareholder of Town & Country Excavation, Inc. Debtor denies any actions in violation of 11 U.S.C. §§ 523 or 727.

This Court has jurisdiction over this adversary proceeding pursuant to 28 U.S.C. § 1334 and § 157. This is a core proceeding.

I. Procedural History

On February 2, 2006, Wendy Schreiber filed a voluntary Chapter 7 petition. Farrell filed the instant complaint and both sides moved for summary judgment. Farrell moved for summary judgment on the basis that its state court judgment against others precluded debtor from litigating liability. The bankruptcy court ruled that debtor is not in privity with Town & Country for purposes of application of claim or issue preclusion. This ruling was affirmed on appeal. The district court further suggested that Farrell might use the judgment and other evidence to demonstrate that debtor is liable for Town & Country's debt. Upon remand, this court tried the issues stated in the parties' pleadings and joint pretrial statement. Unlike its allegations ***908** in its motion for summary judgment, Farrell's complaint and the parties' joint pretrial statement do not contend that debtor is liable to Farrell on the basis of the debt represented by that judgment. Rather, Farrell alleges that debtor, in her capacity as an officer of Town & Country, individually owed a duty under the Texas Construction Trust Fund Act to pay Town & Country's suppliers and failed to do so, thereby establishing a debt for damages owed by debtor in favor of Farrell.

II. Facts

A. Wendy Schreiber's Background and Work History

Wendy Schreiber was born December 14, 1979. At the time of the Home Depot construction she was 23. After graduating high school, Wendy Schreiber worked at Site Preparation, a construction site preparation company. Site Preparation worked on a number of Home Depot construction projects. There Schreiber trained to do preliminary estimates for site work. In 2000 the owner of Site Preparation died and the company closed.

1. Express Site Preparation

After Site Preparation closed, three of its employees, Bill Williams, Shawn Piddeman, and Wendy Schreiber started a company, Express Site Preparation, to perform construction site work. Express Site Preparation was in business for only a year and closed when Piddeman moved out-of-state. Express Site Preparation was financially successful and performed site work on five jobs including three Home Depots. Wendy Schreiber saved approximately $150,000 from her earnings at Express Site Preparation.

2. Town & Country Excavation, Inc.

When Express Site Preparation ceased doing business, Williams and Kurt Codding, a former employee of Home Depot, invited Schreiber to join them to establish Town & Country Excavation, Inc. Kevin Robinson, another employee of Express Site Preparation agreed to act as consultant to Town & Country. [1]

When Town & Country was formed, Bill Williams was in his 60s and nearing retirement, Kurt Codding was 47, Kevin Robinson was 42, and Wendy Schreiber was 23. Initially, Williams was president, Codding was vice-president, and Wendy Schreiber was secretary.

Subsequently, in July or August 2002, Williams retired. At that point, Kurt Codding became president and took a 60% share of the corporate stock. Schreiber remained secretary of the company and a minority shareholder in the company with her interest at 40%.

From its inception date of January 4, 2002, until it ceased doing business in 2004, Town & Country grossed $7,526,905.46. Town & Country's gross receipts for 2003 were $4.7 million. In addition to the shareholders, Town & Country employed Lester Shimonski, Chase Pasley, and Connie Aikens. Connie Aikens controlled the company's computer server, input all invoices, printed all company checks, and compiled the company's payment requests for the Home Depot Corpus Christi job.

B. Home Depot Corpus Christi

T.D. Farrell Construction, Inc., plaintiff and general contractor, was owned 100% by Timothy Farrell. T.D. Farrell Construction, Inc. contracted with Home Depot to build a retail store at 4014 S. Port ***909** Avenue, Corpus Christi, Nueces County, Texas 78415, in 2002 to 2003, for $4,698,764.00. Home Depot paid T.D. Farrell Construction, Inc. in full under its contract.

Inasmuch as Kurt Codding had left Home Depot to start Town & Country Excavation, Inc., there was some concern that if Home Depot was aware that Farrell proposed to use Codding's company as a subcontractor on the Home Depot Corpus Christi job, that Home Depot would not award T.D. Farrell the general construction contract. Monitor Trust had previously acted as sub-contractor to Town & Country, so it was proposed that Monitor Trust act as subcontractor with Farrell and Town & Country sub-sub-contract with Monitor Trust.

T.D. Farrell subcontracted the sitework and utilities for the Home Depot Corpus Christi project to Cyril B. Sturm d/b/a Monitor Trust for $972,000.00. Monitor Trust's scopes of work included: providing site clearing, demolition, haul off, fill, storm drainage, piping, water distribution, sanitary sewer, and temporary roads.

Monitor Trust's sub-sub-contract with Town & Country Excavation, Inc. provides for payment by Monitor Trust to Town & Country of $747,000 of the $972,000, Monitor was to be paid by T.D. Farrell. Under its contract with Monitor Trust, Town & Country Excavation, Inc. was to provide site clearing; grubbing and demolition; earth moving and excavation; a 6 inch rock cap at the building; fine grading; dewater for the scope of work; proof, rolling and compaction; sheeting and shoring as required by OSHA; protection of existing structures; layout; lime stabilization; a concrete flow channel at the bottom of a retention pond; maintain all erosion control; and provide and maintain a six-inch construction road around the building. Kevin Robinson acted as project manager on the Home Depot Corpus Christi job for both Monitor Trust and Town & Country.

Once work began, Farrell refused to pay Monitor Trust in accordance with the contract and Monitor Trust's payment requests. Although the original contract required Farrell to pay Monitor Trust $972,000, Farrell only paid Monitor Trust a total of $662,029.34. Monitor Trust, in turn, paid Town & Country Excavation, Inc., only $503,990.53 of the $747,000 due for Town & Country's work.

Despite receiving only $503,990.53, for its work on the Home Depot Corpus Christi job, Town & Country paid $542,353.11, to suppliers, truckers, equipment lessors, employees, and others, on that job. Town & Country paid suppliers and expenses on the Home Depot Corpus Christi job as follows: building supplies $7,218.77; contract labor $76,024.00; equipment rental $80,605.50; freight and delivery $1361.57; fuel $16,476.08; job materials $155,830.68; meals 314.93; travel $28,471.40; trucking $83,582.75; automobile expense $461.17; equipment maintenance $2,135.94; hotels $933.28; finance charge $172.91; leased equipment $8,437.92; miscellaneous $4,072.99; payroll $68,426.55; legal fees $4,283.79; tools and machinery $42.88; and truck allowance $3,500.00. *See* Plaintiff's Exhibit 1.1. Of this total, Town & Country paid $411,670.38 for labor and materials alone. *See* Defendant's Ex. 2.

Town & Country paid in full all suppliers to the Home Depot Corpus Christi project whose invoices were due as of January 31, 2003, the date of the last payment request Town & Country submitted to Monitor Trust that was paid. In addition, Town & Country made payments in February, and March, 2003, to Contractors Building Supply, Crescent Machinery Inc., Labor Ready, Inc., Haas Resources Company, Orona Bros, Fox Tree and Landscape ***910** Nursery, M & M Transport Martinez Trucking, Padilla Trucking, Cantu's Trucking, Rosendo Nava, Hertz, and Tahoe Trucking. Each of these businesses supplied materials or services to the Home Depot Corpus Christi jobsite.

During the time period that Town & Country worked on the Home Depot Corpus Christi project, the company worked on and received payments from other projects, including a Wal–Mart in Arkansas, Dickinson High School, a Home Depot in Lufkin, Texas, and a Home Depot in McAllen, Texas. In addition to the income Town & Country received from other jobs, Schreiber and Robinson loaned funds or used personal credit cards to pay expenses associated with the Home Depot Corpus Christi's job. Schreiber testified, and the Court finds her testimony credible, that she used funds that she saved from working at Express Site Preparation to fund loans to Town & Country.[2] Town & Country's 2003 tax return reflects loans from shareholders in the amount of $123,667. Schreiber testified that Town & Country's Compass Bank records matched the loan ledger Schreiber kept. Altogether, Schreiber's records show that she received from Town & Country a total of $239,622.86, for reimbursement of

expenses, loan repayments, and draws. Schreiber's draws from Town & Country totaled $75,000.

Instead of paying in accordance with its contract with Monitor Trust, Farrell decided which suppliers should be paid and either paid them directly, back charging against Monitor Trust's pay requests, or issued joint checks payable to Monitor Trust and the supplier. Monitor Trust received no funds from the joint checks.

As work on the Home Depot project progressed, it became necessary for Monitor Trust to incur the cost of delivery of much more limestone than had originally been anticipated by the contracting parties. To pay for these increased costs, Monitor Trust submitted change order requests to Timothy Farrell, who acted as project manager for T.D. Farrell Construction, Inc. Although Farrell knew that far more limestone was required to complete the site work than had been originally anticipated and that far more limestone had in fact been delivered to and incorporated into construction of the project, he refused to submit Monitor Trust's change order requests to Home Depot for approval while the work was on-going. Moreover, although Farrell had paid other suppliers on the job directly or by joint check, he did not pay for limestone delivered to the jobsite by Martin Marietta Materials in February and March 2003, for which it was owed $333,645.34, and for which it filed a lien on April 30, 2003.

As of July 16, 2003, in addition to the funds due Martin Marietta Materials, there remained unpaid the following suppliers: Ingram Ready Mix owed $4,243.40; Rental Service Corp. owed $49,378.87; Crescent Machinery owed $49,736.44; Contractors Building Supply owed $13,969.85; and Austin White Lime owed $18,510.28. All of these suppliers' unpaid invoices are dated and were received after January 31, 2003.

Farrell, alleging that Monitor Trust and Town & Country were responsible for payment of these suppliers, sued and eventually took judgment against Monitor Trust, Town & Country Excavation, Inc. and others, but not debtor, for damages it allegedly suffered arising from these unpaid suppliers. Farrell alleges that he settled with these suppliers for the following amounts and took an assignment from each of its ***911** claims against Town & Country: Ingram Ready–Mix $4,243.40; Rental Service Corp. $20,000; Crescent Machinery $8,000; Contractors Building Supply $13,969.85; and Austin White Lime $4,000. T.D. Farrell alleges that it paid Martin Marietta Materials the sum of $333,645.34 by depositing that amount into the registry of the court of Nueces County, Texas, "of which the amount of $179,645.34 had been previously paid, and the amount of $154,000.00, had not been previously paid by it." *See* Judgment T.D. Farrell V. Sturm, Cause No. 03–03510–E, 148th Judicial District Court of Nueces County, Texas.

Timothy Farrell delayed until September or October of 2003, long after the job was completed, to submit Monitor Trust's requested change orders to Home Depot for approval and payment. Timothy Farrell testified that Home Depot approved change orders totaling $422,915. Farrell testified that change order no. 1 totaling $73,297 included payment for drainage work and for hauling away unsuitable material; change order no. 2 totaling $188,019 included payment for supplying limestone at the main building pad and limestone at the garden center loading dock; and change order no. 3 totaling $161,599, included payment for installing rock for an access road, processing material, and stabilizing subgrade material with lime at the parking lot. These three change orders increased the amount due under the contract for Monitor Trust's scope of work from the original contract price of $972,000, to an adjusted contract price of $1,394,915.00. Although Home Depot made monthly progress payments to Farrell and Farrell added 10% to Monitor Trust's change order requests when it submitted them to Home Depot for approval, Farrell never paid any of this money to Monitor Trust.

III. Violation of § 523(a)(4)

Bankruptcy Code § 523(a)(4) provides:

> (a) A discharge under section 727 ... does not discharge an individual debtor from any debt—
>
> (4) for fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny ...

11 U.S.C. § 523(a)(4).

T.D. Farrell alleges that debtor violated § 523(a)(4), defalcation in a fiduciary capacity, by violating the Texas Construction Trust Fund Act while an officer and shareholder of Town & Country Excavation, Inc. Under Tex. Prop.Code § 162.001(a), trust funds are construction payments made to a contractor or subcontractor or to an officer, director, or agent of a contractor or subcontractor, under a construction

contract for the improvement of specific real property in this state. Tex. Prop.Code § 162.001. The beneficiary of any trust funds paid or received in connection with the improvement, is any artisan, laborer, mechanic, contractor, subcontractor, or materialman who labors or who furnishes labor or material for the construction or repair of an improvement on specific real property in this state. Tex. Prop.Code § 162.003. The trustee of the trust funds is any contractor, subcontractor, or owner or an officer, director, or agent of a contractor, subcontractor, or owner, who receives trust funds or who has control or direction of trust funds. Tex. Prop.Code § 162.002.

Under the act, a trustee misapplies the trust funds if he intentionally or knowingly, or with "intent to defraud" (i.e., he intends to deprive the beneficiaries of the trust funds), directly or indirectly retains, uses, disburses, or otherwise diverts trust funds without first fully paying all current or past due obligations incurred by the trustee to the beneficiaries of the trust funds. Tex. Prop.Code § 162.005(a)(1); Tex. Prop.Code § 162.031(a). "Current or ***912** past due obligations" are those obligations incurred or owed by the trustee for labor or materials furnished in the direct prosecution of the work under the construction contract prior to the receipt of the trust funds and which are due and payable by the trustee no later than 30 days following receipt of the trust funds. Tex. Prop.Code § 162.005(a)(2). It is an affirmative defense to prosecution or other action brought under subsection (a) that the trust funds not paid to the beneficiaries of the trust were used by the trustee to pay the trustee's actual expenses directly related to the construction or repair of the improvement or have been retained by the trustee, after notice to the beneficiary who has made a request for payment, as a result of the trustee's reasonable belief that the beneficiary is not entitled to such funds or have been retained as authorized or required by Chapter 53 of the Texas Property Code. Tex. Prop.Code § 162.031(b).

[1] The Court finds that T.D. Farrell acted as trustee under the Texas Construction Trust Fund Act when it, as general contractor, paid its subcontractor, Monitor Trust, $662,029.34 for construction of the Home Depot Corpus Christi. T.D. Farrell asserts that it is itself also a beneficiary of the funds it paid to Monitor Trust in T.D. Farrell's capacity as trustee under the Texas Construction Trust Fund Act. However, T.D. Farrell has offered no authority supporting its position that it can be both the statutory beneficiary and the statutory trustee of the Home Depot Corpus Christi trust funds. The court in *Robax Corp. v. Professional Parks, Inc.,* Not Reported in F.Supp.2d, 2008 WL 3244150 (N.D.Tex.2008) concluded that a contractor who has paid trust funds downstream does not have the status of a beneficiary of those funds for purposes of asserting a claim against the downstream subcontractor for misuse of those funds:

> Although Texas Waterworks has met many of the elements of a Trust Act claim against defendants, it has not demonstrated that it is among the class of persons whom the Trust Act was intended to protect. The funds Texas Waterworks paid Professional were trust funds, but Texas Waterworks was not a beneficiary of these funds.... The court is not aware of any case in which a party in Texas Waterworks' situation-a contractor who has paid the trust funds at issue to a downstream subcontractor-has successfully asserted a Trust Act claim against a downstream subcontractor for misappropriation of those funds.

Robax Corp. v. Professional Parks, Inc., Not Reported in F.Supp.2d, 2008 WL 3244150 (N.D.Tex.2008). This Court concludes that T.D. Farrell is not a proper plaintiff to assert a claim to the Home Depot Corpus Christi trust funds it paid to Monitor Trust.

[2] Nevertheless, in an effort to circumvent its lack of standing as a statutory beneficiary of the trust funds over which it was trustee, T.D. Farrell obtained assignments from some of the unpaid suppliers of their beneficiary status and T.D. Farrell alleges that, consequently, Wendy Schreiber owes it as a fiduciary duty. T.D. Farrell alleges that each of the following entities executed an assignment to Farrell of its status as a beneficiary of trust funds under the Texas Construction Trust Fund Act: Martin Marietta Materials, Ingram Ready Mix, Rental Service Corp., Crescent Machinery, Contractors Building Supply, and Austin White Lime.

[3] **[4]** The Court finds, first, that there is no evidence that Martin Marietta Materials executed an assignment to T.D. Farrell of any claims or of its statutory beneficiary status. As to the other suppliers, ***913** T.D. Farrell has submitted no authority for the proposition that a general contractor who has

acted as trustee for trust funds can by means of assignment, subrogation, or indemnity assert a statutory claim in place of the actual statutory beneficiary under the Texas Construction Trust Fund Act. The Texas Construction Trust Fund Act "subjects litigants to civil liability if (1) they breach the duty imposed by the Act, and (2) the requisite plaintiffs are within the class of people the Act was designed to protect and have asserted the type of injury the Act was intended to prohibit." *Lively v. Carpet Services, Inc.*, 904 S.W.2d 868, 873 (Tex.App.Hous. [1 Dist.] 1995, writ denied). Where a Texas statute requires a plaintiff to have particular characteristics to obtain the benefit of a protected status, an assignment of the protected status is ineffective. *See e.g. PPG Industries, Inc. v. JMB/Houston Centers Partners Ltd. Partnership,* 146 S.W.3d 79 (Tex.2004) (holding consumer claims under the Texas Deceptive Trade Practices Act non-assignable.) In *Dewayne Rogers Logging, Inc. v. Propac Industries, Ltd.,* 299 S.W.3d 374, 386–387 (Tex.App.Tyler 2009, writ denied) the court explained that indemnification, subrogation and assignment of a statutory status, in that case, DTPA consumer status, is ineffective to grant standing to one who seeks to pursue the statutory claims of another:

> Subrogation is the right of one who has paid an obligation, that another should have paid, to be indemnified by the other. *Int'l Elevator Co., Inc. v. Garcia,* 73 S.W.3d 420, 421 (Tex.App.-Houston [1st Dist.] 2002, no pet.). DTPA claims generally cannot be assigned by an aggrieved consumer to someone else. *PPG Indus., Inc. v. JMB/Houston Ctrs. Partners Ltd. P'ship,* 146 S.W.3d 79, 92 (Tex.2004). Specifically, a subrogee who cannot qualify as a consumer in its own right may not assume the status of its insured for the purposes of pursuing a DTPA claim. *Trimble v. Itz,* 898 S.W.2d 370, 372 (Tex.App.-San Antonio 1995, writ denied). As mentioned earlier, Lloyds has admitted that it cannot, by itself, maintain consumer status. Moreover, as Rogers Logging's subrogee, Lloyds may not pursue claims under the DTPA by assuming Rogers Logging's status as a consumer. *See Trimble,* 898 S.W.2d at 372. Therefore, Lloyds does not have standing to pursue its DTPA claims as Rogers Logging's subrogee. *See* Tex. Bus. & Com.Code Ann. § 17.45(4); *Trimble,* 898 S.W.2d at 372.

Dewayne Rogers Logging, Inc. v. Propac Industries, Ltd., 299 S.W.3d 374 (Tex.App.Tyler 2009).

[5] "The Texas Construction Trust Fund Act was enacted to further the ... legislative intent of protecting materialmen." *Scoggins Const. Co., Inc. v. Dealers Elec. Supply Co.,* 292 S.W.3d 685, 693 (Tex.App.Corpus Christi, 2007 rev'd on other grounds) ("[T]he Trust Fund Act is remedial in nature and is to protect the "exposed" or "unpaid" subcontractor or supplier on a project," citing *Lively,* 904 S.W.2d at 871). Farrell has offered no authority establishing that Texas law permits assignment to a general contractor of the beneficiary protection provided by the Texas Construction Trust Fund Act. The Court declines to conclude that such an assignment is valid under Texas law for trust funds for which the general contractor was trustee.

[6] Moreover, even if Farrell's assignments of the beneficiaries' statutory status are valid, Farrell has not shown that as a result of its payments to the unpaid suppliers, it has become an "unpaid" or "exposed" contractor on the Home Depot Corpus Christi job. To the contrary, the evidence shows Farrell marked up Monitor ***914** Trust's change order requests by 10% when it submitted them to Home Depot for approval. Further, the evidence shows that Home Depot paid Farrell in full. Although, Farrell alleges in its pleadings, both in state and federal court, that it "paid twice" for construction of the Home Depot Corpus Christi, this Court finds that there is no evidence of such. The evidence establishes that Farrell was paid in full for its original contract and for the change order requests approved by Home Depot for Monitor Trusts' scope of work. The evidence establishes that, although Farrell was paid in full under its original contract and for the approved change order requests for increased costs under Monitor Trust's scope of work, Farrell failed to pay construction funds due under its contract with Monitor Trust. The Court concludes that Farrell's complaint that other

downstream suppliers were not paid does not establish rights against debtor under the Texas Construction Trust Fund Act or under 11 U.S.C. § 523.

[7] The Court finds that T.D. Farrell as trustee under the Texas Construction Trust Fund Act for construction of the Home Depot Corpus Christi paid Monitor Trust a total of $662,029.34. The Court finds that Monitor Trust, as trustee, paid Town & Country a total of $503,990.53. The Court finds that Wendy Schreiber as trustee under the Texas Construction Trust Fund Act received a total of $503,990.53 in trust funds for construction of the Home Depot Corpus Christi. The Court finds that Wendy Schreiber, as an officer and shareholder of Town & Country, used all of the trust funds totaling $503,990.53, plus additional funds, altogether totaling $542,353.11, to pay laborers and suppliers who furnished labor or materials for the construction of the Home Depot Corpus Christi and to pay Town & Country's actual expenses directly related to the construction or repair of the Home Depot Corpus Christi. The Court finds that Wendy Schreiber, as trustee of trust funds received in connection with the construction of the Home Depot Corpus Christi, did not misapply the trust funds in violation of the Texas Construction Trust Fund Act. *See* Tex. Prop.Code § 162.005(a)(1); Tex. Prop.Code § 162.031(a). The Court finds that T.D. Farrell has failed to prove a cause of action against Wendy Schreiber under the Texas Construction Trust Fund Act.

In addition, Farrell has failed to demonstrate that the Texas Construction Trust Fund Act creates the type of fiduciary relationship cognizable for an exception to dischargeability under § 523(a)(4). In *In re Tran,* 151 F.3d 339, 342–343 (5th Cir.1998), the Fifth Circuit held "[a] state cannot magically transform ordinary agents, contractors, or sellers into fiduciaries by the simple incantation of the terms 'trust' or 'fiduciary.' " The court ruled that in order to satisfy the dictates of § 523(a)(4), "a statutory trust must (1) include a definable res and (2) impose 'trust-like' duties." *Id.* at 343.

The *Tran* court "trust-like duties" for a state statutory trust to be cognizable under § 523(a)(4):

> The preliminary question-and the one on which the Commission's argument founders-is whether the Act imposes sufficient "trust-like" duties on a ticket sales agent. For if the duties required under the Act are not of the kind necessary to create a fiduciary as that term is used in § 523(a)(4), the only remaining form of trust that could arise under the Act would be one stemming from an agent's wrongdoing; and, as we have seen, such a trust is not what Congress had in mind when designing the exemption contained in § 523(a)(4).

***915** In our previous cases, we have not expressly identified the particular "trust-like" duty-or combination of duties-that a state statute must impose to create the specie of fiduciary that meets muster under § 523(a)(4). Nonetheless, one such duty has loomed large-the duty that a trustee refrain from spending trust funds for non-trust purposes. Indeed, on two occasions, the absence of such a requirement has proved determinative. In Boyle, we examined whether a contractor was a fiduciary under § 523(a)(4) by virtue of the Texas Construction Trust Fund Statute. The version of the statute then in force specified that funds loaned or paid under a construction contract to finance improvements on particular real property were trust funds, and set forth criminal penalties for a contractor or other trustee who, with the intent to defraud, used those funds without paying fully his obligations to beneficiary. In rejecting the argument that the statute constituted as fiduciaries all persons accepting funds or loans under a construction contract, we stressed that the statute prohibited the expenditure of trust funds for non-trust purposes only if done with fraudulent intent.

> [The construction fund statute] does not prohibit a fund holder from paying, without any fraudulent intent, creditors on one project with surplus funds left over from earlier work and then using funds provided for that later project on still other work. In short, the statute does not create "red," "blue," and "yellow" dollars each of which can only be used for "red," "blue," or "yellow" construction project.

We held that, absent such an affirmative requirement, the subject statute did not make fiduciaries out of all contractors for the purposes of § 523(a)(4), but rather made fiduciaries of only those contractors who diverted funds with the intent to defraud.

In *Coburn Company of Beaumont v. Nicholas* [956 F.2d 110 (5th Cir.1992)], we were confronted with an amended version of the Texas Construction Fund Statute featured in Boyle. Although the amended statute broadened the scienter requirement to cover trustees who "intentionally or knowingly" spent trust funds for non-trust purposes before

fully paying all legitimate obligations, it also provided affirmative defenses that permitted a trustee to spend trust funds for non-trust purposes under certain circumstances. As the amended version of the statute, like its predecessor, did not expressly and totally prohibit such expenditures, we again rejected the argument that the statute elevated every contractor who accepts funds or loans under a construction contract to a § 523(a)(4) fiduciary.

Our discussion of the significance of the absence of a statutory prohibition of spending putative trust funds for non-trust purposes does not suggest the converse, i.e., that the mere inclusion of such a prohibition would alone be sufficient to create a fiduciary relationship under the debt discharge exception. The absence of such a prohibition is telling, though, because without such a requirement, the supposed trustee appears not so much to be responsible for managing a beneficiary's funds on the beneficiary's behalf as to be engaged in a typical agency relationship.

Not only do the Act and the regulations promulgated under it fail to prohibit expressly a ticket sales agent from spending lottery ticket proceeds for non-lottery-i.e., non-trust-purposes; neither do they mandate that the agent must segregate lottery proceeds from his other funds. Clearly, the absence of this latter ***916** duty undercuts the argument that the Act seeks to prohibit an agent from spending trust funds for non-trusts purposes without expressly saying so. For, in the absence an express segregation requirement, it would be virtually impossible to monitor even an express spending prohibition, let alone one imposed sub silentio. Therefore, any suggestion that a fiduciary of § 523(a)(4) proportions is somehow conjured up by implication just does not hold water.

In re Tran, 151 F.3d 339, 343–345 (5th Cir.1998) (footnotes omitted.)

[8] The court finds that Farrell has not demonstrated that the Texas Construction Trust Fund Act imposes sufficient trust like duties on a contractor to meet the requirements of § 523(a)(4).

[9] T.D. Farrell alleges that the subcontract between T.D. Farrell and Monitor Trust creates an express trust at paragraph 11.1, which states:

> 11.1 Based upon applications for payment submitted to the Contractor by the Subcontractor, corresponding to applications for payment submitted by the Contractor to the Architect, and certificates of payment issued by the Architect, the Contractor shall make progress payments to the account of the Subcontract Sum to the Subcontractor as provided below and elsewhere in the Subcontract Documents. Unless the Contractor provides the Owner with a payment bond in the full penal sum of the Contract sum, payments received by the Contractor and Subcontractor for Work properly performed by their contractors and suppliers shall be held by the Contractor and Subcontractor for those contractors or suppliers who performed Work or furnished materials, or both under contract with the Contractor or Subcontractor for which payment was made to the Contractor by the Owner or to the Subcontractor by the Contractor, as applicable. Nothing contained herein shall require money to be placed in a separate account and not commingled with money of the Contractor or Subcontractor, shall create any fiduciary liability or tort liability on the part of the Contractor or Subcontractor for breach of trust or shall entitle any person or entity to an award of punitive damages against the Contractor or Subcontractor for breach of the requirements of this provision.

[10] **[11]** To create an express trust by a written instrument, the beneficiary, the res, and the trust purpose must be identified. *Pickelner v. Adler,* 229 S.W.3d 516 (Tex.App.-Hous. [1 Dist.] 2007), review denied. The Court finds that the contract documents do not create an express trust, to the contrary, the quoted provision expressly denies that the

contract creates a fiduciary relationship. Further, for breach of an express trust to give rise to an exception to discharge "[t]he purported trustee's duties must ... arise independent of any contractual obligation. The trustee's obligations, moreover, must have been imposed prior to, rather than by virtue of, any claimed misappropriation or wrong." *In re Tran,* 151 F.3d 339, 342 (5th Cir.1998). The Court concludes that T.D. Farrell has failed to prove that Wendy Schreiber is liable under 11 U.S.C. § 523(a)(4) for defalcation in a fiduciary duty arising from an express trust.

The Court concludes that T.D. Farrell has failed to prove that it holds a debt owed by Wendy Schreiber for breach of a statutory fiduciary duty under the Texas Construction Trust Fund Act, whether owed directly to T.D. Farrell, or indirectly through T.D. Farrell's assignments of the statutory beneficiary status held by others. The Court further finds that T.D. Farrell has failed to prove that it holds a debt owed by Wendy Schreiber for breach of a ***917** fiduciary duty owed to it under an express trust created by the contract documents or otherwise. Moreover, the Court finds that T.D. Farrell has failed to prove that it holds any debt owed by debtor. The Court concludes that T.D. Farrell has failed to prove a breach of fiduciary duty by Wendy Schreiber that is non-dischargeable under 11 U.S.C. § 523(a)(4).

T.D. Farrell contends that Wendy Schreiber directed payments of trust funds to Kevin Robinson, Kurt Codding, and herself while sub-sub-contractors went unpaid. As to this allegation, the Court reiterates its finding that Wendy Schreiber used all of the trust funds to pay laborers and suppliers who furnished labor or materials for the construction of the Home Depot Corpus Christi and to pay Town & Country's actual expenses directly related to the construction or repair of the Home Depot Corpus Christi. Moreover, Town & Country's bank records and debtor's testimony show that Town & Country Excavation, Inc. worked on several simultaneous on-going construction projects at the same time it also worked on the Home Depot Corpus Christi. Schreiber and Robinson loaned funds to support the company's cash flow issues created by Farrell's failure to pay in accordance with the contract with Monitor Trust. The Court finds that debtor's and Robinson's loans to the company were repaid from non-trust funds.

IV. Violation of § 523(a)(6)

Bankruptcy Code § 523(a)(6) provides:

> (a) A discharge under section 727, 1141, 1228(a), 1228(b), or 1328(b) of this title does not discharge an individual debtor from any debt—
>
> ....
>
> (6) for willful and malicious injury by the debtor to another entity or to the property of another entity ...

11 U.S.C. § 523(a)(6).

Farrell alleges it suffered a willful and malicious injury under § 523(a)(6) because debtor knew payments received on the project had to be used to pay subcontractors and suppliers and if not paid, those subs would assert liens against the project for which Farrell would be responsible. Farrell alleges that debtor made payments to herself and to Kevin Robinson at a time when Town & Country was receiving payments on the project and had unpaid debts to subcontractors and suppliers. Farrell alleges that debtor's payments to herself and Kevin Robinson constitutes conversion and that she made the payments knowing it would cause injury to Farrell and with the intent to injure Farrell. Farrell alleges that debtor took money in the amount of $469,484.18, to injure Farrell or its property without Farrell's knowledge or consent and without justification or excuse.

[12] **[13]** The court in *Newman v. Link,* 866 S.W.2d 721, 726 (Tex.App.Houston [14 Dist.] 1993, writ denied) set out the elements of conversion of money as follows:

> Conversion consists of the wrongful exercise of dominion or control over another's property in denial of or inconsistent with the other's rights in that property. *Waisath v. Lack's Stores, Inc.,* 474 S.W.2d 444, 446 (Tex.1971). An action for conversion of money will lie where the money is '(1) delivered for safe keeping; (2) intended to be kept segregated; (3) substantially in the form in which it is received or an intact fund; and (4) not the subject of a title claim by the keeper.' *Edlund v. Bounds,* 842 S.W.2d 719, 727 (Tex.App.-Dallas 1992, writ denied).

866 S.W.2d at 726.

[14] [15] The Court finds that T.D. Farrell has failed to prove that: Farrell delivered money to debtor for safekeeping, that was intended to be kept segregated, substantially in the form in which it was received, and that was not the subject of a ***918** title claim by the keeper. First, Farrell delivered no funds to debtor or to Town & Country. Secondly, the funds Town & Country received from Monitor Trust were to be used to pay suppliers to the Home Depot Corpus Christi job as well as operating expenses of the Town & Country. There were no funds delivered to Town & Country or debtor that were to be kept in an intact fund or in substantially the same form as received. There were no funds delivered to Town & Country or debtor that were to be kept segregated or that was delivered for safe keeping. The Court finds that T.D. Farrell has failed to prove that Schreiber converted any funds or that she made payments to herself or Robinson with the intent to injure Farrell. The Court finds that T.D. Farrell failed to prove that debtor took money in the amount of $469,484.18, to injure Farrell or its property without Farrell's knowledge or consent and without justification or excuse.

V. Discharge under § 727

A. § 727(a)(2)(B)

[16] Bankruptcy Code § 727(a)(2)(B), (a)(3), (a)(4)(A), (a)(5), and (a)(7) provide:

> (a) The court shall grant the debtor a discharge, unless—
>
> (2) the debtor, with intent to hinder, delay, or defraud a creditor or an officer of the estate charged with custody of property under this title, has transferred, removed, destroyed, mutilated, or concealed, or has permitted to be transferred, removed, destroyed, mutilated, or concealed—
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> ....

Farrell alleges that debtor violated § 727(a)(2)(B) because debtor transferred, removed, destroyed, mutilated, or concealed property of the estate after the date of filing of the petition, including books, records, computer equipment, documents, papers and similar records of Town & Country and her personal financial records, records related to construction of her house, and documents related to financial transactions with Kevin Robinson. Farrell alleges that on October 4, 2005, Farrell deposed Kurt Codding who testified that all of the company records were kept at the company office in Katy Texas and that debtor oversaw that office. Farrell admits that Town & Country's project related records were produced, but contends that debtor has failed to produce documents including the financial records of Town & Country from which debtor's financial condition could be ascertained and which relate to loans made by debtor to Town & Country and repayment of those loans. Farrell alleges that it obtained records from Compass Bank showing that Schreiber signed checks to herself and to Robinson between January 2003 and August 2004 when trust funds were allegedly misappropriated.

Debtor filed a chapter 7 voluntary bankruptcy petition on February 2, 2006. Debtor attended creditors' meetings on February 23, 2006, and March 23, 2006. Debtor gave 2004 examination on November 3, 2006. Debtor amended her schedules and statement of affairs on March 15, 2006.

The Court finds that there is no evidence that debtor transferred, removed, destroyed, mutilated, or concealed any property of the estate after the date of filing of the petition. The Court finds that at Kurt Codding's direction the records of Town & Country were shipped to Kurt Codding's home near Dallas for storage prior to debtors' bankruptcy filing. Codding directed all corporate decisions from his home, which he referred to as the "Dallas office" of Town & Country.

***919** The evidence shows that Wendy Schreiber was the minority, 40%, shareholder of Town & Country. Schreiber worked in Town & Country's Katy office and signed all of the company's checks. Schreiber did not, however, prepare or determine the payees or amounts of those checks. Other than paying the rent for the lease of the office space and the office utility bills, the evidence shows that Schreiber did not control any of the financial, business, or operational aspects of Town & Country Excavation, Inc.

The evidence shows that Codding was the sole decision maker for Town & Country. Codding directed Town & Country's employees, including debtor, in the performance of their duties. The evidence shows that when Codding consulted or relied on anyone else, it was Kevin Robinson or Connie Aiken. If a legal matter arose or if someone needed to execute a document on behalf of the company, such as a lien release or to submit a payment application on a construction job, Codding had Robinson or Connie Aiken perform those tasks regardless of whether Schreiber was present and available to perform the necessary task. Schreiber seems to have

understood her position as "corporate secretary" of Town & Country to mean she was the president's administrative assistant. When Codding directed Schreiber to fax, email, or mail documents to him, she did so. When Codding wanted reports, run from the company computer Schreiber or Connie Aiken ran the reports and sent them to him. Robinson oversaw the construction projects on behalf of Town & Country.

When it was time to prepare a payment request on a job, Robinson would notify Codding of the status at the jobsite of which suppliers had delivered materials and were due for payment. Connie Aiken would run computer reports showing invoices submitted for payment and send the information to Codding. Codding would then determine to whom and for how much checks should be written. Connie Aiken would print the checks. Schreiber would sign the checks.

Town & Country ceased business in July or August of 2004. The evidence shows that Town & Country's bank records were located in filing cabinets all along the office wall. When Town & Country was winding down in March 2004, Kurt Codding told Connie Aikens to box up everything including bank records and send the records to him in Dallas, Texas for storage. Connie Aikens complied with Codding's direction. Schreiber had no objection to the boxing and shipping of the corporate records to Codding because he was president of the company and 60% majority shareholder. Connie Aikens also picked up and shipped to Codding Town & Country's corporate records in the possession of Levin & Atwood, the corporation's attorneys. Connie Aiken boxed all of the corporate records at Kurt Codding's direction and shipped all of them to him before the company closed its doors in July of 2004. In addition, the evidence shows that Kurt Codding directed Chase Pasley to load up Town & Country's office equipment when it closed its business and Pasley did so. Kurt Codding also told Wendy Schreiber to go home around that time because the company had no income coming in; so she would not have any more work to do in the office.

Schreiber did not file income tax returns for the two years prior to filing bankruptcy. Schreiber received no income from Town & Country in 2004. In preparation for her creditor's meeting, debtor obtained Town & Country's tax returns from Jerry Denman, Town & Country's accountant. Wendy Schreiber's attorney gave debtor's 2003 tax return and that of Town & Country ***920** to the U.S. Trustee's attorney at Schreiber's first meeting of creditors. Wendy Schreiber produced documents dated from 2003 through 2004 at her deposition. Wendy Schreiber has records of her bank accounts and credit cards from 1998 forward. Since 2002, Wendy Schreiber has been the signatory on two personal Compass Bank accounts, one company Compass Bank account, and in 2005 she opened an account at Hibernia Bank, n/k/a Capital One.

The Court finds that debtor produced all of her personal financial records, including a tax return, bank records, her Town & Country personnel records, and her records of loans made to and repayments made by Town & Country. Debtor also contacted the Town & Country's corporate accountant and obtained and produced Town & Country's tax returns. Debtor also obtained production of some of Town & Country's corporate records by having Robinson contact Codding to ask Codding to ship records to Robinson's home. When Robinson received the records, debtor produced them to Farrell.

B. § 727(a)(3)

Bankruptcy Code § 727(a)(2)(B), (a)(3), (a)(4)(A), (a)(5), and (a)(7) provide:

> (a) The court shall grant the debtor a discharge, unless—
>
> (3) the debtor has concealed, destroyed, mutilated, falsified, or failed to keep or preserve any recorded information, including books, documents, records, and papers, from which the debtor's financial condition or business transactions might be ascertained, unless such act or failure to act was justified under all of the circumstances of the case;

[17] Farrell alleges that debtor violated § 727(a)(3) because Farrell sued Town & Country and others, but not the debtor, in 2003 and sued debtor and Robinson in 2005, concerning the allegedly missing trust funds of Town & Country. Farrell alleges that debtor failed to preserve recorded information concerning her personal finances and of Town & Country in violation of § 723(a)(3). Farrell alleges that after debtor filed bankruptcy, Farrell sought books and records of Town & Country and although Farrell admits that debtor produced project related books and records, Farrell nevertheless contends that debtor has not produced books, records, documents from which debtor's financial condition or business transactions might be ascertained, including documents to support payments to debtor and Robinson made during the construction of the Home Depot Corpus Christi project. Farrell asserts that debtor testified at her

2004 examination that some payments made to her were in repayment of loans. Farrell contends there are no records for these loans.

Farrell contends that it sought discovery through 2004 examinations of financial documents of Town & Country from Kurt Codding, Kevin Robinson, Compass Bank, and debtor. Farrell contends that the bank records it obtained from Compass Bank show that between January 2003 and August 2004, debtor signed checks to herself that totaled over $200,000 and checks to Kevin Robinson that totaled over $400,000. Farrell alleges that debtor could not satisfactorily explain these payments when asked about them in a Rule 2004 examination and has not kept or preserved personal financial records or those of Town & Country that would explain the purpose if any of those payments. Farrell alleges that debtor had an obligation as corporate officer and under the Bankruptcy Code to preserve recorded information related to the assets she controlled and that she failed to do so both before and during state court litigation Farrell filed in June 3, 2003, and this bankruptcy court ***921** litigation. Farrell alleges that Farrell's litigation against Town & Country placed obligations on debtor and on Town and Country to keep or preserve books, records and documents. Farrell alleges that debtor has concealed, destroyed mutilated, falsified, or failed to keep or preserve recorded information including but not limited to books documents records and papers from which debtors financial condition or business transactions might be ascertained and such acts or failures to act were not justified under all of the circumstances of the case.

C. § 727(a)(4)(A)

Bankruptcy Code § 727(a)(2)(B), (a)(3), (a)(4)(A), (a)(5), and (a)(7) provide:

> (a) The court shall grant the debtor a discharge, unless—
>
> (4) the debtor knowingly and fraudulently, in or in connection with the case—
>
> (A) made a false oath or account;
>
> ....

The Court finds that debtor has produced all of her personal records and that those records are adequate to satisfactorily explain her financial transactions. The evidence shows that, until she was made aware of it during the course of this adversary proceeding, Wendy Schreiber did not know that Town & Country was a defendant in any lawsuit. The evidence shows that Schreiber did not retain promissory notes for Town & Country once they were paid in full. Schreiber testified that Town & Country's Compass Bank records matched the loan ledger Schreiber kept documenting her loans to the company. The Court finds Schreiber's testimony to be credible. Schreiber's records show that her reimbursements, draws, expenses, and loans repayments by Town & Country totaled $239,622.86. Schreiber's draws from Town & Country totaled $75,000. The Court finds that debtor did not control the financial records of Town & Country Excavation, Inc. upon its cessation of business and it was appropriate for debtor to rely upon Codding's implicit representation that he would safely store the corporate records as president and majority shareholder of the corporation. The Court finds that debtor adequately explained the payments to herself and to Robinson. The Court finds that debtor's records and explanations are justified under all of the circumstances of the case.

Farrell alleges that debtor has misrepresented her assets and made false sworn statements in violation of § 727(a)(4)(A). Debtor's schedule A describes real property as rural homestead in Weimar, Texas. Debtor valued her interest at $450,000. Farrell contends that this statement is false. Farrell alleges that at the time debtor swore to Schedule A, she had listed or intended to list 20 of the 70 acres of the property including the house for sale for $575,000 at ForSaleByOwner.Com. Further, Farrell alleges that the valuation of the property is false and grossly understated as the listing price for the property currently is $875,000 and has been for months. Farrell alleges that debtor swore at her 341 meeting on February 23, 2006, that the down payment money for the real property listed in Schedule A was taken out of savings. Farrell contends that debtor took the money from Town & Country to make the down payment.

[18] On her schedules, debtor valued her rural homestead of 69.082 acres at 2471 Highway Colorado County, Weimar, Texas, at $450,000.00, with liens totaling $378,149.00. Debtor claimed this property exempt for a value of $71,851.00. First and second liens against the property are held by First Ag Credit in the amounts of $239,127.00 and $139,022.00. Wendy Schreiber testified at her February 23, ***922** 2006, 341 meeting that she made a down payment of $40,000 to acquire her home located in Weimar, Texas. The total mortgage payment is $2,300. Kevin Robinson pays ½ of the monthly mortgage payment, and Wendy Schreiber

pays $1,150. The property is appraised by the local taxing authority at $450,000, which is the value debtor included in her schedules. Debtor believes she has equity in the house of $72,000. The Court finds debtor's testimony credible that she saved her income from Express Site Preparation and that this income funded the purchase of her home. Farrell has failed to introduce any evidence indicating that the value shown in debtor's schedule is false. The Court finds that debtor has explained the circumstances of Town & Country's loan repayments to debtor. The Court finds that debtor has not falsely sworn to the value of her property on schedule A.

[19] Farrell next alleges that in item 18 of her Statement of Financial Affairs, debtor knowingly and fraudulently failed to disclose other businesses she operated within the 6 year time period preceding the commencement of this case, including Lantana Services and EGN Services. The evidence shows that debtor's statement of affairs lists Town & Country Excavation Services, Inc., beginning date April 3, 2002, and ending date June 30, 2004, in response to question 18 requiring debtor to list information concerning all businesses in which debtor was an officer within 6 years prior to commencement of the case. In addition, debtor listed her stock ownership and officer position in response to question 21b. The evidence also shows that for two months during 2002, debtor owned stock in Kurt Codding's company, Durosealant. Schreiber resigned from that company in March 2002 and gave the stock to Kurt Codding. During 2002 and 2003, debtor did business as EGN Services. As EGN Services, debtor hired dump truck drivers and invoiced for the trucking services. Debtor did business as Lantana Services in 2004, and filed an assumed name certificate in Colorado County, Texas. Debtor opened an account for Lantana Services in October of 2004 into which debtor deposited funds in October 2004 and in February of 2005. As Lantana Services, debtor hired truckers and invoiced site contractors for the trucking services. The Court finds debtor's testimony credible that she inadvertently failed to schedule these short term business ventures and her stock in Town & Country Excavation, Inc.

[20] Farrell alleges that debtor swore at her 2004 Examination that she did not know the purpose or circumstances surrounding payments to Kevin Robinson in July 2003. Farrell alleges that statement was false. The Court finds that debtor has explained Town & Country's payments to Kevin Robinson. The Court finds that debtor's inability to respond to Farrell's impromptu demand during deposition that she names the exact purpose of every check written during the existence of Town & Country's work on the Home Depot Corpus Christi does not constitute a knowing and fraudulent false oath or account.

D. § 727(a)(5)

Bankruptcy Code § 727(a)(2)(B), (a)(3), (a)(4)(A), (a)(5), and (a)(7) provide:

> (a) The court shall grant the debtor a discharge, unless—
>
> (5) the debtor has failed to explain satisfactorily, before determination of denial of discharge under this paragraph, any loss of assets or deficiency of assets to meet the debtor's liabilities;
>
> ....

***923** **[21]** Farrell alleges that debtor violated § 727(a)(5) because debtor cannot explain the sources and disposition of her assets and those she controlled as a corporate officer on behalf of Town & Country. Farrell alleges that debtor had not or refused to credibly explain what she did with trust funds of which she was trustee that she paid to herself and Kevin Robinson during the time period between February 2003 and August 2004. Farrell alleges that debtor has failed to explain satisfactorily before determination of denial of discharge any loss of assets or deficiency of assets to meet debtor's or Town & Country's liabilities.

The Court finds that debtor has explained satisfactorily, before determination of denial of discharge, any loss of assets or deficiency of assets to meet the debtor's liabilities. The Court further finds that the evidence is clear that Farrell's failure to pay Monitor Trust on its contract to build the Home Depot Corpus Christi and Monitor Trust's consequent failure to pay Town & Country, contributed to the financial demise of Town & Country. The Court finds that debtor has adequately explained any failure of assets to meet liabilities for both herself and for Town & Country.

E. § 727(1)(2), (3), (4)(A), and (5)

Bankruptcy Code § 727(a)(2)(B), (a)(3), (a)(4)(A), (a)(5), and (a)(7) provide:

> (a) The court shall grant the debtor a discharge, unless—

> (7) the debtor has committed any act specified in paragraph (2), (3), (4), (5), or (6) of this subsection, on or within one year before the date of the filing of the petition, or during the case, in connection with another case, under this title or under the Bankruptcy Act, concerning an insider;

Farrell alleges that under § 727(a)(7), debtor has committed acts specified in § 727(a)(2), (3), (4)(A), and (5) concerning insiders Town & Country and Kevin Robinson. The Court finds that Farrell has failed to prove that debtor committed any act in violation of § 727(a)(7).

VI. Exemptions

[22] Farrell filed an objection to debtor's exemptions. Farrell's objection to exemptions contends that debtor's exemption of her equity in her homestead exceeds that amount allowed by 11 U.S.C. § 522(p), $125,000. Debtor's schedule C shows that debtor exempted her equity in the property, a total of $71,851.00. The Court finds that the amount of interest debtor acquired within the look back period does not exceed the cap of § 522(p). Therefore, debtor's claim of exemption does not violate § 522(p). *See e.g., In re Fehmel,* 372 Fed.Appx. 507 (5 th Cir. Tex.2010). Farrell contends that debtor's listing of her property for $875,000 proves that she has attempted to exempt more than the amount allowed by the cap of § 522(p) and (q). The Court finds that debtor has scheduled her property appropriately. The Court further finds that a seller's listing price without completion of a sale is inadequate to prove value.

Farrell also contends that debtor's exemption of her homestead violates § 522(q)(*l*)(B)(ii). The Court finds that as with the result under § 522(p), debtor has not sought to exempt any amount of interest in excess of the cap of § 522(q).

VII. Conclusion

The Court concludes that T.D. Farrell has failed to prove a cause of action for violation of Tex. Prop.Code § 162.001 et seq. (the Texas Construction Trust Fund Act). The Court concludes further T.D. Farrell has failed to prove that its alleged debt is not dischargeable under 11 U.S.C. § 523(a)(4), or (a)(6). The Court further concludes that Farrell has failed to prove ***924** an objection to debtor's discharge under 11 U.S.C. § 727(a)(2)(B), (a)(3), (a)(4)(A), (a)(5), or (a)(7). Lastly, the Court concludes that T.D. Farrell has failed to prove its objections to debtor's claim of exemption.

All Citations

466 B.R. 903

Footnotes

1 Subsequent to the events described herein, Robinson and Schreiber began a personal relationship and now have two children together. Robinson pays Schreiber child support periodically.

2 Debtor also used her savings to make a down payment on a home.

470 B.R. 1
United States Bankruptcy Court, D. Massachusetts.

In re William A. STELLA, Debtor.
Warren E. Agin, Chapter 7 Trustee, Plaintiff
v.
William A. Stella, Defendant.

Bankruptcy No. 10–11922–JNF.
|
Adversary No. 10–1154.
|
March 7, 2012.

Synopsis

Background: Chapter 7 trustee filed partial objection to debtor's claim of homestead exemption, and also brought adversary proceeding against debtor seeking revocation of discharge. Contested matter and adversary proceeding were consolidated.

Holdings: Following trial, the Bankruptcy Court, Joan N. Feeney, J., held that:

[1] debtor acquired interest in his residence, within meaning of Bankruptcy Code's homestead exemption cap, in conveying property to himself as trustee of trust to which property had been transferred, and

[2] providing schedule of trust beneficiaries to Chapter 7 trustee did not warrant denial of discharge for failure to maintain and preserve adequate financial records.

Ordered accordingly.

West Headnotes (10)

[1] Bankruptcy Waiver or Loss of Exemption

Homestead exemption permitted under state law is subject to the limitation under Bankruptcy Code's homestead exemption cap when three elements exist: (1) an interest in property (2) is acquired by debtor (3) within 1,215 days of the petition filing date. 11 U.S.C.A. § 522(p)(1)(A).

[2] Bankruptcy Waiver or Loss of Exemption

Chapter 7 debtor acquired interest in his residence, within meaning of Bankruptcy Code's homestead exemption cap applicable to homestead interests acquired by debtors during 1,215 days preceding petition filing, where, acting as trustee of trust to which property previously had been transferred, debtor reconveyed property to himself within 1,215-day prepetition period, and, as trustee, had held only bare legal title to property and served as fiduciary for his sons, who were named trust beneficiaries. 11 U.S.C.A. § 522(p)(1)(A).

[3] Bankruptcy Dischargeable Debtors

Statute governing denial of Chapter 7 discharge is to be liberally construed in favor of debtor. 11 U.S.C.A. § 727(a).

[4] Bankruptcy Failure to Keep Records
Bankruptcy Destruction or mutilation of records

Purpose of provision of statute allowing for denial of Chapter 7 discharge based on debtor's conduct in concealing, destroying, mutilating, falsifying, or failing to keep or preserve adequate records is to give creditors and bankruptcy court complete and accurate information concerning status of debtor's affairs and to test completeness of disclosure requisite to discharge; statute also ensures that trustee and creditors are supplied with dependable information on which they can rely in tracing debtor's financial history. 11 U.S.C.A. § 727(a)(3).

[5] Bankruptcy Particular grounds for objection to discharge

Creditor who objects to entry of debtor's Chapter 7 discharge based on debtor's failure to maintain and preserve adequate records has

initial burden of proving (1) that debtor failed to maintain and preserve adequate records, and (2) that such failure makes it impossible to ascertain debtor's financial condition and material business transactions. 11 U.S.C.A. § 727(a)(3).

[6] **Bankruptcy** Particular grounds for objection to discharge

Once creditor objecting to entry of debtor's Chapter 7 discharge based on debtor's failure to maintain and preserve adequate records makes initial showing that debtor's records are inadequate, burden is on debtor to prove justification for such inadequacies. 11 U.S.C.A. § 727(a)(3).

[7] **Bankruptcy** Failure to Keep Records

Plaintiff objecting to debtor's Chapter 7 discharge does not need to prove fraudulent intent to demonstrate debtor's failure to maintain and preserve adequate records. 11 U.S.C.A. § 727(a)(3).

[8] **Bankruptcy** Justification

Debtor opposing objection to Chapter 7 discharge based on his alleged failure to maintain and preserve adequate records can establish justification for the inadequacies of his recorded information based on all the circumstances of the case. 11 U.S.C.A. § 727(a)(3).

[9] **Bankruptcy** Justification

Factors relevant to parties' respective burdens and Chapter 7 debtor's establishment of defense of justification to objection to discharge based on debtor's failure to maintain and preserve adequate records include (1) whether debtor was engaged in business, and if so, complexity and volume of business, (2) amount of debtor's obligations, (3) whether debtor's failure to keep or preserve books and records was due to debtor's fault, (4) debtor's education, business experience, and sophistication, (5) customary business practices for record keeping in debtor's type of business, (6) degree of accuracy disclosed by debtor's existing books and records, (7) extent of any egregious conduct on debtor's part, and (8) debtor's courtroom demeanor.

[10] **Bankruptcy** Sufficiency of records

Bankruptcy Justification

Debtor did not provide Chapter 7 trustee with falsified schedule of beneficiaries for trust into and out of which debtor had transferred his residence prepetition, even though schedule provided was not original one showing debtor's sons as trust beneficiaries, and therefore providing schedule did not warrant denial of discharge for failure to maintain and preserve adequate records; debtor had intended to and had power to make himself sole trust beneficiary, his attorney's mistaken recollections of trust's terms and debtor's status as sole beneficiary reinforced debtor's belief that he could treat property as his own and submit schedule of beneficiaries consistent with reconveyance deed and his intention to regain full ownership of property to obtain homestead exemption, and debtor justifiably relied on attorney's advice in signing and delivering schedule to Chapter 7 trustee. 11 U.S.C.A. § 727(a)(3).

West Codenotes

Prior Version Limited on Preemption Grounds

M.G.L.A. c. 188, § 1

Attorneys and Law Firms

***2** Warren E. Agin, Boston, MA, pro se.

Brian E. Donovan, Law Offices of Brian E. Donovan, Quincy, MA, for Defendant.

MEMORANDUM

JOAN N. FEENEY, Bankruptcy Judge.

I. INTRODUCTION

Two matters are before the Court: 1) the Partial Objection to Debtor's Claim of Homestead Exemption filed by Warren E. Agin, the Chapter 7 Trustee (the "Chapter ***3** 7 Trustee"), and the Response to the Trustee's Partial Objection filed by William A. Stella (the "Debtor") (the "Contested Matter"); and 2) the Chapter 7 Trustee's Complaint against the Debtor pursuant to which the Chapter 7 Trustee seeks revocation of the Debtor's discharge pursuant to 11 U.S.C. § 727(a)(3). The Court consolidated the Contested Matter and the adversary proceeding, both of which involve consideration of the terms of the Stella Family Realty Trust (the "Trust"), which the Debtor established in 2001, and conducted a trial on October 25, 2010. At the trial, two witnesses testified and 27 exhibits were introduced into evidence.

Prior to the trial, the parties filed a Joint Pretrial Statement in both the Contested Matter and the adversary proceeding. They agreed that with respect to the Contested Matter there were no facts in dispute. With respect to the Chapter 7 Trustee's Complaint, they agreed that the following issues of fact were in dispute: 1) Whether the Debtor always believed that he was the sole beneficiary of the Trust; 2) Whether the Debtor believed his signature on, and delivery of, a 2010 Schedule of Beneficiaries of the Trust to the Chapter 7 Trustee was appropriate; and 3) Whether the Debtor justifiably relied on advice of counsel in signing and delivering the 2010 Schedule of Beneficiaries of the Trust to the Chapter 7 Trustee.

The Court now makes its findings of fact and conclusions of law in accordance with Fed. R. Bankr.P. 7052.

II. FACTS

The Debtor filed a Chapter 7 petition on February 26, 2010. The Debtor, who was born on April 5, 1942, is divorced and the father of two adult sons: William A. Stella, Jr. and Andrew J. Stella. Prior to 2007, the Debtor was the owner of Bill Stella Kitchens, Inc. In 2007, he commenced doing business as a sole proprietorship known as BSK Designs. Bill Stella Kitchens, Inc., however, was reincorporated in 2008. The Debtor's home address is 82 Dillingham Way, Hanover, MA 02339 (the "Property"). On August 13, 1987, the Debtor purchased the Property, individually. He financed the purchase with a mortgage on the Property, which was satisfied in 2006.

At all times, the Property has been the Debtor's principal and only residence. When the Debtor purchased his home, he had physical custody of his sons, and they lived with him until they were emancipated. In 2001, the Debtor engaged Thomas Carpenter Esq. ("Attorney Carpenter"), who was associated with the firm of Ardito, Sweeney, Stusse, Robertson & Dupuy, P.C. at the time. The Debtor knew Attorney Carpenter because he had attended Boston College with his son, William A. Stella, Jr. The Debtor asked Attorney Carpenter if he could draft some sort of document which would provide that his sons would receive the Property when he died or became incapacitated. The Debtor wanted to avoid the probate process, as he had heard that it was both expensive and complicated.

Attorney Carpenter and the Debtor discussed the Debtor's wish to protect the Property from creditors for the benefit of his sons, while maintaining control over the Property because it was his principal residence. Attorney Carpenter told the Debtor that he could draft a trust which would satisfy that purpose. Attorney Carpenter stated: "I advised him that I could draft a document for him that would give him complete control of the house." Attorney Carpenter prepared a deed from the Debtor to himself as Trustee of the Trust, as well as the "Declaration of Trust Establishing Stella Family Realty Trust." ***4** The Debtor executed both documents in Attorney Carpenter's Cape Cod office on September 5, 2001. Attorney Carpenter also prepared a Schedule of Beneficiaries of the Trust, which the Debtor signed. The Schedule of Beneficiaries listed the Debtor's two sons, each with a 50% beneficial interest in the Trust. Both William A. Stella Jr. and Andrew J. Stella executed the 2001 Schedule of Beneficiaries which was then notarized. The Declaration of Trust, but not the Schedule of Beneficiaries, was recorded in the Plymouth county Registry of Deeds.

At all times, the Debtor believed he was the actual owner of the Property. At all times, the Debtor paid all expenses for the Property from his personal accounts. At all times, the Debtor paid the mortgage from his personal accounts. At all times, the utility bills were in the Debtor's name and he paid those bills from his personal accounts. In addition, at all times, the Debtor, on his individual state and federal tax returns, deducted expenses for real estate taxes and mortgage interest, whether they were available as itemized deductions or were applied to standard deductions. The tax returns were prepared by the accounting firm of O'Brien, Riley & Ryan, P.C. For example, on Schedule A–Itemized Deductions to his 2003 federal income tax return, the Debtor deducted $4,036 for real estate taxes and $9,025 for mortgage interest. The Debtor claimed the same deductions in the following years.

In addition, he testified that his sons never contributed any monies toward the payment of expenses associated with the Property.

The Trust never applied for or received a Federal Identification Number (FID), and the Trust never filed its own or any other tax return. The Trust never generated any income from rent or otherwise.

In 2006, the Debtor applied to Rockland Trust Company for a mortgage. The mortgagor was the Trust and the Debtor was identified as the Trustee. The Debtor signed all of the loan documents for the mortgage. The Debtor, however, always sent personal checks for the mortgage payments, and Rockland Trust Company always accepted those checks. The 1099's issued by the bank were in the name of William Stella, Trustee, although the Debtor's social security number was set forth on the 1099.

The Town of Hanover issued tax bills after 2002 in the name of "Stella, William A TT, Stella Family Realty Trust." Those bills were sent to the Debtor at his residence. The Debtor paid those bills with his personal funds, and the town accepted those funds and cashed the checks.

In June of 2009, the Debtor called Attorney Carpenter for a meeting. The Debtor told him that his business was not doing well as it was tied to the real estate market and that he had problems with his landlord and had signed a personal guaranty of the lease. He also informed Attorney Carpenter that he thought he might have to seek bankruptcy protection. Attorney Carpenter informed the Debtor that his house "could be in jeopardy." Attorney Carpenter advised the Debtor to deed the Property from the Trust to himself to obtain homestead protection for the Property. The Debtor agreed to have Attorney Carpenter draft the necessary documents, and the Debtor signed them in Attorney Carpenter's office on July 2, 2009. The deed from the Debtor, as Trustee of the Trust, to himself, individually, provided in pertinent part the following:

> The undersigned being the Trustee of the Stella Family Realty Trust, under a declaration of trust dated September 5, 2001 and recorded on September 21, 2001 at the Plymouth County Registry ***5** of Deeds ..., hereby certify in accordance with the terms of the Trust:
>
> 1. I am the sole Trustee and beneficiary of the Trust;
>
> 2. I, *as sole Trustee and beneficiary,* have authority to act with respect to the real property owned by the Trust; and
>
> 3. I, as Trustee, hereby certify that the existence or nonexistence of a fact which constitutes a condition precedent to acts by the Trustee or which are in any other manner germane to affairs of the Trust, shall be binding on all Trustees and the Trust estate in favor of a purchaser or other person relying in good faith on this certificate.

(emphasis supplied). The deed was notarized by Attorney Carpenter. The deed and declaration of homestead were recorded on the Debtor's behalf by Attorney Carpenter on July 9, 2009.

Attorney Carpenter testified that the reference to the Debtor's status as the sole beneficiary was a "typographical error" that he caused and for which he was responsible because he did not have a copy of the original, 2001 Schedule of Beneficiaries in his possession. Neither he nor the Debtor testified that the Debtor instructed Attorney Carpenter to formally amend the Schedule of Beneficiaries to eliminate the Debtor's two sons as the sole beneficiaries of the Trust in July of 2009.

When the Debtor and Attorney Carpenter concluded their meeting, Attorney Carpenter advised the Debtor to consult a bankruptcy lawyer whom he knew because the Debtor had suggested he might have to file a bankruptcy petition. At Attorney Carpenter's suggestion, the Debtor consulted an attorney on Cape Cod whom the parties identified as Attorney Johnson. The Debtor met with Attorney Johnson for approximately 15–20 minutes at which time Attorney Johnson explained the bankruptcy process to the Debtor, including what assets he might retain. The Debtor, however, never discussed the Property with Attorney Johnson and Attorney Johnson did not ask the Debtor anything about it, except to inquire about whether the Debtor owned his own home, to which the Debtor replied in the affirmative.

Sometime after the Debtor's meeting with Attorney Carpenter, in the fall of 2009, the Debtor went to the Hingham Institution for Savings to inquire about getting a mortgage to pay off the equity loan on the Property from the Rockland Trust Company. The Debtor obtained a mortgage and satisfied the mortgage to Rockland Trust Company. The Debtor, individually, was the mortgagor with respect to the new mortgage. In December of 2009 or January of 2010, the Debtor ceased work, although his sons continued the kitchen design business as a limited liability company. In January of 2010, the Debtor contacted Attorney Brian Donovan's office and requested a meeting to discuss filing a bankruptcy petition.

Attorney Donovan met with the Debtor for the first time on January 5, 2010. At the meeting, Attorney Donovan explained the bankruptcy process to the Debtor and asked him about all of his property, including his real estate. The Debtor explained to Attorney Donovan that the Property had been in a trust from 2001 to 2009. Mr. Donovan asked the Debtor to furnish him with a copy of the Trust. The Debtor transmitted, by facsimile, a copy of the Trust to Attorney Donovan on January 5, 2010 after he left Attorney Donovan's office.

In a subsequent conversation with the Debtor on January 5, 2010, Attorney Donovan asked the Debtor to provide him with ***6** a copy of the Schedule of Beneficiaries. The Debtor was unable to find a copy of the Schedule of Beneficiaries and explained that circumstance to Attorney Donovan. Attorney Donovan advised the Debtor to call the attorney who drafted the Trust and obtain a copy of the original from him.

On January 5, 2010, or the next day, the Debtor spoke with Attorney Carpenter about the Schedule of Beneficiaries. Attorney Carpenter told the Debtor that he could not locate the original, 2001 Schedule of Beneficiaries. Attorney Carpenter said "I think you are the original beneficiary. I'll draw it up, I'll fax it to you, and you'll have to sign it."

On January 6, 2010, the Debtor received an unsigned Schedule of Beneficiaries from Attorney Carpenter by facsimile at Stella Kitchens, his sons' place of business. The Debtor signed the 2010 Schedule of Beneficiaries and faxed a copy to Attorney Donovan. The document did not contain a header showing the imprint of Attorney Carpenter's fax machine, although it did show a fax imprint from Stella Kitchens where the Debtor was working. The 2010 Schedule of Beneficiaries identified the Debtor as the 100% beneficiary of the Trust, although the Debtor knew that the 2010 Schedule of Beneficiaries was not the original Schedule of Beneficiaries executed by his sons on September 5, 2001.

Attorney Carpenter testified that he looked at the Trust document quickly and "thought that there was no problem with drafting a new schedule." He explained: "[H]e had the right to amend the trust. He was the Trustee with complete control of the property. So I drafted him a new schedule and just, you know, sent it to him." Despite Attorney Carpenter's testimony that the Schedule was "new," it was undated and did not reflect that it was amended.

The Debtor did not advise Attorney Donovan that the 2010 Schedule of Beneficiaries had just been signed in January of 2010. He did not tell Attorney Donovan that the 2010 Schedule of Beneficiaries was not the original Schedule of Beneficiaries.

Attorney Donovan prepared a Chapter 7 petition for the Debtor's signature and, as noted above, the Debtor filed a Chapter 7 bankruptcy petition on February 26, 2010. On Schedule A–Real Property, he listed the Property with a value of $450,000. On Schedule C–Property Claimed as Exempt, he claimed a Massachusetts homestead, *see* Mass. Gen. Laws ch. 188, § 1.[1] On amended Schedule D–Creditors Holding Secured Claims, the Debtor listed Hingham Institution for Savings with a claim in the sum of $98,146.20 secured by a mortgage on the Property.

On March 11, 2010, Attorney Donovan mailed the Chapter 7 Trustee a copy of the Declaration of Trust, along with a copy of the 2010 Schedule of Beneficiaries. On April 6, 2010, the Debtor attended the section 341 meeting of creditors. On that date, the Debtor testified that he had owned the property from 1987, even though it had been in a Trust for part of that time. In response to the Chapter 7 Trustee's question about the Trust, the Debtor replied that he wanted to provide a mechanism whereby his sons would get the Property upon his death.

On May 11, 2010, the Chapter 7 Trustee sent a letter to Charles Ardito, Esq. of Ardito, Sweeney, Stusse, Robertson & Dupuy, P.C., requesting a copy of the original Schedule of Beneficiaries for the Trust. ***7** The firm obtained the original, 2001 Schedule of Beneficiaries and forwarded it to Attorney Carpenter. On May 24, 2010, Attorney Carpenter transmitted the original Schedule of Beneficiaries to the Chapter 7 Trustee by facsimile. Along with the 2001 Schedule of Beneficiaries, Attorney Carpenter also included a letter explaining the actions taken by the Debtor with regard to the Trust and the Schedule of Beneficiaries.

Since at least June of 2009, the Debtor thought he was the beneficiary of the Trust. The Debtor thought he was the sole beneficiary because he always had control of the property, and because in July of 2009 he signed a deed which Attorney Carpenter had prepared which stated that he was the sole beneficiary of the Trust, as well as the Trustee.

The Debtor always has consulted attorneys with respect to real estate matters. The deed the Debtor signed in July of

2009 provided that he was the sole beneficiary of the Trust, as well as the Trustee, and he believed that to be the case at that time. The Debtor has always considered the Property to be his property, not someone else's.

Attorney Carpenter testified that the Debtor did not instruct him as to the content of the documents he drafted. According to Attorney Carpenter, he drafted the Trust with the intention of enabling the Debtor to replace the beneficiaries who had "zero authority in this trust. No powers to do anything."

III. THE STELLA FAMILY REALTY TRUST

The provisions of the Trust are critical to resolution of the issues before the Court. The Trust, which *is not* a nominee trust, provides in pertinent part the following:

> THIS INSTRUMENT WITNESSES that [the Debtor] ... being about to take title to a certain parcel of land in Plymouth County, Massachusetts, do hereby declare that he will hold said parcel of land and any and all other property, real and personal which may be conveyed or transferred to him as Trustee hereunder, on and upon the following trusts: ...
>
> ARTICLE II—TERMS
>
> The term "Trustee" herein used shall mean not only the above mentioned person but whoever may be Trustee for the time being. The term "Beneficiary" shall mean those designated as such in Article VII hereof.
>
> ARTICLE III—POWERS OF THE TRUSTEE
>
> *The Trustee shall have the entire control and management of the trust property to the same extent as if he was the absolute owner free of trust.* Without limiting the generality of the foregoing, the Trustee shall also have the following powers:
>
> A. He shall have the power to purchase or otherwise acquire such real or personal property as he deems expedient and in the exercise of this power, may make investments and hold property; sell and exchange an interest in real or personal property held by him for cash or for any other consideration and upon such terms and conditions as he deems advisable; to borrow money and mortgage or pledge any part of the trust assets and to issue bonds, notes, or other evidences of indebtedness upon such terms and maturities as he thinks proper, to lend money with or without security; to execute as lessor or lessee leases for any term including terms expiring after the termination of the trustee; and to pay all expenses or other charges and obligations incurred in the administration ***8** of the trust or the assets thereof. ...
>
> ARTICLE IV—RESIGNATION AND SUCCESSOR TRUSTEES
>
> Any Trustee may resign his trust by an instrument in writing signed and acknowledged by him, delivered or sent by registered mail to the continuing trustee or trustee and recorded in the Registry of Deeds wherein this instrument is recorded and in the event there is no continuing trustee, to the beneficiaries if they are living....
>
> ARTICLE V—PROTECTION OF PERSONS DEALING WITH TRUST
>
> * * *
>
> C. A certificate signed by the Trustee as to any fact affecting the trust or the trust property or the administration thereof or as to any change of Trustee or as to any amendment of the trust instrument or the authority of any Trustee or other person to act for the Trustee or as to any other action by the Trustee of [sic] Beneficiaries may without further inquiry be treated as conclusive evidence thereof by persons dealing with the Trustee or any of the trust property.
>
> ARTICLE VI—PROTECTION OF TRUSTEE AND BENEFICIARIES
>
> * * *
>
> C. Subject to Paragraph E of this Article, the Trustee shall not be personally liable for any obligation or liability incurred by this trust or by the Trustee and the Trustee shall be entitled to reimbursement and exoneration out of the trust estate according to law.
>
> D. The trust alone shall be liable for the payment or satisfaction of all obligations and liabilities incurred in carrying on the affairs of this trust.
>
> E. The Trustee shall not be liable to this trust or to the Beneficiaries except for his own acts, neglects and defaults in bad faith.
>
> ARTICLE VII—BENEFICIARIES
>
> The Beneficiaries of this trust are the persons listed as the Beneficiaries in the SCHEDULE OF BENEFICIARIES this day executed by the Beneficiaries and filed with the

> Trustee and his successors and assigns as herein provided for. *The beneficial interest of the Beneficiaries are as may now or hereafter be set forth on said SCHEDULE OF BENEFICIARIES which shall from time to time be amended to reflect any change in the identity of the Beneficiaries or in their respective interest hereunder.*
>
> The said Beneficiaries shall be entitled to such distributions of income and/or capital as the Trustee shall from time to time in his discretion determine, and upon the termination of the trust shall be entitled to a distribution of the trust property in the method hereinafter set forth.
>
> ARTICLE VIII—TERMINATION
>
> This trust shall terminate twenty (20) years after the death of the Trustee originally named herein but may be terminated sooner by an instrument in writing signed by the Trustee. Upon termination of the trust, the Trustee shall apply the trust property first toward the payment and discharge of all debts, liabilities and obligations of the Trustee, direct or contingent, and shall distribute the balance of the trust property to and among the Beneficiaries then entitled to distribution in the shares proved in Article VII....
>
> * * *
>
> ARTICLE X
>
> This Declaration of Trust may be recorded in any Registry of Deeds in an district in which any property of the trust may be located, and if so recorded, ***9** any amendment thereof shall likewise be recorded therein.

(emphasis supplied).

IV. POSITIONS OF THE PARTIES

A. *Partial Objection to Debtor's Claim of Exemption*

1. The Chapter 7 Trustee

The Chapter 7 Trustee asserts that the Debtor's equity in the Property is worth about $352,000. He maintains that because the Debtor, who declared that equity exempt pursuant to 11 U.S.C. § 522(b)(3)(A) and Mass. Gen. Laws, ch. 188, § 1, acquired his interest in the Property less than 1,215 days before he filed his bankruptcy petition, his exemption is limited to $136,875, the statutory cap in effect at the commencement of the Debtor's case, pursuant to 11 U.S.C. § 522(p). He argues:

> It is undisputed that Mr. Stella never respected the form of the trust and he continued to treat the house as his own individual personal property. This fact does not prevent section 522(p)(1) from limiting his exemption. Notwithstanding his failure to respect the trust mechanism, he intentionally elected to place the house in the trust. He intentionally chose to represent to the outside world that the house was no longer his. He is bound by the effect of that decision and is bound by the trust's legal structure.

The Chapter 7 Trustee also argues:

> The trust is what it purports to be. It is an irrevocable, non-amenable, grantor trust into which Mr. Stella placed his home for the benefit of his two sons. Prior to the transfer his sole interest in the house was his possessory interest and the bare legal title he held as trustee. As a result of the transfer, he became the owner of the house in fee simple. He acquired quantifiable legal and equitable value as a result of the transfer and, as a result, his exemption in the house is capped by 11 U.S.C. § 522(p)(1).

Addressing the Debtor's arguments that the Trust was, in effect, a nullity, the Chapter 7 Trustee contends that the Debtor cannot avoid the ramifications of the Trust because his creditors might be able to do so. He states:

> [T]hat remedy is not available to Mr. Stella. Massachusetts' state law

> recognizes that when someone creates a trust for their own benefit creditors can reach the trust assets. *State Street Bank and Trust Co. v. Reiser,* 7 Mass.App.Ct. 633, 636, 389 N.E.2d 768 (1979). It does not give the settlor the right to ignore the trust and claim the assets as his own; trust avoidance is a creditor remedy. *Merchants Nat'l Bank v. Morrissey,* 329 Mass. 601, 605, 109 N.E.2d 821 (1953); *In re Tosi,* 383 B.R. 1, 10–12 (Bankr.D.Mass.2008); *In re Landry,* 226 B.R. 507 (Bankr.D.Mass.1998).

The Chapter 7 Trustee concludes:

> Even with broad powers, the trustee holds legal title, not an equitable interest. *See In re Chew,* 496 F.3d 11, 15–16 (1st Cir.2007)(in dicta, stating that if creditors had a beneficial interest in the debtor's home under a constructive trust theory, the debtor would not be able to exempt that interest in the home because he would have only bare legal title). The trustee acts as a fiduciary for the beneficiaries. *Fogelin v. Nordblom,* 402 Mass. 218, 223, 521 N.E.2d 1007 (Mass.1988). His actions remain constrained by those fiduciary obligations. *Id.* at 225–227 [521 N.E.2d 1007]; Rest.3d Trusts § 70 (2007). Even very broad discretionary powers are always subject to control of a court of equity to assure that in exercise of those powers the purposes of the trust ***10** are fulfilled. *Mazzola v. Myers,* 363 Mass. 625, 638, 296 N.E.2d 481, 490 (1973). The fact that the trust document gave Mr. Stella broad powers is not the same thing as saying he could do whatever he liked with the trust property. He was a trustee of the trust assets for the benefit of the beneficiaries and his actions were limited by the obligations state law places on trustees.

2. The Debtor

The Debtor argues that because the Beneficiaries had no powers under the Trust and because he reserved to himself complete authority to exercise control over the assets of the Trust and was the settlor, he had the power to revoke the Schedule of Beneficiaries and make himself the sole Beneficiary. In view of the his ability to terminate the Trust, amend the Trust, change the Beneficiaries and apply all Trust property to the payment of his liabilities, the Debtor concludes that under Massachusetts law creditors would have the right to reach the Trust assets as if they were his own. Citing *ITT Commercial Fin. Corp. v. Stockdale,* 25 Mass.App.Ct. 986, 987, 521 N.E.2d 417 (1988) (extending the Massachusetts Appellate Court decision in *State Street Bank and Trust Co., Inc. v. Reiser,* 7 Mass.App.Ct. 633, 638, 389 N.E.2d 768 (1979), a case in which creditors of a settlor/beneficiary, who reserved the power to revoke, amend or direct the disposition of principal or income during his life, could reach trust assets), the Debtor concludes:

> [I]f the Trust had remained in full force and effect on February 26, 2010 and Stella had filed a Chapter 7 bankruptcy showing no interest in the property held by the Stella Family Realty Trust, the Chapter 7 Trustee, under the authority cited, would have a remedy to include these trust assets as property of the estate under § 541. "The controlling issue is whether the Trust and the Trust res are property of the Debtor's bankruptcy estate because the Debtor, as co-settlor and sole trustee of the Trust, retained broad power to alter and amend the Trust and retained the incidents of ownership of the Trust res." *In re Jane A. Tougas,* 338 B.R. 164 (Mass.Bankr.2006).
>
> It is clear from the above analysis that the language of the Stella Family Realty Trust would permit the Chapter 7 Trustee to file a complaint which would include the trust property in the Debtor's Chapter 7 estate under § 541. In view of this conclusion, the Trustee cannot conversely argue, therefore, that the Debtor's property interest only originated in July, 2009.

B. *The Complaint*

1. The Trustee

The Trustee recites that on January 5, 2010 the Debtor's attorney asked him to provide a copy of the Schedule of Beneficiaries of the Trust. When the Debtor was unable to locate a copy of the Schedule, he contacted Attorney Carpenter to obtain a copy. Attorney Carpenter then prepared a document showing the Debtor as the sole beneficiary of the Trust and faxed the Debtor the document on January 6, 2010. The same day, the Debtor signed the document, which was neither dated nor notarized, and faxed it to his counsel. The document did not contain a header showing the imprint of Attorney Carpenter's fax machine, although it did show a fax imprint from Stella Kitchens where the Debtor worked. The Debtor did not inform his bankruptcy counsel that the 2010 Schedule of Beneficiaries had just been signed or that it was not the original, 2001 Schedule of Beneficiaries. On May 24, 2010, the Debtor's counsel provided the Schedule of Beneficiaries to the Trustee.

***11** The Trustee maintains that the Debtor knew that the Schedule provided to the Trustee through his counsel was not the original and was a falsified document within the meaning of 11 U.S.C. § 727(a)(3). Indeed, the Trustee maintains that this Court could infer that the Debtor intended to deceive him and his bankruptcy counsel about the Schedule of Beneficiaries, adding that his reliance on the fact that Attorney Carpenter prepared the Schedule is neither justification nor a defense when it should have be clear to the Debtor, who, as a businessman, was sophisticated enough to consider probate matters and the need to protect his residence through a homestead, that the Schedule was false.

2. The Debtor

The Debtor argues that his discharge should not be denied. He states:

> No where in the agreed facts of the case, nor in any testimony given by the debtor or Carpenter does the record indicate that the debtor failed to produce any records which were requested, nor did he destroy any records which were requested. Further, while the debtor produced what turned out to be an erroneous Schedule of Beneficiaries, he himself did nothing to obfuscate or prevent the trustee from obtaining the actual one. In fact, even though the debtor stated that he could not find the original schedule, there is no testimony from anyone, nor can it be argued, that he had the original in his custody and control and willfully refused to produce it or that he hid it from the trustee. Finally, Stella himself did not draft the erroneous Schedule, but went back to the attorney who drafted the original documents, upon whom he had relied on in the past ... and sought assistance in producing for the trustee a schedule which he thought reflected the actual one drafted in 2001.... Carpenter substantiated the testimony of the debtor.... The debtor also testified that he never had any intent to deceive, hide or otherwise frustrate any of the bankruptcy proceedings....

The Debtor adds that he was engaged in the business of kitchen remodeling and was not schooled in the law. He argues that he relied on Attorney Carpenter for the establishment and maintenance of his records. He also states that he believed it was appropriate for him to file the Schedule prepared by Attorney Carpenter and disputes that he acted with any fraudulent intent.

V. DISCUSSION

A. *The Partial Objection to Debtor's Claim of Exemption*

1. Applicable Law

[1] Section 522(p)(1) of the Bankruptcy Code in relevant part provides:

> ... a debtor may not exempt any amount of interest that was acquired by the debtor during the 1215–day period

> preceding the date of the filing of the petition that exceeds in the aggregate [$125,000] ... in value in—
>
> > A) real or personal property that the debtor or a dependent of the debtor uses as a residence[.]

11 U.S.C. § 522(p)(1)(A). According to the United States Bankruptcy Appellate Panel for the First Circuit in *Aroesty v. Bankowski (In re Aroesty),* 385 B.R. 1 (1st Cir. BAP 2008), "a homestead exemption permitted under state law is subject to the limitation under § 522(p)(1) when three elements exist: (i) an interest in property (ii) is acquired by the debtor (iii) within 1,215 days of the petition filing date." *Id.* at 4. The Chapter 7 Trustee, as the objecting party, has the burden of proving that the debtor is not entitled to the claimed exemption. Fed. R. Bankr.P. 4003(c).

***12** At the outset, it is important to note that the Trust at issue in this case was not a nominee trust. In *In re Khan,* 375 B.R. 5 (1st Cir. BAP 2007), the bankruptcy appellate panel observed:

> Under Massachusetts law, "[a] nominee trust is an entity created for the purpose of holding legal title to property with the trustees having only perfunctory duties; upon termination of the trust, the beneficiaries accede to title as 'tenants in common in proportion to their beneficial interests.' " *Johnston v. Holiday Inns, Inc.,* 595 F.2d 890, 893 (1st Cir.1979) (quoting Robert L. Birnhaum & James F. Monahan, *The Nominee Trust in Massachusetts Real Estate Practice,* 60 Mass. L.Q. 364, 365 (Winter 1976)). The key aspect of a nominee trust is the limitation on the powers of the trustees. "Unlike in a 'true trust', the trustees of a nominee trust have no power, as such, to act in respect of the trust property, but may only act at the direction of (in effect, as agents for) the beneficiaries." Birnhaum & Monahan, *supra,* at 365. Therefore, in a nominee trust, the legal title of the trustee and the equitable title of the beneficiary merge when the same person hold both titles. *In re Szwyd,* 346 B.R. 290, 293 (Bankr.D.Mass.2006), *aff'd,* 370 B.R. 882 (1st Cir. BAP 2007).

In *Aroesty,* the Debtor transferred property to her parents as trustees of a nominee trust of which she was the sole beneficiary. Within 1,215 days of the commencement of her bankruptcy case, "three transactions occurred: the Debtor recorded a declaration of homestead as the beneficiary of the Trust, the Trust conveyed the Property to the Debtor, and the Debtor recorded a second declaration of homestead as the title owner of the Property. The deed making this conveyance was recorded." 385 B.R. at 3. The bankruptcy appellate panel in *Aroesty* examined "the question of whether the Debtor acquired an interest within 1,215 days of filing her petition, thereby triggering the indexed cap imposed by section 522(p)." *Id.* at 2–3. It rejected the debtor's argument "that an individual who owns a beneficial interest in the subject property beyond the 1,215–day period and later becomes the title owner, does not acquire an 'interest' by recording a declaration of homestead during the requisite period ... [and] ... is that by recording the declaration, she merely classified her interest in the Property as a homestead." *Id.* at 6. The panel explained that "this argument fails to account for the legal title the Trust conveyed," adding that "the Trustee correctly points out that the issue is not whether the recording of the declaration created an 'interest,' but whether the legal title is an 'interest' under § 522(p)(1)." *Id.* at 6–7. The panel concluded:

> "Although the word 'interest' is not defined in the Bankruptcy Code, it has been interpreted in the context of § 522(p) to mean 'some legal or equitable interest that be quantified by a monetary figure,' ... or simply as 'equity in the homestead.' " [*In re*] *Khan,* 375 B.R. [5] at 9 [(B.A.P. 1st Cir.2007)] (citations omitted). Prior to the December 19, 2006 conveyance, the Debtor held a beneficial interest in the Property. As a result of the conveyance, the Debtor obtained title interest in Property. Since the net equity in the Property is $406,512, the Debtor received title interest in property with a value of $406,512. This title interest has a quantifiable monetary value, and thus, it is an "interest" under § 522(p)(1).

The Panel further observed:

> Although not disputed, the Panel notes that the other two elements required under § 522(p)(1) are present in this case, namely that the Debtor "acquired" the interest in property within the ***13** meaning of § 522(p)(1) and within the requisite time. The Debtor "acquired" the title interest by accepting and recording the deed, and then

recording the second declaration of homestead. *See* *In re Leung,* 356 B.R. 317, 322 (Bankr.D.Mass.2006) (finding that the debtor "acquired" an interest when he "accepted delivery of the deed and then made the affirmative step to declare a homestead"); *see also* *In re Rasmussen,* 349 B.R. 747, 757 (Bankr.M.D.Fla.2006). Additionally, the Trust conveyed the title interest on December 19, 2006, and the Debtor filed her petition on December 27, 2006. As such, the Debtor acquired the interest within 1,215 days of her petition date.

Id. at 7.

2. Analysis

[2] This Court finds the decision in *Aroesty* is dispositive of the issue of whether the Debtor acquired "any amount of interest" in the Property. Regardless of whether or not creditors or a Chapter 7 Trustee could obtain a declaratory judgment that the Trust was a sham or that the Trust *res* is property of the Debtor's bankruptcy estate had he not conveyed the Property to himself, *see, e.g.,* *Braunstein v. Beatrice (In re Beatrice),* 277 B.R. 439 (Bankr.D.Mass.2002), *aff'd,* 296 B.R. 576 (1st Cir. BAP 2003), the terms of the Trust were in effect prior to the July 2, 2009 conveyance from the Debtor, as Trustee of the Trust, to himself. Until that time, the Debtor, as Trustee, held only bare legal title and served as a fiduciary for his sons, the Trust beneficiaries. To the extent that the deed recites that the Debtor was sole Trustee and beneficiary, there was no evidence that the Debtor formally amended the Schedule of Beneficiaries before July 2, 2009. Moreover, in the instant case, unlike *Aroesty* and *In re Szwyd,* 346 B.R. 290 (Bankr.D.Mass.2006) (where debtor was sole trustee and beneficiary of trust, doctrine of merger permitted him to claim a homestead), the Debtor was never formally a beneficiary of the Trust until after July 2, 2009,[2] as Attorney Carpenter testified that the reference to the Debtor in the deed as a beneficiary of the Trust was a "typographical error." The Debtor, as Trustee, was not the equitable owner of the Property, despite his mistaken belief to the contrary. Accordingly, cases such as *Redmond v. Kester (In re Kester),* 339 B.R. 749 (10th Cir. BAP 2006), *aff'd,* 493 F.3d 1208 (10th Cir.2007), where the court permitted debtors who were beneficiaries of a self-settled revocable trust to claim a homestead under Kansas law, are distinguishable.

The Court is mindful that the Supreme Judicial Court has adopted a liberal construction of the Massachusetts Homestead Statute. *See* *Shamban v. Masidlover,* 429 Mass. 50, 53–54, 705 N.E.2d 1136 (1999); *Dwyer v. Cempellin,* 424 Mass. 26, 30 n. 7, 673 N.E.2d 863 (1996). Nevertheless, just as 11 U.S.C. § 522(c) preempts Massachusetts law for preexisting liens for debts contracted prior to the recordation of the homestead, *see* *Patriot Portfolio LLC v. Weinstein (In re Weinstein),* 164 F.3d 677 (1st Cir.1999), *cert. denied,* 527 U.S. 1036, 119 S.Ct. 2394, 144 L.Ed.2d 794 (1999), 11 U.S.C. § 522(p) restricts the amount of a claim of exemption in a valid homestead in circumstances such as here, where a debtor ***14** acquires an interest in property within 1,215 days of the commencement of a bankruptcy case. Stated another way, this Court finds that the cap imposed by section 522(p) does not conflict with the policy of liberally construing homestead entitlement so as to permit debtors to conflate trusts, such as the one in the instant case, offensively to take advantage of an available exemption, particularly where the trust was established for a legitimate purpose.[3]

While the Court has been unable to find any cases precisely on point, in *In re Hecker,* 414 B.R. 499 (Bankr.D.Minn.2009), the court refused to permit a debtor to employ so-called reverse veil piercing to obtain homestead protection for property owned by a limited liability company in which the debtor had an interest. Noting that reverse veil piercing to exempt assets held by a corporation was unique to Minnesota, 414 B.R. at 504, the court explained why it would not permit application of the doctrine in the case before it. The court stated:

> The facts of Hecker's case do not support the equitable remedy of veil piercing. Not only has he failed demonstrate a sufficient closeness of identity and a lack of prejudice to shareholders and creditors, but just as importantly, he has not demonstrated that it would be "unfair and unjust not to pierce the corporate veil." [*Miller & Schroeder, Inc. v.*] *Gearman,* 413 N.W.2d [194] at 196–97 [(Minn.App.1987)]. Hecker is an experienced businessman who has owned and operated dozens of auto dealerships, car rental franchises and other businesses. The *Gearman* case also involved an established, experienced businessman who, perhaps unlike the family farmers in *Hedge* and [*State Bank in Eden Valley v.*] *Euerle Farms* [441 N.W.2d 121

(Minn.App.1989)], had created and acted through his corporate entity with a sophisticated understanding of its benefits:

> In this case we have two established, experienced business parties involved in a commercial transaction. Gearman has acted through his corporation for over twenty years, held various properties through it, acquired title to the Hotel in 1980 and executed two mortgages through it, and enjoyed the benefits thereof. It is therefore neither unfair nor unjust to leave Gearman in a position where he must repay money he borrowed in order to carry on business activities.

Gearman at 197. Hecker acquired the Crosslake properties through a limited liability company as part of an intentional strategy to keep them out of his wife's hands. He enjoyed the benefits of the limited liability protection for many years. He owned many properties through his limited liability companies and surely would have had the means to purchase a homestead property in his own name.

In both *Hedge* and *Euerle Farms*, the parties seeking the homestead exemption through reverse piercing would have been entitled to the exemption prior to incorporating, and the question before the court was whether the debtors lost their homestead exemptions by incorporating. The property in this case ***15** was not Hecker's homestead prior to formation of the limited liability company. It was not classified as a homestead property for real estate tax purposes. It was only on the eve of bankruptcy that he decided to move into the home and claim it as his homestead. Unlike the situations in *Hedge* and *Euerle Farms*, this property is not a farm and is not essential to Hecker's business, but rather it is a luxury lakefront property. There are important policy considerations supporting the homestead exemption, and Minnesota has " 'long recognized the importance, notwithstanding the just demands of creditors, for a debtor's home to be a 'sanctuary.' " *Hedge,* 375 N.W.2d at 480 (quoting *Denzer v. Prendergast,* 267 Minn. 212, 126 N.W.2d 440, 443 (1964)). However, Hecker has the burden under Minnesota law to demonstrate that it would be unfair or unjust not to pierce the corporate veil, and he has not done so. *Gearman,* 413 N.W.2d at 196–97.

In re Hecker, 414. R. at 504. While this Court recognizes that the Debtor could have obtained homestead protection prior to the conveyance of the Property to the Trust in 2001, the Court finds that the Debtor's use of the Trust vehicle was part of a legitimate estate plan. When the Debtor's financial affairs deteriorated, he elected to abandon the Trust vehicle to claim a Massachusetts homestead in the Property standing in his own name. The Court finds that the Debtor's argument for something akin to reverse veil piercing is inconsistent with the equitable remedy used by Chapter 7 trustees and others to benefit creditors to obtain property held in revocable trusts.

B. *The Chapter 7 Trustee's Complaint under 11 U.S.C. § 727(a)(3)*

1. Applicable Law

The Chapter 7 Trustee seeks the denial of the Debtor's discharge pursuant to 11 U.S.C. § 727(a)(3) on the ground that the Debtor provided him with a false Schedule of Beneficiaries in 2010. The Chapter 7 Trustee alleged that the falsified Schedule of Beneficiaries constituted recorded information from which the Debtor's financial condition or business transactions might be ascertained and the Debtor's act in delivering the false Schedule of Beneficiaries was unjustified.

[3] Section 727(a)(3) provides that "[t]he court shall grant the debtor a discharge, unless ... the debtor has concealed, destroyed, mutilated, *falsified,* or failed to keep or preserve any *recorded information,* including books, documents, records, and papers, from which the debtor's financial condition or business transactions might be ascertained, unless such act or failure to act was justified under all of the circumstances of the case [.]" 11 U.S.C. § 727(a)(3) (emphasis supplied). As the court observed in *In re Bailey,* 375 B.R. 410, 415 (Bankr.S.D.Ohio 2007), "[a]s an exception to discharge and consistent with the overriding goal of providing a 'fresh start' to honest bankruptcy debtors, the statute is to be liberally construed in favor of the Debtor." *Id.* at 415 (citing *Haynes v. Carter (In re Carter),* 274 B.R. 481, 484 (Bankr.S.D.Ohio 2002) (citations omitted)). The court, however, added: "a discharge is a privilege, and not a right, and should only benefit an honest debtor." *In re Bailey,* 375 B.R. at 415 (citing *In re Juzwiak,* 89 F.3d 424, 427 (7th Cir.1996) (citations omitted)).

[4] The purpose of section 727(a)(3) "is to give creditors and the bankruptcy court complete and accurate information

concerning the status of the debtor's affairs and to test the completeness of the disclosure requisite to a discharge. The statute ***16** also ensures that the trustee and creditors are supplied with dependable information on which they can rely in tracing a debtor's financial history." *Meridian Bank v. Alten,* 958 F.2d 1226, 1230 (3rd Cir.1992).

[5] **[6]** Litigation involving 11 U.S.C. § 727(a)(3) involves a shift in the burden of proof. According to the court in *In re Burrik,* 459 B.R. 881 (Bankr.W.D.Pa.2011),

> A creditor who objects to the entry of a debtor's discharge under § 727(a)(3) has the initial burden of proving "(1) that the debtor failed to maintain and preserve adequate records, and (2) that such failure makes it impossible to ascertain the debtor's financial condition and material business transactions." *Id.* at 1232. Once a "creditor make[s] an initial showing that the debtor's records are inadequate ... the burden is [then] on the debtor to prove justification [for said inadequacies]."

459 B.R. at 890 (citing *Meridian Bank v. Alten,* 958 F.2d at 1232). The court in *Burrik,* further observed that "[t]he respective burdens of proof placed upon an objecting creditor and the debtor under § 727(a)(3) are that of persuasion and said burdens must be met by a preponderance of the evidence." 459 B.R. at 890 (citing *inter alia* *In re Ishkhanian,* 210 B.R. 944, 949 (Bankr.E.D.Pa.1997)) (relying on *Grogan v. Garner,* 498 U.S. 279, 285–91, 111 S.Ct. 654, 658–61, 112 L.Ed.2d 755 (1991)).

Many courts have examined the meaning of recorded information. The court in *Bailey* observed that a plaintiff "is not entitled to perfect, or even necessarily complete, records," adding that "[i]nstead, the Debtor must provide the Plaintiff 'with enough information to ascertain the debtor's financial condition and track his financial dealings with substantial completeness and accuracy for a reasonable period past to present.' " 375 B.R. at 415 (citing, *inter alia,* *Turoczy Bonding Co. v. Strbac (In re Strbac),* 235 B.R. 880, 882 (6th Cir. BAP 1999)). The Court in *Burrik* expressed the following views:

> First, "said records may be neither (a) 'chaotic or incomplete,' (b) in such a condition that a creditor is 'required to speculate as to the financial history or condition of the debtor,' nor (c) in such a condition that a 'creditor [is compelled] to organize and reconstruct the debtor's business affairs.' " *In re Buzzelli,* 246 B.R. 75, 96 (Bankr.W.D.Pa.2000) (internal citations omitted). Second, "[o]ral testimony is not a valid substitute or supplement for concrete written records," *In re Juzwiak,* 89 F.3d 424, 429–30 (7th Cir.1996), which means that records are inadequate if gaps therein exist that can only be filled by the oral testimony of a debtor, *see* *Buzzelli,* 246 B.R. at 97. Third, a debtor's records must be such that " '[c]reditors ... [need] not be forced to undertake an independent investigation of a debtor's affairs.' " *Juzwiak,* 89 F.3d at 429; *Buzzelli,* 246 B.R. at 96–97 (quoting *Juzwiak).* Fourth, "[t]he more complex the debtor's financial situation, the more numerous and detailed the debtor's financial records are supposed to be," *In re Pulos,* 168 B.R. 682, 692 (Bankr.D.Minn.1994); therefore, a debtor who runs "a business enterprise engaged in a steady stream of large scale transactions involving substantial sums of money," in contrast to a typical consumer debtor, must maintain detailed financial records, *Juzwiak,* 89 F.3d at 428.

Burrik, 459 B.R. at 890. *See also Canha v. Gubellini (In re Gubellini),* No. 09–016, 2009 WL 8466789 (1st Cir. BAP 2009).

[7] A plaintiff does not need to prove fraudulent intent to demonstrate a section 727(a)(3) violation. *Razzaboni v. Schifano (In re Schifano),* 378 F.3d 60, 70 (1st Cir.2004); *Juzwiak,* 89 F.3d at 430; *see* ***17** *also* *Meridian Bank,* 958 F.2d at 1234 ("the court need not find that the debtor intended to conceal his financial condition" in order for a creditor to prevail under § 727(a)(3)).

[8] **[9]** A debtor can establish justification for the inadequacies of his recorded information based on all the circumstances of the case. *Meridian Bank,* 958 F.2d at 1231. *Lassman v. Hegarty (In re Hegarty),* 400 B.R. 332, 342–43 (Bankr.D.Mass.2008). In *U.S. Trustee v. Sohmer (In re Sohmer),* 434 B.R. 234 (Bankr.D.Mass.2010), this Court identified the following relevant factors relevant to the parties' respective burdens and the establishment of the defense of justification:

> 1. Whether the debtor was engaged in business, and if so, the complexity and volume of the business;

2. The amount of the debtor's obligations;

3. Whether the debtor's failure to keep or preserve books and records was due to the debtor's fault;

4. The debtor's education, business experience and sophistication;

5. The customary business practices for record keeping in the debtor's type of business;

6. The degree of accuracy disclosed by the debtor's existing books and records;

7. The extent of any egregious conduct on the debtor's part; and

8. The debtor's courtroom demeanor.

434 B.R. at 257 (citing *In re Kowalski,* 316 B.R. 596, 601–02 (Bankr.E.D.N.Y.2004), and *Krohn v. Frommann (In re Frommann),* 153 B.R. 113, 117 (Bankr.E.D.N.Y.1993)).

2. Analysis

[10] The Court finds that the Trustee failed to sustain his burden of proving that the Debtor provided him with a falsified Schedule of Beneficiaries. The Debtor first considered filing a bankruptcy petition in June of 2009 when his financial circumstances had deteriorated. His business of designing and installing kitchens was tied to the real estate market, and the deterioration of the housing market and a dispute with the landlord compelled him to consult with Attorney Carpenter. Attorney Carpenter informed the Debtor that his house could be in jeopardy and to transfer the Property from the Trust to himself the purpose of recording a homestead under Mass. Gen. Laws ch. 188, § 1.

Between June of 2009, when he consulted Attorney Carpenter and February of 2010 when the Debtor filed his Chapter 7 petition, the Debtor acquired a fee simple interest in the Property. Additionally, he obtained a mortgage from Hingham Institution for Savings and satisfied the outstanding obligation to Rockland Trust Company. At the commencement of his case, the Property was encumbered by a mortgage to Hingham Institution for Savings in the sum of approximately $98,000 and the equity was protected by a Massachusetts homestead.

The Debtor initially consulted Attorney Carpenter in 2001 about protecting the Property for the benefit of his sons. Attorney Carpenter drafted the Trust document and prepared the Schedule of Beneficiaries which was executed by the Debtor's sons and notarized. The Debtor always thought of the Property as his own and paid expenses for the Property from his personal bank accounts, although he must have been aware that the Property was held in Trust for the benefit of his sons because tax bills were addressed to him as "Stella William A TT Stella Family Realty Trust." Additionally, the parties agreed that in 2006 he applied to Rockland Trust Company for a mortgage and the mortgage that the he obtained was in his name ***18** as Trustee of the Trust. Nevertheless, there was no evidence that the Debtor had a keen understanding of, and ability to discern the relationship and nuances between trust and bankruptcy law, particularly where, at all times, he believed that he was the actual owner of the Property.

Article VII of the Trust, together with its other terms, provided the Debtor with the power to change beneficiaries ("The beneficial interest of the Beneficiaries are as may now or hereafter be set forth on said SCHEDULE OF BENEFICIARIES which shall from time to time be amended to reflect any change in the identity of the Beneficiaries or in their respective interest hereunder."). When the terms of the Trust are considered in conjunction with the deed prepared by Attorney Carpenter in July of 2009 and the 2010 Schedule of Beneficiaries, it is clear that the Debtor did not submit a false Schedule of Beneficiaries to the Trustee in 2010. The deed from the Debtor, as Trustee, to himself, as a practical matter terminated the Trust.

Although the Debtor did not formally amended the Schedule of Beneficiaries prior to executing the deed on July 2, 2009, Attorney's Carpenters' recollection of the Trust's terms and the Debtor's status as sole beneficiary reinforced the Debtor's belief that he could treat the Property as his own and submit to his counsel a Schedule of Beneficiaries consistent with what was set forth in the deed and his intention to regain full and indivisible ownership of the Property for purposes of obtaining homestead protection pursuant to Mass. Gen. Laws ch. 188, § 1. The Debtor's ability to amend the identity of the beneficiaries together with Attorney Carpenter's imperfect recollection that the Debtor was the sole beneficiary resulted in the production of the 2010 Schedule of Beneficiaries. While newly minted for the Chapter 7 Trustee's benefit, it was not false within the meaning of section 727(a)(3). The Debtor intended to be and had the power to make

himself sole beneficiary of the Trust. Weighing the applicable factors identified by this Court in *In re Sohmer,* 434 B.R. at 257, the Court finds that the Debtor believed that he was the sole beneficiary of the Trust; that he did not know that signing and delivering the 2010 Schedule of Beneficiaries of the Trust to his counsel and the Trustee was inappropriate; and that he justifiably relied on the advice of Attorney Carpenter in signing and delivering the 2010 Schedule of Beneficiaries of the Trust.

VI. CONCLUSION

In view of the foregoing, the Court shall enter an order sustaining the Chapter 7 Trustee's Partial Objection to Debtor's Claim of Homestead Exemption. The Court shall enter judgment in favor of the Debtor and against the Trustee in the adversary proceeding.

All Citations

470 B.R. 1

Footnotes

1 The Debtor's claimed homestead exemption is governed by the statute in effect prior to the repeal and recodification effective March 16, 2011.

2 Although the deed from the Debtor as Trustee of the Trust to himself reflected that he was “sole Trustee and beneficiary” and although he provided the Chapter 7 Trustee with Schedule of Beneficiaries identifying himself as the sole 100% beneficiary, there was no evidence that the Debtor, as Trustee, took any steps to remove his sons from the Schedule of Beneficiaries they executed and which was notarized on September 5, 2001 prior to July 2, 2009.

3 In view of the amendments to Mass. Gen. Laws ch. 188, § 1 et seq., the issue is unlikely to arise with frequency in the future as an “owner” can claim a homestead if he or she is the holder of a beneficial interest in a trust. Notably, even if the amended statute, whose effective date was March 16, 2010, were to apply to the Debtor's case, the Debtor did not hold a beneficial interest in the Trust when he filed his bankruptcy case.

848 F.3d 655
United States Court of Appeals, Fifth Circuit.

In the MATTER OF: Jeremy WIGGAINS, Debtor
Tanya Wiggains, Appellant
v.
Diane G. Reed, Appellee

No. 15-11249
|
FILED February 14, 2017

Synopsis

Background: Chapter 7 trustee brought adversary proceeding to avoid, as fraudulent transfer, debtor's prepetition partition of residence that he owned as community property with his nondebtor-wife. The United States Bankruptcy Court for the Northern District of Texas, Stacey G.C. Jernigan, J., 2015 WL 1954438, entered judgment in favor of trustee. Following sale of this property, wife moved for award of portion of sales proceeds based on her Texas homestead interest in property. The Bankruptcy Court, Jernigan, J., 535 B.R. 700, determined that wife was limited to what she would receive by virtue of debtor-husband's capped homestead exemption in property. Appeal was taken from both decisions directly to the Court of Appeals.

Holdings: The Court of Appeals, Leslie H. Southwick, Circuit Judge, held that:

[1] bankruptcy court did not clearly err, in proceeding to avoid Chapter 7 debtor's prepetition partition of community property as fraudulent transfer, in finding that debtor-husband had acted with intent to hinder or delay his creditors;

[2] section of Bankruptcy Code governing circumstances under which trustee may sell both estate's interest and interest of any co-owner in property in which debtor had interest prepetition did not apply to residence which was in nature of community property prior to being partitioned, and which was brought into bankruptcy estate in its entirety upon avoidance of partition transaction as fraudulent transfer; and

[3] there was nothing special or unique about nondebtor-spouse's homestead interest in residential property acquired by debtor-husband a mere nine months in advance of bankruptcy that would make it confiscatory, in violation of the Takings Clause, to prevent nondebtor-spouse from receiving out of proceeds from sale of this property any more than she would receive by virtue of capped homestead exemption.

Affirmed.

Procedural Posture(s): On Appeal.

West Headnotes (23)

[1] **Bankruptcy** Conclusions of law; de novo review

Bankruptcy Clear error

On direct appeal from judgment of bankruptcy court, the Court of Appeals would review fact findings for clear error and bankruptcy court's conclusions of law de novo. Fed. R. Bankr. P. 8013.

3 Cases that cite this headnote

[2] **Bankruptcy** Clear error

Finding of fact is "clearly erroneous" only if, on entire evidence, appellate court is left with definite and firm conviction that mistake has been committed. Fed. R. Bankr. P. 8013.

1 Cases that cite this headnote

[3] **Federal Courts** Conflicting or undisputed evidence

"Clear error" review is especially rigorous when the Court of Appeals reviews lower court's assessment of trial testimony, because trier of fact has seen and judged the witnesses.

[4] **Federal Courts** Conflicting or undisputed evidence

When there are two permissible views of the evidence, fact-finder's choice between them cannot be "clearly erroneous."

[5] **Statutes** Statute as a Whole; Relation of Parts to Whole and to One Another

In interpreting statute, court starts with the language of statute, reading it as a whole and being mindful of linguistic choices made by Congress.

[6] **Statutes** Plain language; plain, ordinary, common, or literal meaning

When statute's language is plain and unambiguous, it must be given effect.

[7] **Bankruptcy** Intent of debtor

Transfer is avoidable as actually fraudulent to creditors if it was made with intent to defraud creditors, but also if it was made with intent to hinder or to delay creditors; Congress' use of disjunctive word "or" indicates that any one of these three states of mind will suffice. 11 U.S.C.A. § 548(a)(1)(A).

9 Cases that cite this headnote

[8] **Bankruptcy** Fraudulent transfers

Bankruptcy court did not clearly err, in proceeding to avoid Chapter 7 debtor's prepetition partition of community property as fraudulent transfer, in finding that debtor-husband had acted with intent to hinder or delay his creditors in partitioning community property only one hour prior to commencement of his bankruptcy case; timing of execution of partition agreement and debtor's forthright admission that this transaction was intended to safeguard as much property as possible for benefit of his nondebtor-spouse by preventing it from entering bankruptcy estate supported bankruptcy court's finding as to debtor's intent. 11 U.S.C.A. § 548(a)(1)(A).

6 Cases that cite this headnote

[9] **Bankruptcy** Fraudulent transfers

In fraudulent transfer avoidance proceeding, because transferor's actual intent is rarely susceptible to direct proof, courts look to circumstances of the transfer to infer intent. 11 U.S.C.A. § 548(a)(1)(A).

1 Cases that cite this headnote

[10] **Bankruptcy** Fraudulent transfers

When debtor admits that he acted with requisite intent to hinder, delay or defraud creditors in making challenged transfer, there is no need for court to rely on circumstantial evidence or inferences in determining whether debtor had that intent, and whether transfer is avoidable as actually fraudulent transfer. 11 U.S.C.A. § 548(a)(1)(A).

9 Cases that cite this headnote

[11] **Bankruptcy** Particular cases and issues

Deference to bankruptcy court's fact finding is particularly appropriate on issues of intent, which often depend on assessing a witness' credibility. Fed. R. Bankr. P. 8013.

1 Cases that cite this headnote

[12] **Homestead** Nature of estate or right

"Homestead," in both the popular and legal sense, means the homeplace or family home, and also property which is protected because it is family home.

[13] **Homestead** Family relation in general

Homestead Exceptions from exemptions in general

Texas constitution grants to a spouse a legal interest in homestead that will stand firm against all claims except for three types of constitutionally permitted liens against homesteads, namely, those that secure purchase money debts, tax debts, or debts for home improvements. Tex. Const. art. 16, § 50.

[14] **Homestead** Exceptions from exemptions in general

Texas homestead laws are almost absolute in their protections against forced sale. Tex. Const. art. 16, § 50; Tex. Prop. Code Ann. § 41.001(a).

1 Cases that cite this headnote

[15] **Homestead** Nature and extent of right created

Homestead Family relation in general

Despite its vigor and breadth, protection that Texas homestead laws provide to spouses is not in nature of economic interest; homestead interest gives protective legal security rather than vested economic rights. Tex. Const. art. 16, § 50; Tex. Prop. Code Ann. § 41.001.

1 Cases that cite this headnote

[16] **Homestead** Nature and extent of right created

Homestead Family relation in general

Under Texas law, a spouse has only a possessory interest in real property by virtue of its homestead character. Tex. Const. art. 16, § 50; Tex. Prop. Code Ann. § 41.001.

[17] **Homestead** Proceeds of Homestead

Homestead Loss or relinquishment of right in general

Under Texas law, just as former homestead loses its homestead character when its owner abandons it, so the proceeds from sale of that former homestead lose their homestead character and become proceeds of former homestead. Tex. Prop. Code Ann. § 41.001.

[18] **Bankruptcy** Encumbered property; limited or joint interests

Descent and Distribution Contingent or Inchoate Rights

Dower or curtesy rights, within meaning of bankruptcy statute authorizing trustee to sell estate property free and clear of any vested or contingent rights in nature of dower or curtesy, are inchoate rights that do not vest until a spouse's death. 11 U.S.C.A. § 363(g).

[19] **Descent and Distribution** Dower and Curtesy

"Dower" refers to the interest that widow takes in estate of her deceased husband, while "curtesy" is the corresponding right of husband.

[20] **Bankruptcy** Encumbered property; limited or joint interests

Section of Bankruptcy Code governing circumstances under which trustee may sell both estate's interest and interest of any co-owner in property in which debtor had interest prepetition did not apply to residence which was in nature of community property prior to being partitioned one hour in advance of debtor's Chapter 7 filing, and which was brought into bankruptcy estate in its entirety upon avoidance of partition transaction as fraudulent transfer; statute did not require that debtor's nondebtor-spouse receive any share of proceeds from sale of residence beyond what she would receive as result of capped homestead exemption that had been claimed by debtor. 11 U.S.C.A. §§ 363(h, j), 522(p), 548(a)(1)(A).

[21] **Bankruptcy** Encumbered property; limited or joint interests

Eminent Domain Contracts in general; creditors' rights

There was nothing special or unique about nondebtor-spouse's homestead interest in residential property acquired by debtor-husband a mere nine months in advance of his Chapter 7 filing that would make it either onerous or confiscatory, in violation of the Takings Clause, to prevent nondebtor-spouse from receiving out of proceeds from sale of this property any more than she would receive by virtue of capped

homestead exemption claimed by debtor. U.S. Const. Amend. 5; 11 U.S.C.A. § 522(p).

[22] **Bankruptcy** Effect of State Law

To extent that there was any conflict between the Bankruptcy Code's cap on state law homestead available to debtor in recently acquired residential property, which applied to limit what nondebtor-wife would receive upon sale of this property, and Texas homestead interest granted to wife, bankruptcy law controlled. U.S. Const. art. 6, cl. 2; 11 U.S.C.A. § 522(p); Tex. Const. art. 16, § 50; Tex. Prop. Code Ann. § 41.001.

[23] **Bankruptcy** Effect of state law in general

Once state law property interests are defined, federal law controls the consequences in bankruptcy.

***658** Appeal from the United States Bankruptcy Court for the Northern District of Texas, Stacey G.C. Jernigan, U.S. Bankruptcy Judge

Attorneys and Law Firms

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Before JOLLY, BARKSDALE, and SOUTHWICK, Circuit Judges.

Opinion

LESLIE H. SOUTHWICK, Circuit Judge:

The bankruptcy court held that an agreement between the debtor and his spouse that partitioned their homestead property was a fraudulent transfer. Consequently, the non-debtor spouse had no interest in the proceeds from the sale of the homestead. This court granted the parties' joint request to permit an appeal directly to this court. We AFFIRM.

FACTUAL AND PROCEDURAL BACKGROUND

Jeremy Wiggains and his wife Tanya, married since 2007, purchased an expensive home in an exclusive Dallas suburb in late 2012. During their brief residency, the couple made valuable improvements as part of their investment strategy to increase profits from a future sale of the home.

In the summer of 2013, the Wiggainses began marketing their home. In August 2013, they signed a sales contract for $3.4 million. A few days before they received the purchase offer, two significant events occurred. First, the Wiggainses, upon the advice of counsel, executed and filed a "Partition Agreement," which sought to recharacterize their home from community property to separate property, one half belonging to each spouse. The Partition Agreement further provided that each spouse would have "sole and exclusive authority, management, and control of their separate property...."

Second, Mr. Wiggains filed for bankruptcy under Chapter 7 of the Bankruptcy Code one hour after recording the Partition Agreement. He claimed an exemption for his separate interest in the home under Texas law, which is subject to the $155,675 homestead exemption cap of Section 522(p) of the Bankruptcy Code, enacted in 2005 as part of the Bankruptcy Abuse Prevention and Consumer Protection Act ("BAPCPA") to address the so-called "mansion loophole." After various objections by the Trustee and certain creditors, Mr. Wiggains agreed to limit his homestead exemption to $130,675. Mrs. Wiggains did not separately file for bankruptcy.

The family resided at the home until it was sold by the Chapter 7 Trustee for $3.4 million, netting $568,668.41 in cash proceeds after payment of all liens, claims, ***659** and encumbrances. The net from the sale was further decreased by the disbursement of $130,675 to Mr. Wiggains pursuant to his homestead exemption. [1]

On May 5, 2014, Mrs. Wiggains initiated an adversary proceeding seeking a declaratory judgment recognizing that the Partition Agreement gave her a one-half separate property interest in the net proceeds from the sale. The Trustee counterclaimed to avoid the Partition Agreement and for a declaration that the remaining proceeds from the sale were property of the estate. The bankruptcy court held a one-day trial on these issues on October 21, 2014.

At trial, Mr. Wiggains testified that he entered into the Partition Agreement, upon the advice of counsel, with the purpose of excluding his wife's community-property interest in the homestead from his bankruptcy estate. He understood his bankruptcy exemption was statutorily capped at $155,675, an amount which he correctly believed the net sale proceeds would exceed. Although the couple discussed the possibility that both would declare bankruptcy so that they could receive the double homestead exemption of $311,350, Mr. Wiggains testified that he thought entering into the Partition Agreement was the right thing to do as he did not believe his wife was obligated on his business debts. Whether she would have been liable is not an issue raised here.

In its April 2015 decision, the bankruptcy court held that Mr. Wiggains's "sole actual intent in entering the Partition Agreement was to avoid the effect of the limitation placed on his homestead exemption by section 522(p) of the Bankruptcy Code," and the court equated such intent with "gamesmanship for the purpose of placing reachable assets outside of creditors' reach." The bankruptcy court also stated that Mr. Wiggains's "articulated intent to preserve for his family as much money as possible is the same as an intent to shield as much money as possible from creditors...."

The bankruptcy court declared the Partition Agreement avoidable as a fraudulent transfer, leaving the amount of the net sale proceeds in excess of Mr. Wiggains's exemption to be nonexempt property of the estate. The bankruptcy court also determined that Mrs. Wiggains had "no right or interest in the Homestead Net Sale Proceeds by virtue of the Partition Agreement." A principal factor in these conclusions was that the couple executed the Partition Agreement "in the shadow of an imminent bankruptcy filing" for no other reason than to shield a portion of Mr. Wiggains's assets from his creditors, which the bankruptcy court determined "can only be reasonably interpreted as an act done with intent to hinder and/or delay creditors."

In its initial decision, the bankruptcy court did not decide whether Mrs. Wiggains might be entitled to some distribution from the net sale proceeds under Section 363(j) of the Bankruptcy Code on account of her separate homestead interest, notwithstanding the avoidance of the Partition Agreement. Notably, Section 363(j) requires the Trustee, after a sale of certain types of property, to apportion and distribute sale proceeds to a debtor's spouse or co-owner. 11 U.S.C. § 363(j). On ***660** April 20, 2015, Mrs. Wiggains filed a motion in the underlying bankruptcy case to have compensation paid to her from the net sale proceeds for her separate homestead interest.

On July 1, 2015, which was after amending its initial opinion to make it an interlocutory order and also to consolidate the contested matter into the adversary proceeding, the bankruptcy court held an evidentiary hearing on Mrs. Wiggains's homestead compensation request. Mrs. Wiggains was the only witness during this second hearing. She testified that her family was renting a 6,000–square–foot house (at a cost of $5,000 per month) because they did not have funds to purchase a new homestead; that her husband was employed by a local automobile dealership; and that the family had exhausted all funds derived from the $130,675 homestead exemption. Based on an expert report, which the bankruptcy court found irrelevant, Mrs. Wiggains argued she was entitled to as much as 95% of the balance of the net sale proceeds.

The bankruptcy court concluded that Mrs. Wiggains failed to carry her burden to show entitlement to any compensation from the sale of the homestead under Section 363(j) or any other provision of the Bankruptcy Code. The bankruptcy court noted that the proffered evidence was "not particularly compelling," and did not show that the "Homestead had anything more than general intrinsic value to her." On September 4, 2015, the bankruptcy court entered its final judgment avoiding the Partition Agreement, a declaratory judgment that the Trustee was entitled to the balance of the net sale proceeds, and its judgment that Mrs. Wiggains was not entitled to a distribution from the net sale proceeds pursuant to Section 363(j).

After filing a timely notice of appeal to the district court on September 22, 2015, Mrs. Wiggains filed with this court a request, which was joined by the Trustee, to allow a direct appeal here under 28 U.S.C. § 158(d). We granted the request on December 16, 2015.

DISCUSSION

[1] **[2]** **[3]** **[4]** We review the fact findings in an order from a bankruptcy court for clear error and its conclusions of law *de novo*. *Total Minatome Corp. v. Jack/Wade Drilling, Inc. (In re Jack/Wade Drilling, Inc.)*, 258 F.3d 385, 387 (5th

Cir. 2001). "A finding of fact is clearly erroneous only if on the entire evidence, the court is left with the definite and firm conviction that a mistake has been committed." *Robertson v. Dennis (In re Dennis)*, 330 F.3d 696, 701 (5th Cir. 2003) (quotation marks omitted). "Clear error review is especially rigorous when we review a lower court's assessment of trial testimony, because the trier of fact has seen and judged the witnesses." *Moore v. CITGO Ref. & Chems. Co.*, 735 F.3d 309, 315 (5th Cir. 2013) (quotation marks omitted). "Where there are two permissible views of the evidence, the factfinder's choice between them cannot be clearly erroneous." *First Nat'l Bank LaGrange v. Martin (In re Martin)*, 963 F.2d 809, 814 (5th Cir. 1992) (quotation marks omitted).

I. The Avoidance of the Partition Agreement

Mrs. Wiggains contends the bankruptcy court clearly erred when it found Mr. Wiggains acted with actual intent to hinder or delay his creditors by executing the Partition Agreement. Specifically, she challenges the bankruptcy court's factual finding by arguing the court (1) failed to engage in a contextual analysis to determine her husband's intent in executing the Partition Agreement, and (2) erroneously discounted her husband's legitimate intent to preserve her homestead interest.

***661** [5] [6] We start with the language of the statute, "reading it as a whole and mindful of the linguistic choices made by Congress." *Whatley v. Resolution Trust Corp.*, 32 F.3d 905, 909 (5th Cir. 1994). Where a statute's language is "plain and unambiguous, it must be given effect." *BMC Software, Inc. v. C.I.R.*, 780 F.3d 669, 674 (5th Cir. 2015) (quotation marks omitted). By statute, a bankruptcy trustee may avoid any pre-petition transfer of assets by a debtor "that was made or incurred on or within 2 years before the date of the filing of the petition" if the debtor made the transfer "with actual intent to hinder, delay, or defraud" any past or future creditor. 11 U.S.C. § 548(a)(1)(A).

[7] The phrase "intent to hinder, delay, or defraud" is not defined in the Bankruptcy Code. We find relevant meaning in the fact that the phrase is stated in the disjunctive, which signifies that an intent to hinder or to delay or to defraud is sufficient.[2] *See* 5 COLLIER ON BANKRUPTCY ¶ 548.04[1][a] (Alan N. Resnick & Henry J. Sommer, eds., 16th ed. 2016). Ours is not a novel interpretation. The Supreme Court repudiated common misconceptions that surround a debtor's pre-bankruptcy activities by declaring that "[a] conveyance is illegal if made with an intent to defraud the creditors of the grantor, but equally it is illegal if made with an intent to hinder and delay them." *Shapiro v. Wilgus*, 287 U.S. 348, 354, 53 S.Ct. 142, 77 L.Ed. 355 (1932). Other courts examining a debtor's intent when deciding whether to deny discharge under Section 727(a)(2)(A) also construe "hinder, delay, or defraud" as being three separate states of mind. *See* *Retz v. Samson (In re Retz)*, 606 F.3d 1189, 1200 (9th Cir. 2010) (finding it "sufficient if the debtor's intent is to hinder or delay a creditor"); *Smiley v. First Nat'l Bank of Belleville (In re Smiley)*, 864 F.2d 562, 568 (7th Cir. 1989) (denying discharge where it "[wa]s clear that [the debtor] intended to hinder or delay his creditors, even if he had no intent to defraud them").

[8] [9] The Trustee stipulated there was no intent to defraud, so our focus turns to whether the Bankruptcy Court clearly erred in its assessment that Mr. Wiggains had actual intent to hinder or delay his creditors. We start from the reality that a transferor's actual intent is rarely susceptible to direct proof. *See* *In re Dennis*, 330 F.3d at 701. Given these evidentiary difficulties, courts have looked to the circumstances of the transfer to infer intent. *See* *id.* at 701–02. When fraud is suggested, this court has recognized six "badges of fraud" to help identify that intent—factors such as inadequate consideration, close relationship between grantor and grantee, or financial condition of the debtor before and after the transfer. *See Soza v. Hill (In re Soza)*, 542 F.3d 1060, 1067 (5th Cir. 2008). Though some of those factors are also useful in determining the intents to hinder or delay, the bankruptcy court did not try, nor found it necessary, to fit its analysis within the category of fraudulent badges. Neither will we. Without a list of factors, we seek to determine whether there is sufficient evidence of improper intent.

***662** Mrs. Wiggains directs us to three bankruptcy court opinions that examined the context of a transfer to determine intent. The first two present scenarios in which the bankruptcy courts denied a debtor's discharge based on a finding that the debtor acted with actual intent to hinder or delay his creditors. *Brooke Credit Corp. v. Lobell (In re Lobell)*, 390 B.R. 206, 219–20 (Bankr. M.D. La. 2008); *Bank of Oklahoma, N.A. v. Boudrot (In re Boudrot)*, 287 B.R. 582, 587–88 (Bankr. W.D. Okla. 2002). Having no direct testimony of their respective debtor's intent to hinder or delay, the bankruptcy courts

undertook a contextual analysis to reach these conclusions. *See In re Lobell*, 390 B.R. at 219 (concluding that the debtor acted with intent to hinder her creditor based on "evidence of several badges of fraud"); *In re Boudrot*, 287 B.R. at 587 (finding "substantial evidence that [the debtors] were motivated by a desire to hinder, delay or defraud" their creditors).

The third case on which Mrs. Wiggains relies more closely aligns with the facts in this case, namely, a situation in which a debtor's intent is rather clear. There, the bankruptcy court found the debtor transferred his property with the intent to hinder, delay, or defraud his creditors. *See* *Albuquerque Nat'l Bank v. Zouhar (In re Zouhar)*, 10 B.R. 154, 158 (Bankr. D.N.M. 1981) (transfer under a previous, but not substantively different, version of the Bankruptcy Act). Unlike the debtors in *Lobell* and *Boudrot*, the debtor in *Zouhar* "candidly admitted the purpose of" his transfer was "to shield the[ ] assets from his creditors." *Id.* at 156. He also "forthrightly admitted that he ... merely utilized this method as a device to shield his assets from his creditors." *Id.* at 157. The bankruptcy court found that the debtor's "candid admission" was "supported by the sequence of events," including the debtor's purchase of a home approximately two months before filing for bankruptcy. *Id.*

[10] In summary, in the first two cases the bankruptcy courts analyzed the circumstances surrounding the allegedly fraudulent transfers because of ambiguity about intent. In the third case, *Zouhar*, as well as here, there was direct evidence of a debtor's actual intent to hinder or delay. "Actual intent ... may be inferred from the actions of the debtor and may be shown by circumstantial evidence." *In re Dennis*, 330 F.3d at 701–02 (alteration omitted) (quoting *Pavy v. Chastant (In re Chastant)*, 873 F.2d 89, 91 (5th Cir. 1989)). We agree with another court that held: "When a debtor admits that he acted with the [necessary] intent ... there is no need for the court to rely on circumstantial evidence or inferences in determining whether the debtor had" that intent. *See* *First Beverly Bank v. Adeeb (In re Adeeb)*, 787 F.2d 1339, 1343 (9th Cir. 1986).

Mrs. Wiggains argues that the bankruptcy court read an illegitimate motivation in her husband's express testimony and erroneously found that his intent was to shield assets from his creditors. In support of this argument, she refers to her husband's response to the question of whether the Partition Agreement was intended to keep their homestead out of the bankruptcy estate: "I guess that's semantics. At the time we felt like it wasn't necessarily keeping anything out. At the time we honestly felt like it was more preserving [Mrs. Wiggains's] own rights."

We agree with Mr. Wiggains's characterization; semantics and labeling are indeed involved. Keeping property in the hands of his wife is the mirror of keeping property out of the hands of creditors. It is true, as Mrs. Wiggains argues, that the property was divided to allow her to get value from the homestead. That benign purpose, though, was being pursued at the ***663** moment before Mr. Wiggains's filing of a bankruptcy petition that would have caused the entire property to go into the bankruptcy estate for the benefit of creditors, leaving no portion, beyond Mr. Wiggains's reduced homestead exemption, to endure for the couple's benefit. If not for the creditors who could make claims on the net proceeds, there was no stated need for the partition.

We have previously recognized "the line between legitimate pre-bankruptcy planning and [impermissible intent] ... is not clear." *Swift v. Bank of San Antonio (In re Swift)*, 3 F.3d 929, 931 (5th Cir. 1993). Courts' efforts to label their analytical approach for determining whether otherwise lawful pre-bankruptcy planning exceeds the bounds of propriety provide us a colorful cast of characterizations. *See* *Wolkowitz v. Beverly (In re Beverly)*, 374 B.R. 221, 245 (9th Cir.BAP 2007) ("In classical terms, it is the Sword of Damocles."); *Morgan Fiduciary, Ltd. v. Citizens & S. Int'l Bank*, 95 B.R. 232, 234 (S.D. Fla. 1988) (smell test); *Zouhar*, 10 B.R. at 157 (slaughtered-hog test). We have no metaphors to contribute, so we press on.

Mr. Wiggains's testimony alone reflects his clear intent to hinder the creditors, though couched in terms of allowing his wife to receive value from the home. The bankruptcy court in essence held that the necessary effect of this transfer was to deprive creditors. The bankruptcy court considered the evidence and made the finding that the intent to enter into the Partition Agreement in order to preserve value from a home for the non-debtor spouse was not legally independent from the intent to hinder and delay Mr. Wiggains's creditors in bankruptcy. The bankruptcy court based its findings of fact largely upon Mr. Wiggains's own testimony evincing the

couple's strategic decision to place a portion of his assets beyond the reach of creditors.

Generally, "a court can hardly expect one who fraudulently transfers property to step up and admit it under oath." 5 COLLIER ON BANKRUPTCY ¶ 548.04[1][b]. Here, the timing of the transfer, coupled with the fact the partition was one of several options admittedly considered to allow as much value as possible to be retained outside of the bankruptcy estate, are relevant extrinsic evidence of improper intent even without any admissions. From the standpoint of the creditors, which is the proper perspective, the Partition Agreement sought to reduce drastically the amount available to creditors. *See* *Hinsley v. Boudloche (In re Hinsley)*, 201 F.3d 638, 644 (5th Cir. 2000).

[11] Deference to the bankruptcy court's findings is particularly appropriate on the issue of intent. Such a determination often depends on assessing a debtor's credibility. *See* *Perry v. Dearing (In re Perry)*, 345 F.3d 303, 309 (5th Cir. 2003). "We will not attempt to reassess the credibility of witnesses whom we have not had an opportunity to see on the stand." *Texas Mortg. Servs. Corp. v. Guadulupe Sav. & Loan Assoc. (In re Texas Mortg. Servs. Corp.)*, 761 F.2d 1068, 1078 (5th Cir. 1985). "Moreover, when the bankruptcy court's weighing of the evidence is plausible in light of the record taken as a whole, a finding of clear error is precluded, even if we would have weighed the evidence differently." *Bradley v. Ingalls (In re Bradley)*, 501 F.3d 421, 434 (5th Cir. 2007). We find no clear error in the bankruptcy court's assessment of this debtor's intent, that by placing a portion of the homestead beyond the reach of his creditors on the eve of bankruptcy, he was seeking to hinder or delay.

***664** *II. Homestead Interest under Section 363(j) of the Bankruptcy Code*

Mrs. Wiggains argues that by denying her distribution of $448,491.71 from the net sale proceeds, the bankruptcy court misapplied our caselaw that protects a non-debtor spouse's separate homestead interest. She also contends that Section 363(j) of the Bankruptcy Code is available as a mechanism for distribution of proceeds to her as a non-debtor spouse.

[12] **[13]** **[14]** " 'Homestead,' in both the popular and legal sense, means the 'homeplace' or family home, and also property which is protected because it is the family home." *Estate of Johnson v. C.I.R.*, 718 F.2d 1303, 1307 n.12 (5th Cir. 1983). Protection for homesteads in Texas is extensive. [3] *See* TEX. CONST. art. XVI, § 50. "From the beginning of Texas' statehood in 1845, its constitutions have provided homestead protection to its residents." *England v. FDIC (In re England)*, 975 F.2d 1168, 1172 (5th Cir. 1992). The Texas constitution grants to a spouse a legal interest in the homestead that will stand firm against all claims except for "the three types of constitutionally permitted liens against homesteads," namely, those that secure purchase money, for taxes, or for home improvement debts. *Heggen v. Pemelton*, 836 S.W.2d 145, 148 (Tex. 1992).

The constitutional protection is codified in the Texas Property Code: "A homestead ... [is] exempt from seizure for the claims of creditors," subject to certain exceptions not relevant here. TEX. PROP. CODE § 41.001(a). Several other Texas statutes protect spouses across a range of circumstances involving the abandonment, sale, and conveyance of a homestead. *See* *Kim v. Dome Entm't Ctr., Inc. (In re Kim)*, 748 F.3d 647, 653 n.11 (5th Cir. 2014).

[15] **[16]** **[17]** Despite its vigor and breadth, the protection does not grant a spouse an *economic* interest. "The homestead interest ... gives protective legal security rather than vested economic rights." *Heggen*, 836 S.W.2d at 148 (quoted in *Kim*, 748 F.3d at 661). A "spouse has only a possessory interest in the real property by virtue of its homestead character." *Kim*, 748 F.3d at 661. "Texas law has consistently distinguished *homestead* from *former homestead* and has done so for well over a century." *England*, 975 F.2d at 1173 (emphasis in original). Going one step further, we recognized that "[j]ust as the former homestead loses its homestead character when its owner abandons it, so the proceeds of the sale of that former homestead lose their homestead character and become proceeds of *former* homestead." *Id.* (emphasis in original).

With this background, we turn to the final issue: even after we accept that her husband had the intent to hinder and delay his creditors, must we recognize that Mrs. Wiggains has her

own interest for which compensation is due beyond what was paid to her husband?

Much of the analytical work has already been done for us in two of our relatively recent opinions. The earlier of the two involved a non-debtor spouse who sought compensation for her separate interest in a homestead she shared with her husband. *See* *Kim*, 748 F.3d at 650. The couple had acquired the residence prior to BAPCPA's passage, unlike in the present case when the purchase occurred well after BAPCPA ***665** was on the scene. *See* *id.* at 657. We first addressed Mrs. Kim's argument that the bankruptcy court lacked the authority to order a forced sale of the property. *Id.* at 653. We held this argument foreclosed by the clear statutory language of Section 363 and Supreme Court precedent. *Id.* at 654–55.

Next we focused on whether Mrs. Kim would be entitled to compensation for her homestead interest beyond the amount her husband elected as a statutory exemption under Section 522(p). *Id.* at 656. This is in essence our question too. In seeking compensation, Mrs. Kim relied upon a hypothetical scenario in which the Supreme Court assumed, "only for the sake of illustration, that a homestead estate is the exact economic equivalent of a life estate...." *See* *United States v. Rodgers*, 461 U.S. 677, 698, 103 S.Ct. 2132, 76 L.Ed.2d 236 (1983) (emphasis omitted). In *Kim*, though, we commented that "it is not entirely clear that Texas courts would place exactly the same economic value on homestead rights as it would on a life estate"; we were bold to say that the hypothetical "would seem to overvalue homestead rights...." *Kim*, 748 F.3d at 661–62.

Mrs. Kim maintained that a constitutional taking would occur if she were "not compensated for the loss of her homestead rights in" the marital property. *Id.* at 657. We acknowledged that such a "constitutional argument is likely limited to cases ... in which the real property that constituted the homestead was acquired before" BAPCPA's passage. *Id.* We never reached either the constitutional issue or whether Section 363(j) was a basis for compensation because of the limited briefing. *Id.* at 663.

The other relevant decision is *Thaw v. Moser (In re Thaw)*, 769 F.3d 366 (5th Cir. 2014). There, we highlighted the "important limitation" our *Kim* holding placed on a Takings Clause argument in this context, namely, that the argument is "likely limited to cases ... in which the real property that constituted the homestead was acquired before the BAPCPA was enacted." *Id.* at 369 (quoting *Kim*, 748 F.3d at 657). The homestead property in *Thaw*—as here—was purchased after BAPCPA was adopted. *Id.* at 369–70. We held this timing to be "dispositive" (no longer using the qualifier "likely"), and Mrs. Thaw was foreclosed from "press[ing] a Takings Clause claim under *Rodgers* and *In re Kim*." *Id.* at 370.

Consequently, a Takings Clause argument relating to the Wiggains's homestead, acquired post-BAPCPA, must fail. Still, the bankruptcy court was correct in stating there may be an alternative "Takings Clause-type Constitutional argument, if the statute operates in such a way to confiscate a property interest." *Wiggains v. Reed (In re Wiggains)*, 535 B.R. 700, 717 (Bankr. N.D. Tex. 2015). The bankruptcy court was relying on our *Thaw* discussion of the Supreme Court's *Rodgers* decision, which held that if a statute allowed for a "gratuitous confiscation" of property, due process concerns would arise. *Thaw*, 769 F.3d at 370 (discussing *Rodgers*, 461 U.S. at 697, 103 S.Ct. 2132).

There was no "gratuitous confiscation" in *Thaw* because the proceeds from a sale were to be apportioned between the creditors and the non-debtor spouse. *Id.* at 371 (citing 11 U.S.C. § 363(j)). An additional protection from confiscation, we held, is that Section 363(i) provides a non-debtor spouse a right of first refusal to purchase the homestead property. *Id.* (citing 11 U.S.C. § 363(i)). We determined these "safeguards" were sufficient to prevent a forced sale of the *Thaw* property from being a "gratuitous confiscation." *Id.*

Our analysis did not end there. Mrs. Thaw also argued that another Supreme ***666** Court decision, this one involving regulatory takings, required that she be compensated. *See*

Palazzolo v. Rhode Island, 533 U.S. 606, 121 S.Ct. 2448, 150 L.Ed.2d 592 (2001). There the Court recognized "[t]he Takings Clause ... in certain circumstances allows a landowner to assert that a particular exercise of the State's regulatory power is so unreasonable or onerous as to compel compensation." *Id.* at 627, 121 S.Ct. 2448. The *Thaw* court determined that "*Palazzolo*'s narrow exception" did not apply to Mrs. Thaw's request for compensation as a non-debtor spouse for her separate homestead interest. *Thaw*, 769 F.3d at 371. "Just as the Bankruptcy Code protects a non-debtor from gratuitous confiscation, it makes the sale of the property not so unreasonable or onerous as to compel compensation." *Id.* (quotation marks omitted).

One final argument we did not address in *Thaw* was how Section 363 would apply to apportion any proceeds. We refused because any ruling would be an advisory opinion. *Id.* at 372 n.3. Among the reasons it would have been advisory is that there were no proceeds to apportion, as the bankruptcy court held the debtor had forfeited his homestead exemption by acting with an "intent to hinder, delay, and defraud his creditors...." *Id.* at 368.

No such forfeiture occurred here, and there are proceeds from a sale of the homestead. We therefore examine Section 363(j) to determine whether it guides distribution of net proceeds from the sale of a homestead where a non-debtor spouse claims a separate homestead interest. Section 363(j) provides:

> After a sale of property to which subsection (g) or (h) of this section applies, the trustee shall distribute to the debtor's spouse or the co-owners of such property, as the case may be, and to the estate, the proceeds of such sale, less the costs and expenses, not including any compensation of the trustee, of such sale, according to the interests of such spouse or co-owners, and of the estate.

11 U.S.C. § 363(j). We examine the two referenced subsections.

[18] **[19]** Subsection (g) applies to "any vested or contingent right in the nature of dower or curtesy."[4] 11 U.S.C. § 363(g). Dower or curtesy rights are inchoate rights that do not vest until a spouse's death. They have no relevance here.

The only other reference in Section 363(j) is to subsection (h). It applies to "the interest of any co-owner in property in which the debtor had, at the time of the commencement of the case, an undivided interest as a tenant in common, joint tenant, or tenant by the entirety...." 11 U.S.C. § 363(h). The bankruptcy court held that, under Section 541(a)(2), all interests of the debtor and his spouse in the community property became part of the estate. In that court's view, the residence was not property in which the debtor and a co-owner had an interest. Therefore, subsection (h) had no application.

In defending the ruling, the Trustee first properly denies that either *Kim* or *Thaw* ever held that Section 363(j) actually controls. The issue was not adequately raised in *Kim*, and we expressed no opinion. *Kim*, 748 F.3d at 663. It is true that in *Thaw*, we stated that Section 363 "is designed to minimize takings concerns," *Thaw*, 769 F.3d at 371, meaning that it provides for compensation at least some of the time when those concerns might otherwise arise. We also said that Section 363(j) ***667** would control the apportionment of proceeds from the sale of a Texas homestead between the estate and the non-debtor spouse. *Id.* In our conclusion, we held that Section 363 "governs the distribution, if any," to the non-debtor spouse. *Id.* at 372. Whatever all that meant, it is evident that in *Thaw* we never addressed the precise terms of Section 363(j) and applied them. Instead, we now interpret the discussion to be a placeholder, a recognition that Section 363(j) is where to look when considering issues such as those that are before us now.

[20] The Trustee argues that Section 363(j) is actually inapplicable because neither of its predicate subsections, (g) and (h), has any relevance to Texas homestead interests. We agree with the bankruptcy court and the Trustee that subsection (g), which covers dower and curtesy, does not apply. As to subsection (h), the Trustee argues it is inapplicable when the bankruptcy estate is one of the owners of the relevant property:

> Sections 363(f) and (h) only apply to sales of property of an entity *other than* the estate. Since the estate owns the interest of both the debtor *and* the non-debtor spouse, there *is no* other entity to be concerned with § 363(h). Therefore, that subsection simply does not apply with respect to the non-debtor spouse.
>
> The failure of § 363(h) to apply its four requirements to a non-debtor spouse's interest in community property is no legislative oversight. In § 363(i), Congress allowed a "first right of refusal" to co-owners when property is sold under § 363(h), and *also allowed* such a first right of refusal to the non-debtor spouse with respect to community property that is property of the estate. If Congress had intended for the four requirements of § 363(h) to apply to community property, it could have included "the spouse's interest in community property" in § 363(h) as it did in § 363(i).

In re Hendrick, 45 B.R. 976, 987–88 (M.D. La. 1985) (emphasis in original).

Agreeing with *Hendrick* as to subsection (h), the Trustee also argues that *Hendrick* is correct about Section 363(i), which, as we earlier discussed, provides a non-debtor spouse a right of first refusal to purchase homestead property. The Trustee argues that subsection is the protection for a non-debtor spouse when dealing with a couple's homestead.

This court once stated its agreement with the *Hendrick* analysis, though in a nonprecedential opinion. *See Solomon v. Milbank (In re Solomon)*, 129 F.3d 608, 1997 WL 680934, at *3 (5th Cir. 1997) (unpublished). Though *Solomon* is not controlling, we can adopt its analysis on this point. We do. Despite Mrs. Wiggains's argument, *Solomon* is consistent with *Thaw* and *Kim* inasmuch as nothing in those two precedents require reading Section 363(j) to apply to a sale of a homestead held in Texas as community property. Section 363(j), of course, and its reference to subsection (h), apply nationwide. The difficulty of applying those parts of Section 363 to a Texas homestead in no way affects its general utility.

[21] Having eliminated these possibilities, the bankruptcy court then considered whether there was "something special and unique about a non-debtor spouse's homestead interest" to make limiting the award to the value of the debtor spouse's Section 552(p) cap (here, the $155,675, reduced to $130,675) either confiscatory or onerous. *In re Wiggains*, 535 B.R. at 720. The bankruptcy court said that "certain, special circumstances" may entitle a non-debtor spouse to "just compensation" from a forced sale of their homestead. *Id.*

***668** As previously stated, there is no doubt that a homestead interest "gives protective legal security rather than vested economic rights." *Kim*, 748 F.3d at 659 (quoting *Heggen*, 836 S.W.2d at 148). To explain the nature of this protection, we borrow from a common idiom of property law that describes property as a "bundle of sticks." Rather than being another stick in the bundle, a party's homestead interest "is a protective safe in which the bundle is put." *Venn v. Reinhard (In re Reinhard)*, 377 B.R. 315, 319 (Bankr. N.D. Fla. 2007). If the safe is empty, as is the case here and in other community-property states where the entire homestead property is brought in as a part of the bankruptcy estate, it can hardly be argued that an otherwise voluntary sale of a homestead entitles a non-debtor spouse to compensation for the contents of her empty safe.

We agree with the bankruptcy court that this case does not present the type of exceptional circumstance that may entitle a non-debtor spouse to compensation beyond the statutory cap of their spouse's homestead exemption. Well before Mr. Wiggains filed his bankruptcy petition, the couple actively sought to sell the home so they could reap the equity they gained in their brief nine months of ownership of the luxury investment property. The Wiggainses actively participated in the sales process, even when the Trustee had the sole authority to sell the homestead, and they did not object when the Sale Order was entered. There is nothing confiscatory about that process.

Palazzolo also cannot provide Mrs. Wiggains the relief she now seeks. She offers very little argument that the sale of her interest in the property is "so unreasonable or onerous as to compel compensation" under the Takings Clause. *See* *Palazzolo*, 533 U.S. at 627, 121 S.Ct. 2448. The short amount of time that Mrs. Wiggains and her family resided in their Texas homestead, an investment property, combined with the family's posh lifestyle and ongoing exorbitant living expenses, does not present the appropriate factual basis that would otherwise entitle her to compensation. In any event, we noted in *Thaw* that the foundation of this Takings Clause argument likely crumbles for a home purchased post-BAPCPA where the party seeking compensation "was on constructive notice of how the Bankruptcy Code would operate in the event of [the debtor's] bankruptcy." *Thaw*, 769 F.3d at 371–72. Such is the case here.

[22] **[23]** Our ruling in no way denigrates the importance of a Texas homestead interest. It is constitutionally protected; it provides "a secure asylum of which the family cannot be deprived by creditors." *England*, 975 F.2d at 1174 (quoting *Herman Iken & Co. v. Olenick*, 42 Tex. 195, 198 (1874)). On the other hand, "the intent and purpose of the BAPCPA was to limit the dollar amount of homestead exemptions." *Kim*, 748 F.3d at 658. If there is a clash of policies here, the Supremacy Clause controls. *See* *Rodgers*, 461 U.S. at 701, 103 S.Ct. 2132. "Once state-law property interests are defined, federal law controls the consequences." *United States v. Elashi*, 789 F.3d 547, 552 (5th Cir. 2015).

When it became clear that Mr. Wiggains would file bankruptcy to satisfy his outstanding debts, the couple entertained various options and made their best estimate on ultimate financial benefits by having only Mr. Wiggains file after the Partition Agreement was recorded. Allowing Mrs. Wiggains to sidestep the statutory limits for homestead exemptions and obtain approximately $500,000 in proceeds that otherwise are for creditors would lay waste to ***669** the provisions of the Bankruptcy Code involved here.

AFFIRMED.

All Citations

848 F.3d 655, 77 Collier Bankr.Cas.2d 511

Footnotes

1 Mr. Wiggains initially filed a motion to sell the homestead but lacked authority to do so under Section 363(b) of the Bankruptcy Code. Subsequently, the Trustee brought an expedited motion to sell the property, to which Mr. Wiggains did not object. After a hearing held on September 6, 2013, the bankruptcy court authorized the sale under the terms of the purchase contract and free and clear of any liens and encumbrances pursuant to Section 363(f)(3).

2 Mrs. Wiggains asserted at oral argument that were we to read the phrase "intent to hinder, delay, or defraud" in the disjunctive, a circuit split with the Eighth Circuit would arise. The Eighth Circuit, though, merely noted it had "been reluctant to deny a homestead exemption without a finding of intent to defraud." *Addison v. Seaver (In re Addison)*, 540 F.3d 805, 812 (8th Cir. 2008) (citing *Sholdan v. Dietz*, 108 F.3d 886, 888 (8th Cir. 1997)). In *Sholdan*, the Eighth Circuit did not conclude that an intent to hinder or delay was inadequate to render a transfer fraudulent; instead, the panel determined the facts did not support such a finding. *Sholdan*, 108 F.3d at 888. Notably, the panel stated it did "not mean to say that the test of 'hinder or delay' might not prevail under another set of facts." *Id.*

3 "The Texas homestead laws are almost absolute in their protections against forced sale." *United States v. Rodgers*, 461 U.S. 677, 711, 103 S.Ct. 2132, 76 L.Ed.2d 236 (1983). "Texas cases have consistently held

that the fundamental purpose of the Texas homestead laws is to secure a *place of residence* against financial disaster." *England v. FDIC (In re England)*, 975 F.2d 1168, 1174 (5th Cir. 1992).

4 Dower "refers to the interest a widow takes in the estate of her deceased husband." *Estate of Johnson*, 718 F.2d at 1305 n.9. "Curtesy is the corresponding right of the husband...." *Id.*

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406 B.R. 79
United States District Court, D. Kansas.

Linda S. PARKS, Trustee, Central Plains Steel Co., and Salina Steel Supply, Inc., Appellants,
v.
Bruce Earl ANDERSON–Debtor, Appellee.

Nos. 08–1111–EFM, 08–1112–EFM, 08–1113–EFM.
|
May 19, 2009.

Synopsis

Background: Judgment creditors objected to Chapter 7 debtor's homestead exemption, contending that debtor enhanced value of homestead by paying down mortgage with proceeds of property disposed of with intent to hinder, delay, or defraud creditors within 10 years of petition date. Debtor objected to claims filed by creditors, challenging their standing as creditors. The Bankruptcy Court, Robert E. Nugent, Chief Judge, 386 B.R. 315, overruled creditors' objection to homestead exemption, and creditors appealed. In separate proceeding, Chapter 7 trustee had objected to Kansas homestead exemption claimed by debtor, not on theory that mortgage paydown was fraudulent, but on theory that debtor had thereby acquired "interest" in homestead, during the 1215-day period preceding petition date, that "exceed[ed] in the aggregate $125,000 in value," and the Bankruptcy Court, Nugent, Chief Judge, 374 B.R. 848, had denied trustee's motion for summary judgment on this objection. Trustee appealed. Matters were consolidated for purpose of appeal.

Holdings: The District Court, Eric F. Melgren, J., held that:

[1] term "interest," as used in section of Bankruptcy Code which sets forth homestead exemption cap, referred to equity, not title, so that debtor, by converting nonexempt assets and using proceeds to pay down his residential mortgage debt within 1,215 days of his bankruptcy filing, thereby "acquired" an "interest" in homestead property and triggered application of statutory cap;

[2] bankruptcy court did not clearly err in finding that circumstances did not warrant piercing the corporate veil in order to make individual Chapter 7 debtor liable for his solely-owned companies' debts to creditor; and

[3] bankruptcy court did not clearly err in finding that Chapter 7 debtor did not make transfers of non-exempt funds to his home mortgage lender with actual intent to hinder, delay or defraud creditors, as required for value of his homestead exemption under Kansas law to be reduced by amount of such transfers.

Affirmed in part and reversed and remanded in part.

Procedural Posture(s): On Appeal; Motion for Summary Judgment.

West Headnotes (21)

[1] **Bankruptcy** Conclusions of law; de novo review

Bankruptcy Clear error

District court reviews bankruptcy court's factual findings for clear error, and its conclusions of law de novo. Fed.Rules Bankr.Proc.Rule 8013, 11 U.S.C.A.

1 Cases that cite this headnote

[2] **Bankruptcy** Conclusions of law; de novo review

Bankruptcy court's determination that Chapter 7 debtor, by paying down residential mortgage within 1,215 days of his bankruptcy filing, had not "acquired" an "interest" in homestead property within this statutory lookback period and had not triggered statutory cap on his state law homestead rights, involved issue of statutory interpretation, which district court would review de novo. 11 U.S.C.A. § 522(p).

1 Cases that cite this headnote

[3] **Bankruptcy** Particular cases and issues

Bankruptcy court's determination that corporation and limited liability company (LLC) were not Chapter 7 debtor's alter egos, such that creditor of corporation and LLC was not creditor of estate, was finding of fact, reviewable for

clear error. Fed.Rules Bankr.Proc.Rule 8013, 11 U.S.C.A.

[4] **Bankruptcy** Particular cases and issues

Finding that Chapter 7 debtor had not converted non-exempt assets into exempt homestead by paying down amount of his residential mortgage debt with actual intent to hinder, delay or defraud creditors, such that value of his state law homestead exemption did not have to be reduced by amount of these fraudulent transfers, was finding of fact, reviewable for clear error. 11 U.S.C.A. § 522(*o*).

3 Cases that cite this headnote

[5] **Bankruptcy** Clear error

For factual finding to be "clearly erroneous," it must be more than possibly or even probably wrong; error must be pellucid to any objective observer. Fed.Rules Bankr.Proc.Rule 8013, 11 U.S.C.A.

1 Cases that cite this headnote

[6] **Bankruptcy** Waiver or Loss of Exemption

Term "interest," as used in section of Bankruptcy Code which sets forth homestead exemption cap established by the Bankruptcy Abuse Prevention and Consumer Protection Act (BAPCPA), and which prevents debtor from claiming as exempt homestead "any amount of interest that was acquired by the debtor during the 1215-day period preceding the date of the filing of the petition that exceeds in the aggregate $125,000 in value," referred to equity, not title, so that Chapter 7 debtor, by converting nonexempt assets and using proceeds to pay down his residential mortgage debt within 1,215 days of his bankruptcy filing, thereby "acquired" an "interest" in homestead property and triggered application of statutory cap, even though he acquired title to his home well outside this 1,215-day lookback period. 11 U.S.C.A. § 522(p).

5 Cases that cite this headnote

[7] **Statutes** Plain language; plain, ordinary, common, or literal meaning

If statute is unambiguous, court must interpret statutory language according to its plain meaning.

1 Cases that cite this headnote

[8] **Statutes** Plain language; plain, ordinary, common, or literal meaning

Court must presume that legislative purpose is reflected by the ordinary meaning of language used in statute.

[9] **Statutes** Context

It is fundamental canon of statutory construction that words of statute must be read in their context and with view to their place in overall statutory scheme.

1 Cases that cite this headnote

[10] **Statutes** Intent

Statutes Policy considerations; public policy

Statutes Plain, literal, or clear meaning; ambiguity

Statutes Amendments, additions, and other changes

If language of statute is ambiguous, court looks to legislative history and to underlying public policy of statute to determine legislative intent.

[11] **Statutes** Similarity or difference

Statutes Similarity or difference

While there is no per se rule of statutory interpretation that identical words used in different parts of same act are intended to have same meaning, there is presumption that this is so.

[12] **Bankruptcy** Waiver or Loss of Exemption

While homeowner does not lose exempt status of his equity in homestead by transferring that equity into a new homestead within 1,215 days preceding petition date, homeowner's transfer of non-exempt funds into homestead during this same 1,215-day period is not protected by state homestead exemption laws, to extent that the equity acquired exceeds the $125,000 cap imposed by the Bankruptcy Abuse Prevention and Consumer Protection Act (BAPCPA) amendments. 11 U.S.C.A. § 522(p).

1 Cases that cite this headnote

[13] **Bankruptcy** Waiver or Loss of Exemption
Bankruptcy Preference, fraudulent transfer, or concealment

Under the Bankruptcy Abuse Prevention and Consumer Protection Act (BAPCPA) amendments to bankruptcy exemption statute, debtor may transfer non-exempt assets into homestead during the 1,215-day period preceding petition date, while still taking advantage of any state homestead exemption allowed for recently acquired equity, if transfer is not done with fraudulent intent, and if transfer, in the aggregate, is less than $125,000. 11 U.S.C.A. § 522(*o*, p).

2 Cases that cite this headnote

[14] **Corporations and Business Organizations** Presumptions and burden of proof

Presumption in Kansas is that corporation and its shareholders are separate and distinct.

1 Cases that cite this headnote

[15] **Corporations and Business Organizations** Disregarding Corporate Entity; Piercing Corporate Veil
Corporations and Business Organizations Reluctance to apply remedy

Under Kansas law, corporate form may be disregarded, and corporation and its stockholders may be treated as identical, in appropriate circumstances; however, power to pierce corporate veil is to be exercised reluctantly and cautiously.

1 Cases that cite this headnote

[16] **Corporations and Business Organizations** Instrumentality in general

Under Kansas law, alter ego doctrine imposes liability on individual who uses corporation merely as instrumentality to conduct his own personal business in effort to remedy fraud or injustice perpetrated not on corporation, but on third persons dealing with corporation.

[17] **Corporations and Business Organizations** Alter ego in general

Under alter ego doctrine as applied in Kansas, court merely disregards corporate entity and holds individual responsible for his acts knowingly and intentionally done in name of corporation.

[18] **Corporations and Business Organizations** Factors Considered

In deciding whether to disregard the corporate entity, Kansas courts consider eight factors: (1) undercapitalization of one-man corporation; (2) failure to observe corporate formalities; (3) nonpayment of dividends; (4) siphoning of corporate funds by dominant stockholder; (5) nonfunctioning of other officers or directors; (6) absence of corporate records; (7) use of corporation as facade for operations of dominant stockholder or stockholders; and (8) use of corporate entity in promoting injustice or fraud.

[19] **Bankruptcy** Weight and sufficiency
Corporations and Business Organizations Insolvency, bankruptcy, and receivership

Bankruptcy court did not clearly err in finding that circumstances did not warrant piercing

the corporate veil in order to make individual Chapter 7 debtor liable for his solely-owned companies' debts to creditor, where court reviewed all of facts and evaluated them against relevant factors and concluded that, while debtor may not have maintained good minute books for companies or adequately documented loan which he obtained from one of companies, veil piercing was not warranted given that company was adequately capitalized when debtor took loan, that debtor annually filed franchise tax reports and federal and state income tax returns, and that debtor's actions respecting companies' assets did not amount to promotion of fraud or injustice.

[20] **Bankruptcy** Proceedings

Burden is on party seeking reduction in debtor's state law homestead exemption based on his fraudulent conversion of nonexempt assets into exempt homestead to establish that debtor intended to hinder, delay or defraud his creditors, and party must satisfy that burden by a preponderance of evidence. 11 U.S.C.A. § 522(*o*).

4 Cases that cite this headnote

[21] **Bankruptcy** Preference, fraudulent transfer, or concealment

Bankruptcy Proceedings

Bankruptcy court did not clearly err in finding that Chapter 7 debtor did not make transfers of non-exempt funds to his home mortgage lender with actual intent to hinder, delay or defraud creditors, as required for value of his homestead exemption under Kansas law to be reduced by amount of such transfers; in so holding, bankruptcy court focused on fact that debtor did not conceal transfers, did not borrow funds to make transfers, and was not rendered insolvent by transfers, and mere fact that mortgage paydown may have hindered creditors and may have been done intentionally, without something more, did not compel different conclusion. 11 U.S.C.A. § 522(*o*).

2 Cases that cite this headnote

***82 MEMORANDUM AND ORDER**

ERIC F. MELGREN, District Judge.

Appellants Linda S. Parks, Trustee ("Parks"), Central Plains Steel Co. ("Central Plains"), and Salina Steel Supply, Inc. ("Salina Steel") bring this appeal from the United States Bankruptcy Court for the District of Kansas, Case No. 05–19222, against Appellee Bruce Earl Anderson ("Anderson"), in which the Bankruptcy Court ruled that 11 U.S.C. § 522(p)(1) does not apply to a debtor who purchases a homestead outside the 1,215 day period preceding the bankruptcy filing but pays down the mortgage in excess of $125,000 during the 1,215 day period. Central Plains and Salina Steel also appeal from the bankruptcy court's ruling that Anderson's conversion of a nonexempt asset into an exempt asset was not done with the intent to hinder, delay, or defraud creditors under § 522(*o*), and that Central Plains has no claim against Anderson or his bankruptcy estate and is not a creditor in this case. For the reasons set forth below, this Court overrules the bankruptcy court's order with respect to the homestead exemption claim under 11 U.S.C. § 522(p)(1), and sustains the bankruptcy court's order on the remaining claims.

I. Procedural Background

Parks filed a Motion for Summary Judgment on July 27, 2007, objecting to Anderson's claim of a homestead exemption under 11 U.S.C. § 522(p)(1). [1] Salina Steel and Central Plains joined in Parks' objection. [2] Anderson subsequently filed his response and a cross-motion for summary judgment on August 27, 2007. [3] On October 2, 2007, the bankruptcy court issued its Order, which denied Parks' Motion, and granted summary judgment in favor of Anderson on Parks' objection to Anderson's homestead exemption based upon § 522(p)(1).

***83** Salina Steel and Central Plains also objected to Anderson's homestead exemption claim based upon 11 U.S.C. § 522(*o*).[4] On November 13, 2007, the bankruptcy court held an evidentiary hearing on the objection, taking the matter under advisement.[5] On April 11, 2008, the bankruptcy court issued its Order in which it held that Central Plains could not pierce the corporate veil so as to permit it to pursue its claim against Anderson in his individual capacity; therefore, Central Plains was not a creditor in this bankruptcy and has no valid claim against Anderson or his bankruptcy estate.[6] The court further held that Anderson did not act with the intent to hinder, delay, or defraud his creditors, and accordingly, overruled Salina Steel's objection to Anderson's homestead exemption claim.[7]

As a result of the bankruptcy court's rulings, on April 22, 2008, Parks, Salina Steel, and Central Plains each filed a Notice of Appeal with this Court.[8] On June 27, 2008, Parks filed a Motion to Consolidate the cases, which the Court granted.

II. Factual Background

Although the parties have not stipulated to the facts in this case, after reviewing the record and the parties' briefs, the Court finds the bankruptcy court's factual findings accurate and supported by the record, and accordingly, adopts its factual summary.[9]

Facts Pertaining to the Claims

Anderson owned several entities. His principal business was the manufacture and sale of lifts for storing and servicing automobiles. Aerotech Designs, Inc. ("Aerotech") manufactured the lifts and Auto Lifters of America, L.L.C. ("Auto Lifters") marketed them.[10] Anderson also owned a business called U.S. Credit L.L.C., which financed the purchase of equipment used in manufacturing the lifts. Anderson owned all or a controlling share of the stock or equity in each of these entities. He held all of the executive offices of each entity and was the only director. Aerotech was organized in 1991 and its manufacturing facility was located in Newton. Auto Lifters was organized in 1989, and its business office was located in Andover. Prior to 1989, Anderson ran a lift business, apparently as a sole proprietor doing business as Auto Lifters. Aerotech and Auto Lifters ceased operations in late April of 2005. Anderson also owned an unrelated entity called Park City Investors, L.L.C., a company that acquired and sold real property in Park City, Kansas.

Central Plains began selling steel to Anderson in 1985. Central Plains began ***84** by invoicing Auto Lifters, but by the time the lift business folded in 2005, [Central Plains] was invoicing Aerotech. Central Plains' credit manager testified that he did not really differentiate between the two entities, and that he knew Anderson owned both. After Auto Lifters and Aerotech went out of business, Central Plains sought and obtained a consent judgment in the principal amount of $162,392 against the two companies on August 2, 2005 in the District Court of Sedgwick County, Kansas. There is no contract, guaranty, or other writing shown that would support a contractual relationship of any kind between Central Plains and Anderson individually or personally.[11] Central Plains asserts a claim of $172,403.41 for steel sold from January to April of 2005.

Salina Steel also has a judgment. It was entered November 9, 2005 against Auto Lifters for steel sold in the amount of $188,232 in the District Court of Saline County, Kansas. More importantly, Salina Steel asserts an individual claim against Anderson based upon his execution of a guaranty on October 22, 2004. Salina Steel's credit manager testified that she obtained a security interest in the steel Salina Steel shipped to Aerotech and Auto Lifters on October 22, 2004 and, at the same time, obtained personal guaranties from Anderson and his son, Cameron Anderson, who managed the plant. In general, Salina Steel invoiced Auto Lifters but received payment from Aerotech for its product. Salina Steel asserts a claim of $188,232.62 for product sold February 15, 2005 to April 21, 2005 on account to Auto Lifters and guaranteed by Anderson.

Facts Pertaining to the Disposition of Anderson's Non–Exempt Real Estate Assets

Prior to 1998, Anderson found a six acre tract of land north of Wichita at 61 st Street and I–35 highway that had commercial development potential. With his brother-in-law, Tony Udden, he formed Park City Investors, L.L.C. ("PCI") to acquire and hold this land for resale. In 1998, PCI sold part of the tract to CBOCS West, Inc. for $569,000. CBOCS erected a Cracker Barrel Restaurant on that site. According to the seller's statement for this transaction, from these proceeds, Anderson received

$138,418 representing funds he had loaned to PCI. After other deductions, the net payout to PCI was $332,331.79. From that amount, PCI bought and paid for two houses on or adjacent to the Cracker Barrel site for $122,387. PCI also moved four houses off the Cracker Barrel tract and sold them at auction for $36,295. Of the auction amount, PCI retained $10,000. Anderson and Udden split the net of the CBOCS sale proceeds after paying for the two houses.

Shortly thereafter, Udden declared bankruptcy and, in July of 1998, PCI redeemed Udden's membership leaving Anderson the sole member of PCI. To redeem Udden's membership, PCI purchased land in Andover, Kansas to convey to Udden in a tax-free exchange for his interest in the company. The redemption agreement was signed and closed in July and the land purchase and trade was accomplished in September of 1998. In order to effectuate this transaction, PCI needed $220,000. Anderson testified that his accountant advised that a loan be taken out of Auto Lifters. He ***85** withdrew the money from Auto Lifters in an undocumented loan to him as a shareholder. This loan was never repaid. There is no dispute that Anderson controlled Auto Lifters and caused this loan to be made.

Then, in April of 2002, PCI made an agreement to sell the remainder of the initial PCI investment property to Hattan Properties, L.L.C. When this transaction closed, PCI received the gross price of $484,887. Net proceeds to PCI were $444,749.42. Of this amount, Anderson distributed $219,000 to Auto Lifters. In June of 2002, Auto Lifters transferred that amount back to Anderson who funded two certificates of deposit at Conway Bank, each in the amount of $100,000. [12]

When Auto Lifters and Aerotech began to lose money after 2003 and incur difficulties maintaining vendor payments, Anderson cashed one of the CDs and, in March of 2005, obtained a personal line of credit of $100,000 from the Citizens State Bank of Hesston, secured by a $100,000 CD at that bank and acquired with the proceeds of the Conway Bank CD. Anderson drew $75,000 down on that line and disbursed the loan proceeds to Aerotech ($50,000) and Auto Lifters ($25,000) during 2005.

The balance of the proceeds of the second PCI sale were paid to Bruce Anderson ($20,000), to Bruce and Lana Anderson ($53,000 for taxes), and to U.S. Credit ($150,000). Lana Anderson is Bruce's wife. She is a practicing dentist and is not a debtor in this proceeding. On November 8, 2002, U.S. Credit paid Aerotech $100,000 as a loan. Auto Lifters also deposited $20,000 in Aerotech's account that day. Aerotech never repaid the $100,000 U.S. Credit loan.

PCI sold its remaining Park City property in April of 2002 to Hattan Properties and received $139,227.25. This sum was used to purchase Sumner County real property that was like-kind exchanged and sold, resulting in the deposit of $106,831.82 in PCI's Intrust Bank account in November of 2003, of which $96,287.27 were disbursed to Bruce Anderson on September 20, 2004.

In July of 2005, Anderson sold a tract of land in Newton, where the Aerotech manufacturing facility had been located, to Robert Coleman. Coleman paid $150,000 for the land and $50,000 for the equipment. Because the equipment was pledged to Citizens State bank of Hesston, it received $8,600. A Newton bank holding the mortgage on the land received about $71,000. After other deductions for costs and taxes, Anderson received $115,734.61. At least part of this amount he deposited into an account at Capital Federal Savings, his home mortgage lender.

The Hesston bank paid the balance of its line of credit to Anderson with his pledged $100,000 CD and refunded him $33,368.64. This amount, along with the proceeds of the remaining Conway Bank CD mentioned above, $107, 385.21, were deposited in the Capital Federal account.

Thus, it appears to the Court that non-exempt assets of $240,000 were converted to Anderson's exempt homestead. Those non-exempt assets included (1) the Conway Bank $100,000 CD acquired in 2002 with proceeds from the second PCI real estate sale; (2) the $115,000 net proceeds from the sale of the Newton ***86** facility and property in July of 2005; and (3) the $33,000 proceeds remaining of the $100,000 CD used to secure the Hesston Bank $100,000 line of credit.

Anderson's Home

In December 1998, Anderson and his wife purchased a large home that abuts the north golf course at Crestview Country Club in East Wichita for $350,000. [13] The Trustee's appraiser valued this property at $636,000. [14] The home is subject to a substantial mortgage held by

Capitol Federal, and, on July 18, 2005, shortly before this case was filed, Anderson paid Capitol Federal $240,000 by debiting his Capitol Federal account.[15] According to the schedules filed in this case, Capitol Federal is owed approximately $170,000 after receiving the $240,000 payment. In his bankruptcy filings, Anderson claimed the home exempt and scheduled the value of the home at $411,800.[16] Anderson significantly increased the equity in his homestead by making this transfer and did so from funds that would have been otherwise available to his creditors in this case. When directly questioned by the [bankruptcy court] about his motivation in making this payment, Anderson stated, "I don't know."

Anderson's Conduct of the Businesses

Anderson did not conduct the day to day management of his companies, but he did exert significant control over their financial and business affairs. As noted above, he owned a controlling or absolute interest in all of them. He was the sole director or member of each entity and held all executive or managerial positions. Auto Lifters and Aerotech were both incorporated with the assistance of an attorney. Anderson conceded that after preparing the organizing documents and minutes for Auto Lifters and Aerotech, he did not conduct shareholder or director meetings, nor did he prepare and maintain minutes of annual meetings. Auto Lifters and Aerotech did file tax returns and corporate annual reports every year. Auto Lifters and Aerotech also maintained separate books and records and separate bank accounts.

Both Aerotech and Auto Lifters operated on thin capital. Anderson initially paid in about $66,000 in capital to Auto Lifters and that amount remained stable throughout the life of the company. According to the Auto Lifters' tax returns, the company's retained earnings were greater than zero until 2004. While the shareholders' equity continued to diminish throughout this period, Anderson denied that he thought the company was "struggling." He attributed its difficulties to Chinese competition and the increased cost of materials (e.g. powder coating finish). By 2004, Auto Lifters had a considerable order backlog of over 100 lifts. It was unable to procure the components to complete the lifts in work-in-progress. Auto Lifters had accepted ***87** orders and credit card deposits from numerous customers but was unable to deliver goods. Intrust Bank cleared credit card deposits for Auto Lifters and eventually sued the company for over $200,000 it paid as a result of this backlog.

However, in 1998, when PCI "borrowed" the $220,000 to redeem Udden's interest, Auto Lifters was comfortably solvent. Even after the loan was made, the company had retained earnings of over $100,000. By the end of 2002, that amount had dwindled to about $34,000. By the end of 2003, retained earnings had plummeted to [negative] $248,000. There is nothing to suggest that Anderson made the PCI loan in 1998 with no intent to pay it back other than the fact that on several occasions, PCI had more than sufficient funds to do so and did not. It is significant that from July 15, 2004 to March of 2005, Aerotech continued to pay both Salina Steel and Central Plains (and many other suppliers) on some of their invoices. Anderson historically received salary from both companies but does not appear to have taken extraordinary draws in this period. When the companies began to experience financial difficulties in 2004, Anderson ceased taking a salary. He personally borrowed money, secured in part by the Conway Bank CD acquired with PCI real estate sales proceeds, to fund the operations of the companies.

Anderson has a high school education, sixteen credit hours of college and is a retired fireman. He does not appear to have had any formal business or accounting training. He testified that after his businesses closed in July of 2005, he suffered, and continues to suffer severe depression. Anderson has not worked since. At the time of trial and during the discovery period, he was taking Xanax and Zoloft for that malady. He did not demonstrate much intimate familiarity with any of the details of his businesses, leading the Court to suspect that he was intellectually overwhelmed by the responsibility of dealing with three or four separate entities. After Udden left PCI, Anderson appears to have been the only equity holder in each of these entities, assisted only by his son, Roland Boesker, plant managers, and his bookkeeper.

Anderson fully disclosed the conversion and transfers noted above in his Statement of Financial Affairs.

III. Standard of Review

[1] "On appeal from the bankruptcy court, the district court sits as an appellate court."[17] A district court reviews a bankruptcy court's factual findings for clear error, and reviews its conclusions of law de novo.[18] The district court may

affirm, modify, or reverse a bankruptcy judge's judgment, order, or decree, or remand with instructions for further proceedings. [19]

[2] [3] [4] [5] Appellants' objection to Anderson's homestead exemption claim is an issue that pertains to statutory interpretation, for which this Court's review is de novo. [20] Further, the bankruptcy court ***88** determined that Auto Lifters and Aerotech were not Anderson's alter ego, a finding of fact, and accordingly, we review that determination under the clearly erroneous standard. [21] Lastly, "a bankruptcy court's finding of fraudulent intent on the part of a debtor is a finding of fact, rather than a conclusion of law," and therefore, we apply the clearly erroneous standard. [22] For a factual finding to be clearly erroneous, it "must be more than possibly or even probably wrong; the error must be pellucid to any objective observer." [23]

IV. Analysis

This appeal concerns whether the bankruptcy court erred in finding: (1) that 11 U.S.C. § 522(p)(1) does not apply to a debtor who purchased a homestead outside the 1,215 day period preceding the bankruptcy filing but pays down the mortgage in excess of $125,000 during the 1,215 day period; (2) that there was no justification to warrant piercing the corporate veil, thereby precluding Central Plains from proceeding with a claim in this bankruptcy; and (3) that Anderson did not convert non-exempt assets to exempt assets with the intent to hinder, delay, or defraud his creditors. The Court addresses each in turn.

Homestead exemption under 11 U.S.C. § 522(p)(1)

[6] As the bankruptcy court noted, the resolution of this issue turns on the interpretation of "interest" as referenced in 11 U.S.C. § 522(p)(1), and the nature of the interest *acquired* during the 1,215 day period preceding a bankruptcy filing. Section 522(p) provides in pertinent part:

> (1) Except as provided in paragraph (2) of this subsection and sections 544 and 548, 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 interest that was acquired by the debtor during the 1215–day period preceding the date of the filing of the petition that exceeds in the aggregate [$125,000] [24] in value in—
>
> (A) real or personal property that the debtor or a dependent of the debtor uses as a residence.
>
> ...
>
> (2)(B) For purposes of paragraph (1), any amount of such interest does not include any interest transferred from a debtor's previous principal residence (which was acquired prior to the beginning of such 1215–day period) into the debtor's current principle residence, if the debtor's previous and current residences are located in the same State. [25]

The bankruptcy court concluded that the term "interest" refers to title or ownership of a homestead and not equity, thereby permitting Anderson to claim as exempt the $240,000 he transferred into his mortgage within the 1,215–days preceding his bankruptcy filing. The bankruptcy court reached its decision after conducting its own independent research, which included ***89** review of authoritative bankruptcy treatises, and the cases cited by the parties.

On appeal, trustee Parks, Salina Steel, and Central Plains argue that the bankruptcy court improperly interpreted the language of 11 U.S.C. § 522(p) in finding that the term "interest" refers to title. Parks argues that the statute's language is unambiguous and is "broad enough to include equity that the Debtor acquires during the 1215 days before bankruptcy." [26] The phrases "any amount of interest," "value," and "in the aggregate" each refer to a quantitative interest that is more consistent with equity than with title. Moreover, Appellants argue that a homeowner cannot acquire an "amount of title," nor can a homeowner accrue title "in the aggregate." Parks further asserts that the term "interest" in § 522(p)(2)(B) refers to equity, and based on principles of statutory construction, suggests that "interest" in (p)(1) also means equity. Parks contends that to interpret "interest" otherwise would leave § 522(p)(2)(B) incomprehensible, which is a result that Congress would not have intended.

Both Salina Steel and Central Plains posit the additional argument that "interest" pertains to an active acquisition of equity, which includes a debtor's act of substantially paying down a mortgage prior to filing for bankruptcy.

Appellants rely on *In re Rasmussen*[27] to support their arguments. Appellants argue that the bankruptcy court in *Rasmussen* correctly interpreted "interest" to mean acquisition of equity rather than an ownership interest. The bankruptcy court in the instant matter, however, disagreed, and found *Rasmussen* to be readily distinguishable from the instant matter on its facts. Although *Rasmussen* dealt with debtors who purchased their homestead within the 1215–day period preceding their bankruptcy filing (rather than, as in this case, a homestead purchased outside the 1215–day period), we find the court's analysis and interpretation of the terms within § 522(p) are nevertheless, instructive.[28]

The *Rasmussen* court addressed the question of whether the monetary cap set forth in § 522(p) applied to an increase in a homestead's value due to appreciation during the 1215–day period. In answering that question, the court had to determine whether that "interest" acquired by the debtor counted toward the statute's $125,000 cap, thereby requiring the court to determine the meaning of the term "interest." Citing *In re Sainlar*[29] and *In re Blair,*[30] the *Rasmussen* court concluded that an increase in value due to appreciation during the 1215–day period was not an "interest" acquired under § 522(p), and overruled the trustee's objection to the debtor's exemption.[31] While *Rasmussen* agreed with the ultimate holdings in *Sainlar* and *Blair* based on the facts of each case, the court disagreed with those decisions in that each interpreted the "interest" acquired by a debtor as an ownership interest.[32] Instead, the *Rasmussen* court ***90** determined that "interest" meant equity acquired in the homestead during the 1215–day period.[33] In support of its conclusion, the court referred to the same language used in § 522(p)(2)(B):

> This conclusion is buttressed by the use of the same phrase "any amount of interest" ... in section 522(p)(2)(B): "For purposes of paragraph (1), *any amount of such interest* does not include any interest transferred form a debtor's previous principal residence ... into the debtor's current principal residence...." 11 U.S.C. § 522(p)(2)(B) (emphasis added). This second use of the term "interest" can only refer to the equity in the prior residence that is rolled into the current homestead.[34]

The court further reasoned that because a term used within the same section must be given the same definition, "amount of interest" in both 522(p)(1) and 522(p)(2) must refer to equity.[35]

The court in *Rasmussen* also disagreed with the *Sainlar* court's interpretation of "acquired by the debtor." Although *Rasmussen* agreed that "acquired" means "obtained as one's own," it disagreed with *Sainlar's* application of the phrase to only the acquisition of title or ownership. The *Rasmussen* court decided that a debtor may acquire equity in one of three ways. A debtor may acquire equity by making a down payment, paying down a mortgage, or through appreciation due to market conditions.[36] The first two require active conduct by a debtor, while the latter does not. The court explained that the phrase "by the debtor" is a restrictive clause modifying the term "acquired," which implies that more than a passive acquisition of equity was required to trigger the provision, such as the affirmative act of a mortgage pay down.[37] The court also addressed the phrase "aggregate of $125,000 in value," stating that the phrase "implies that successive acquisitions of equity by the debtor are to be aggregated,"[38] further supporting its reasoning that "interest" applies to equity and not to fee ownership.

Appellants also cite a Fifth Circuit Court of Appeals decision, *In re Rogers,*[39] in support of their position. *Rogers* was an appeal from the northern district of ***91** Texas[40] in which the district court defined "interest" within section 522(p)(1) as equity, thereby affirming a Texas district court decision overturning a bankruptcy court's holding that "interest" meant fee title.[41] The issue before the appellate court, however, was whether § 522(p)(1) applied to a homestead interest established within the 1,215–day period when the debtor acquired title to the property before that period, the answer of which did not turn on the meaning of "interest."[42] Nevertheless, the court conducted an analysis on the term's meaning, and, although not part of its holding, noted that a court's adoption of the fee title definition of "interest" is "an easily-applied rule that is arguably in conflict with the statutory language indicating that the term 'interest' refers to a quantitative or monetary value," or, equity.[43]

Anderson counters by arguing that § 522(p) does not apply to equity acquired within the 1,215–day period preceding a bankruptcy filing, but instead applies to an ownership interest acquired within that time period. Anderson contends that because equity cannot be acquired, the terms used within

the section can only lead to the interpretation that "interest" means title, which a person can acquire. Moreover, Anderson asserts that Congress provided a method for creditors to challenge fraudulent mortgage payments during the 1,215–day period by enacting the fraudulent transfer provision in § 522(*o*), and if "interest" meant equity, then § 522(*o*) would be superfluous.

Anderson suggests that even if the statute is construed as ambiguous, turning to legislative history supports the bankruptcy court's holding, as Congress intended to eliminate the "mansion loophole" by preventing a person from moving from a state with a limited homestead exemption to one with an unlimited homestead exemption, acquiring ownership in property, and then claiming that property as a homestead when the property has been owned for less than the 1,215 day period. Anderson contends that the legislative history in no way "even hints that 'equity' was what Congress was trying to reach" when enacting the statute, but instead, indicates its target was an ownership interest. [44]

Anderson primarily relies on two bankruptcy court decisions, *In re Blair* and *In re Sainlar*, to support his position that the term "interest," as used in § 522(p), refers to title rather than equity. *In re Blair,* a northern district of Texas bankruptcy court decision, involved a debtor who purchased homestead property outside the 1,215–day period prior to filing bankruptcy, but continued to build equity in the property by making regularly monthly mortgage payments during the 1,215–day period. [45] The bankruptcy court's analysis turned on whether a person can "acquire" equity in property, which it determined that one could not. The court, however, ***92** concluded that one *could* acquire title to property. [46]

To support its conclusion that a person could acquire title but not equity in property, the *Blair* court cited *In re Virissimo,* [47] *In re Wayrynen,* [48] and *In re McNabb.* [49] These cases, however, do not support the proposition the *Blair* bankruptcy court posits. Rather than using the term "acquire" to imply that a person could not acquire equity in property, these courts simply used the term to indicate that the monetary cap applies to a debtor who "acquires," or obtains or purchases, their homes within the 1,215–day period. [50] Nowhere in these opinions do the courts imply that equity cannot be acquired, and this Court declines to adopt such a narrow interpretation. The *Blair* court ultimately concluded, based on its determination that one cannot acquire equity, that the term "interest" meant title, and accordingly, because the debtor held title to the homestead prior to the 1,215–day period, the statute did not apply.

In re Sainlar is a decision from the bankruptcy court of the Middle District of Florida, decided six months prior to, and by a bankruptcy court in the same district, as *Rasmussen.* The sole issue in the case was to determine the meaning of the term "interest" as contained in § 522(p)(1) so the bankruptcy court could decide whether the $125,000 cap applied to equity gained through substantial appreciation of the property during the 1,215 day period. [51] The debtors purchased their home outside the 1,215–day period, and claimed the house as an exemption upon filing their bankruptcy petition. [52] The court held that the term "interest" as used in § 522(p)(1) meant acquisition of ownership of real property. [53] As with In re Blair, the court's analysis turned on whether equity could be "acquired." [54] The court provided the legal definitions for both "acquired" and "interest," then, without any further analysis or legal authority, concluded that "[t]itle to real property is acquired, equity is not." [55] Thus, the bankruptcy court determined that § 522(p)(1) applies only when a debtor "purchased or otherwise acquired" title to property within the 1,215–day period. [56]

While not cited by either party, this Court also finds the bankruptcy court's analysis in *In re Reinhard* persuasive. [57] In *Reinhard,* the court analyzed the meaning of "interest" within § 522(p) to answer the question of whether the acquisition of Florida homestead status alone within the 1,215–day period implicates the statutory cap. [58] In its analysis, the bankruptcy court found enough ambiguity in § 522(p) so as to require the court to analyze and ***93** determine the meaning of the language used by Congress within the statute. [59]

The court began by looking at the text of the statute to determine Congress' intent. First, the court noted that the statute refers to "any *amount* of interest," limiting that amount to an "aggregate $125,000 in *value.*" [60] The court concluded the use of such terms, along with use of a specific dollar figure, indicates that "interest" refers to a monetary meaning, or equity, and not simply one of an ownership interest. [61] Citing Blacks Law Dictionary, the court further found the common, ordinary meaning of "interest" further supports its

conclusion, finding that a "debtor must acquire some amount of interest in the value of one of the four types of property listed during the 1,215–day period in order for the cap to apply." [62]

[7] [8] [9] [10] A court may interpret the meaning of terms within a statute one of two ways. If the statute is unambiguous, the court must interpret the statutory language "according to its plain meaning." [63] This is because the court must presume that the "legislative purpose is reflected by the ordinary meaning of the language used in the statute." [64] It is a fundamental canon of statutory construction that "the words of a statute must be read in their context and with a view to their place in the overall statutory scheme." [65] "If the statute's plain language is ambiguous ..., we look to the legislative history and the underlying public policy of the statute [to determine Congressional intent]." [66]

[11] Section 522(p) prohibits a debtor from exempting "any amount of interest that was acquired by the debtor during the 1215–day period preceding the date of the filing of the petition that exceeds in the aggregate [$125,000] in value." [67] Rather than isolate any one term within a given section, we must determine the plain meaning of the terms used and then construe those terms within the context with the entire statutory scheme. [68] Congress did not define the term "interest" within the statute, so the Court must turn to the term's common, or ordinary and plain meaning, construing the term in context of the entire statute.

The statute precludes a debtor from exempting *"any amount* of interest" exceeding ***94** *"in the aggregate* $125,000." [69] "In the aggregate" means "formed by combining into a single whole or total." [70] "Amount" implies value, and if Congress had intended to restrict this term to refer to only title, it would have done so by excluding the "any amount of" phrase preceding the term. Construing these terms together only permits this Court to agree with the bankruptcy courts' analysis in *Rogers, Rasmussen*, and *Reinhard,* and conclude that "interest" refers to a quantitative or monetary value-a concept consistent with equity.

As previously discussed, we are also not convinced that equity cannot be "acquired." To "acquire" something means "[t]o gain possession or control of" or "to get or obtain" [71] Contrary to Anderson's position, a number of courts have discussed equity as being value that a person *can* acquire. [72] We agree, and conclude that one can "acquire" equity in property.

Appellants also argue that interpreting "interest" as "equity" allows a consistent reading of § 522(p)(2)(B), whereas a "title" definition would make it incomprehensible. We agree. Section 522(p)(2)(B) allows an exemption to the homestead cap in that it permits a debtor to transfer "any interest" from the debtor's previous principle residence into the current residence if both residences are located within the same state. [73] As Parks correctly asserts, a person does not transfer title from one residence to another, but instead, transfers equity. The bankruptcy court decisions cited by Anderson either ignores the impact of a "title" definition on § 522(p)(2)(B) or provides an explanation that makes no sense. For example, the *Blair* court, in explaining why applying a "title" meaning to the statute is more consistent than applying one of "equity," explains that

> Essentially, [§ 522(p)(2)(B)] allows for rollover by debtors of the equity in one home to another home located in the same state. A debtor is not subject to the homestead cap if he takes the proceeds of his first residence and reinvests them in a second residence even within the prescribed period of section 522(p). [Reading this statute in the context of equity rather than title] would seem at odds with this provision. [74]

The court then proceeded with no further analysis or reasoning to the conclusion that "[if] debtors had sold their home during the 1215 day period and bought another they would be protected. Surely the non-selling debtors should enjoy the same protections." [75]

***95 [12]** Equity in a homestead purchased outside the 1,215 day period is an exempt asset under the bankruptcy code, and a homeowner selling that homestead and purchasing another does nothing more than transfer that already-existing exempt asset (equity in the old homestead) into another exempt asset (equity into the new homestead). The homeowner does not lose the exempt status of the equity by transferring the equity of a previous homestead into a new homestead. However, a homeowner's transfer of non-exempt funds during the 1,215–day period from, for example, a bank account, into the homestead as exempt equity above

the $125,000 cap imposed under § 522(p)(1) is not a protected transfer under the statute. Permitting the transfer of a non-exempt asset into an exempt asset during the 1,215–day period above the $125,000 cap would run contrary to the plain reading of this section. Section 522(p) does permit a debtor to transfer funds from a non-exempt asset into homestead equity so long as it does not exceed $125,000 in the aggregate and is not done with fraudulent intent. Where there is fraudulent intent, § 522(*o*) may be invoked as a remedy.

[13] Anderson further argues that to allow "interest" to be interpreted as "equity" would make § 522(*o*) superfluous. We disagree. As just stated, § 522(p) permits a debtor to transfer non-exempt assets into a homestead during the 1,215–day period if that transfer is not done with fraudulent intent and if the transfer, in the aggregate, is less than $125,000. Section 522(*o*) provides that a transfer of any amount "shall be reduced to the extent that such value is attributable to any portion of any property that the debtor disposed of in the 10–year period ending on the date of the filing of the petition with the intent to hinder, delay, or defraud a creditor...." [76] To impose § 522(*o*) upon a debtor requires a showing of actual intent of the debtor to hinder or defraud. [77] Absent actual intent to hinder or defraud, a debtor transferring non-exempt assets to an exempt asset during the 1,215–day period is protected up to $125,000. [78] Therefore, we find no conflict between § 522(*o*) and § 522(p) in applying an "equity" definition to the term "interest."

Accordingly, this Court finds that the term "interest," as used within § 522(p), refers to equity acquired by a debtor within the 1,215–day period prior to filing bankruptcy. As a result, a debtor may not exempt equity acquired in a homestead during the 1,215–day period prior to filing bankruptcy that exceeds in the aggregate $125,000. [79] Therefore, we reverse the bankruptcy court's holding on this issue.

Piercing the Corporate Veil/Alter Ego

[14] **[15]** Appellant Central Plains claims that the bankruptcy court erred by failing to find that the corporations were Anderson's alter ego, and by refusing to pierce the corporate veil of Anderson's corporations, thereby concluding that Central Plains had no standing as a creditor in the instant action. The presumption in Kansas is that a corporation and its shareholders are separate and distinct. [80] When appropriate, "the corporate form will be disregarded and the corporation and its stockholders may be treated as identical." ***96** [81] However, the "[p]ower to pierce the corporate veil is to be exercised reluctantly and cautiously." [82]

[16] **[17]** **[18]** The Kansas Supreme Court described the alter ego doctrine as one used to:

> impose liability on the individual who uses a corporation merely as an instrumentality to conduct his own personal business. Such liability arises from fraud or injustice perpetrated not on the corporation but on third persons dealing with the corporation. Under it the court merely disregards the corporate entity and holds the individual responsible for his acts knowingly and intentionally done in the name of the corporation. [83]

In determining whether to disregard the corporate entity, a court considers eight factors: (1) undercapitalization of a one-man corporation; (2) failure to observe corporate formalities; (3) nonpayment of dividends; (4) siphoning of corporate funds by the dominant stockholder; (5) nonfunctioning of other officers or directors; (6) absence of corporate records; (7) the use of the corporation as a facade for operations of the dominant stockholder or stockholders; and (8) the use of the corporate entity in promoting injustice or fraud. [84]

[19] It is clear that the bankruptcy court, in its analysis of Great Plains' claims, conducted a thorough review of the facts and evaluated those facts against all factors applicable to this case. The bankruptcy court paid particular attention to whether Anderson's actions amounted to the promotion of fraud or injustice, and concluded that based on the record, the court found that his actions did not. [85] Based on its analysis, the bankruptcy court declined to pierce the corporate veil. After this Court's review of the record, we do not find the bankruptcy court's decision to be clearly erroneous and

affirm the court's decision. Accordingly, Central Plains has no valid claim against Anderson in his individual capacity or his bankruptcy estate, and is not a creditor in this case.

Section 522(o) Intent to hinder, delay, or defraud creditors

Appellants Central Plains and Salina Steel join to appeal this case, claiming that the bankruptcy court erred in finding that Anderson did not act with the intent to hinder, delay, or defraud his creditors within the meaning of § 522(*o*) when he transferred $240,000 to pay down his mortgage shortly before filing his bankruptcy petition. However, because Central Plains is not a creditor in this action, its claim is moot. Appellant Parks does not join this issue on appeal.

The bankruptcy court held an evidentiary hearing regarding this matter on November 13, 2007, where it had the opportunity to hear and evaluate the evidence and judge the credibility of witnesses. After the hearing, the court took the matter under advisement.

[20] **[21]** The burden is on the objecting party to establish by a preponderance of the evidence that the debtor intended to hinder, delay, or defraud his creditors.[86] ***97** In applying the facts to the badges of fraud identified under 11 U.S.C. § 727(a) and 11 U.S.C. § 548(a), the court found that Salina Steel demonstrated that three of eight badges of fraud and three of the eleven badges of fraud existed, respectively. In its analysis, the court noted its concern regarding Anderson's response of "I don't know" when asked why he paid down his mortgage instead of his creditors.[87] While the mortgage paydown may have hindered Anderson's creditors and may have been done intentionally, without something more, the bankruptcy court was unable to conclude that Anderson made the transfer with the actual intent to hinder.[88] The bankruptcy court ultimately determined that Salina Steel failed to establish that Anderson had the "actual intent" required under § 522(*o*) to hinder, delay, or defraud his creditors so as to permit the court to deny discharge.

After reviewing the record, this Court is convinced that the bankruptcy court's finding that Anderson's actions regarding the transfer of a non-exempt asset to pay down his mortgage was not done with the actual intent to hinder, delay, or defraud his creditors is supported by the evidence and is not clearly erroneous. Therefore, the Court affirms the bankruptcy court's holding on this issue.

Accordingly,

IT IS THEREFORE ORDERED that the bankruptcy court's October 2, 2007 Order denying the trustee's motion for summary judgment and granting summary judgment in favor of debtor is REVERSED and REMANDED to the bankruptcy court for further proceedings consistent with this Order.

IT IS FURTHER ORDERED that the bankruptcy court's April 11, 2008 Order is hereby AFFIRMED.

IT IS SO ORDERED.

All Citations

406 B.R. 79, Bankr. L. Rep. P 81,492

Footnotes

1 Bankr.Doc. 249.

2 Bankr.Docs. 66, 70.

3 Bankr.Docs. 258–59.

4 Bankr.Docs. 66, 70. Parks also objected to Anderson's homestead exemption claim based upon 11 U.S.C. § 522(o), but subsequently abandoned her claim. Bankr.Docs. 21 ¶ 6, 245.

5 Bankr.Doc. 290.

6 *In re Anderson,* 386 B.R. 315, 327 (Bankr.D.Kan.2008).

7 *Id.* at 331–32.

8 Each Appeal was filed under separate case number (Parks: 08–1111, Salina Steel: 08–1112, and Central Plains: 08–1113).

9 The bankruptcy court's factual summary is derived from its opinions in *In re Anderson,* 374 B.R. 848 (Bankr.D.Kan.2007) and *In re Anderson,* 386 B.R. 315 (Bankr.D.Kan.2008). Footnotes have been added by this Court.

10 The bankruptcy court noted that Auto Lifters was a debtor in a chapter 7 case filed in its court, case no. 06–10071. Aerotech Designs was an alleged debtor in an involuntary case filed in 2005, case no. 05–19160, which was closed without the entry of an order of relief.

11 As the bankruptcy court correctly noted, any standing that Central Plains has in this case is predicated on its being able to pierce the corporate veil of these entities to hold Anderson personally accountable for their debts.

12 The bankruptcy noted that no proof was presented concerning the fate of the other $19,000.

13 The original mortgage on the property was held by the Midland National Bank in the amount of $375,000. Anderson and his wife refinanced the property on or about November 22, 2000 with Capital Federal Savings, executing a note and mortgage for $500,000. The appraised market value of the property at the time of refinance was $650,000. Anderson and his wife hold the property as joint tenants with right of survivorship.

14 The trustee's appraisal was completed after Anderson filed this bankruptcy in 2005.

15 Anderson filed his petition for chapter 7 bankruptcy relief on October 14, 2005.

16 Anderson's value was based on the 2005 ad valorem tax valuation.

17 *In re Barber,* 191 B.R. 879, 882 (D.Kan.1996).

18 *Zions First Nat'l Bank, N.A. v. Christiansen Brothers, Inc.,* 66 F.3d 1560, 1563 (10th Cir.1995).

19 Fed. R. Bankr.P. 8013.

20 *In re Lanning,* 545 F.3d 1269, 1274 (10th Cir.2008).

21 *Floyd v. I.R.S.,* 151 F.3d 1295, 1298 (10th Cir.1998) (citing *G.M. Leasing Corp. v. United States,* 514 F.2d 935, 939 (10th Cir.1975)) (court's finding of alter ego status "presumptively correct and must be left undisturbed on appeal unless ... clearly erroneous"), *rev'd in part on other grounds,* 429 U.S. 338, 97 S.Ct. 619, 50 L.Ed.2d 530 (1977).

22 *In re Sayler,* 98 B.R. 536, 538 (D.Kan.1987).

23 *Penncro Assocs., Inc. v. Sprint Spectrum, L.P.,* 499 F.3d 1151, 1161 (10th Cir.2007) (quoting *United States v. Cardenas–Alatorre,* 485 F.3d 1111, 1118–19 (10th Cir.2007)).

24 For cases commenced on or after April 1, 2007, the dollar amount is $136,875.

25 11 U.S.C. § 522(p).

26 Doc. 10, p. 9.

27 349 B.R. 747 (Bankr.M.D.Fla.2006).

28 While the facts of a particular case may cause a court to vary its application of a statute, the meaning of terms within that statute will not change.

29 344 B.R. 669 (Bankr.M.D.Fla.2006). The Court notes that *Sainlar* was decided six months prior to *Rasmussen* in the same bankruptcy court, but by a different bankruptcy judge.

30 334 B.R. 374 (Bankr.N.D.Tex.2005).

31 *Rasmussen,* 349 B.R. at 756.

32 *Id.*

33 *Id.*

34 *Id.*

35 *Id.*

36 *Id.* at 757.

37 *Id.*

38 *Id.* The *Rasmussen* court provides the following example of aggregating value: "[I]f a debtor within the 1,215–day period purchased a home for $750,000, paying $100,000 down and financing the balance by a bank mortgage and then a month after the purchase paid off the $650,000 mortgage, the amount of equity acquired by the debtor's affirmative acts of paying $100,000 down at the time of purchase and then paying off the $650,000 mortgage would be aggregated. In this example, the debtor's permitted exemption of $125,000 will have been exceeded by $625,000." *Id.*

39 513 F.3d 212 (5th Cir.2008). This Fifth Circuit opinion in *In re Rogers* was published over a year after the bankruptcy court in the instant matter decided the issue that is presently before this Court. At the time the bankruptcy court below issued its opinion, the only appellate decision construing § 522(p)(1) and the term "interest" was *In re Khan,* 375 B.R. 5 (1st Cir. BAP 2007). *In re Khan* was an appeal from the district of Massachusetts bankruptcy court in which the issue was whether real property conveyed by a trust to the debtor within the 1,215–day period was subject to the statutory limit imposed by § 522(p)(1). The B.A.P. held that because debtor acquired the property from the trust within the look-back period, it was subject to the monetary cap.

40 *In re Rogers,* 354 B.R. 792 (N.D.Tex.2006).

41 *In re Rogers,* 513 F.3d at 217–18.

42 The Fifth Circuit determined that a homestead interest, for purposes of declaring such for exemption under the bankruptcy code, was not the equivalent of title or equity. *Id.* at 222.

43 *Id.* at 221.

44 Doc. 14, p. 25. Although Anderson suggests that the legislative history for the statute supports his position, arguments can similarly be made that the legislative history supports an "equity" interpretation. *See, e.g., In re Reinhard,* 377 B.R. 315, 320–21 (Bankr.N.D.Fla.2007) (stating language in legislative history imposing aggregate monetary limitation and referring to value indicate the legislature's intent to target equity).

45 *In re Blair,* 334 B.R. at 375.

46 *Id.* at 377.

47 332 B.R. 201 (Bankr.D.Nev.2005).

48 332 B.R. 479 (Bankr.S.D.Fla.2005).

49 326 B.R. 785 (Bankr.D.Ariz.2005).

50 *In re Blair,* 334 B.R. at 377.

51 *In re Sainlar,* 344 B.R. at 671.

52 *Id.* at 670.

53 *Id.* at 673.

54 *Id.*

55 *Id.*

56 *Id.* at 674.

57 377 B.R. 315 (Bankr.N.D.Fla.2007). The *Reinhard* opinion was also published after the bankruptcy court's decision in the instant matter. Again, this Court is cognizant that the factual background and application is not on point with the present matter; however, differing factual scenarios do not alter the meaning of terms within a statute.

58 *Id.* at 319–21.

59 *Id.* at 320.

60 *Id.* (emphasis in original); *see also* 11 U.S.C. § 522(p)(1).

61 *See Reinhard,* 377 B.R. at 320.

62 *Id.*

63 *Bowdry v. United Air Lines, Inc.,* 956 F.2d 999, 1002 (10th Cir.1992).

64 *Edwards v. Valdez,* 789 F.2d 1477, 1482 (1986) (citing *United States v. Locke,* 471 U.S. 84, 105 S.Ct. 1785, 1793, 85 L.Ed.2d 64 (1985)); *see also Park 'N Fly, Inc. v. Dollar Park & Fly, Inc.,* 469 U.S. 189, 194, 105 S.Ct. 658, 83 L.Ed.2d 582 (1985) (stating "[s]tatutory construction must begin with the language employed by Congress and the assumption that the ordinary meaning of that language accurately expresses the legislative purpose.").

65 *Davis v. Mich. Dept. of Treasury,* 489 U.S. 803, 809, 109 S.Ct. 1500, 103 L.Ed.2d 891 (1989).

66 *Id.* (internal quotation and citation omitted).

67 11 U.S.C. § 522(p)(1).

68 "While there is no per se rule of statutory interpretation that identical words used in different parts of the same act are intended to have the same meaning, there is a presumption that this is so." *Lippoldt v. Cole,* 468 F.3d 1204, 1213 (10th Cir.2006) (citing *United States v. Cleveland Indians Baseball Co.,* 532 U.S. 200, 214, 121 S.Ct. 1433, 149 L.Ed.2d 401 (2001)).

69 11 U.S.C. § 522(p)(1).

70 BLACKS LAW DICTIONARY 72 (8th ed.2004).

71 *Id.* at 25.

72 *See Arevalo v. C.I.R.,* 469 F.3d 436, 439 (5th Cir.2006) (looking at "not just the passage of bare legal title" but whether the purchaser acquired any equity in the property to determine ownership); *Upham v. C.I.R.,* 923 F.2d 1328, 1334 (8th Cir.1991) (analyzing transfer of title and acquisition of equity as separate factors indicative of property ownership); *Houchins v. Comm'r of Internal Revenue,* 79 T.C. 570, 591, 1982 WL 11155 (1982) (identifying "whether the purchaser acquired any equity in the property" as a factor in determining whether the benefit or burden of property ownership has been transferred); *Benton v. Comm'r,* 1950 WL 7531 (T.C. Sept. 20, 1950) (a renter acquires no equity in property through rent payments). The Court is cognizant that the cases cited are related to tax law and are not factually on-point with the instant matter; however, whether equity can or cannot be "acquired" is not fact driven, and those cases referencing such remains relevant to our analysis.

73 11 U.S.C. § 522(p)(2).

74 *In re Blair,* 334 B.R. at 377.

75 *Id.*

76 11 U.S.C. 522(*o*).

77 *In re Carey,* 938 F.2d 1073, 1077 (10th Cir.1991).

78 *See* 11 U.S.C. § 522(p)(1).

79 After April 1, 2007, the dollar amount is $136,875.

80 *Kvassay v. Murray,* 15 Kan.App.2d 426, 436, 808 P.2d 896, 904 (1991).

81 *Id.* (quoting *Sampson v. Hunt,* 233 Kan. 572, 579, 665 P.2d 743, 751 (1983)).

82 *Id.*; see also Wegerer v. First Commodity Corp. of Boston, 744 F.2d 719, 729 (10th Cir.1984).

83 *Sampson,* 233 Kan. at 579, 665 P.2d at 751.

84 *Kvassay,* 15 Kan.App.2d at 437, 808 P.2d at 904.

85 *Anderson,* 386 B.R. at 326.

86 *In re Agnew,* 355 B.R. 276, 284 (Bankr.D.Kan.2006).

87 Anderson suggests in his brief that his response is explained by the bankruptcy court's earlier finding that he only has a high school education, minimal credit hours in college, and does not appear to have any formal business or accounting training. He also suffered and continued to suffer from severe depression from being intellectually overwhelmed by the responsibility of dealing with three or four separate entities. Doc. 16, p. 22 n. 15 (referring to *Anderson,* 386 B.R. at 323).

88 *Anderson,* 386 B.R. at 331.

KeyCite Yellow Flag - Negative Treatment
Disagreed With by In re Nestlen, 10th Cir.BAP (Okla.), December 21, 2010

370 B.R. 859
United States Bankruptcy Court,
S.D. Florida,
Fort Lauderdale Division.

In re William A. LIMPERIS
and Janet L. Limperis, Debtors.

No. 06–15791–BKC–JKO.
|
May 10, 2007.

Synopsis

Background: Trustee objected to state law homestead exemption claimed by Chapter 13 debtors in property acquired within 1,215 days of petition date. Debtors acknowledged that they were limited by the $125,000 cap imposed by the Bankruptcy Abuse Prevention and Consumer Protection Act (BAPCPA) in state law homestead exemption that they could claim, but asserted right to stack the capped exemption available to each debtor.

Holding: The Bankruptcy Court, John Karl Olson, J., held that debtors were entitled to stacked Florida homestead exemption in maximum amount of $250,000.

Objection overruled.

West Headnotes (1)

[1] **Bankruptcy** Co-Debtors; Stacking
Bankruptcy Waiver or Loss of Exemption

Subsection of bankruptcy exemption statute indicating that, in joint case, exemption statute applies separately with respect to each debtor applied to cap imposed by another subsection of that same statute on state law homestead exemption available to debtor in property acquired within 1,215 days of petition date, so that joint Chapter 13 debtors' homestead exemption, which was unlimited as to value under Florida law, was limited by this cap to $125,000 as to each debtor for residential property acquired during 1,215-day period, and debtors were entitled to stacked Florida homestead exemption in maximum amount of $250,000. 11 U.S.C.A. § 522(m, p); West's F.S.A. Const. Art. 10, § 4.

3 Cases that cite this headnote

Attorneys and Law Firms

***860** Brian J. Cohen, Esq., Coral Springs, FL, for Debtor.

Robin R. Weiner, Trustee.

ORDER OVERRULING TRUSTEE'S OBJECTION TO DEBTOR'S HOMESTEAD EXEMPTION

JOHN KARL OLSON, Bankruptcy Judge.

THIS CASE came before the Court on March 12, 2007, on the Trustee's Objection to Debtors' Claim of Exemption [CP 28]. The Debtors filed no written response. The Court heard oral argument from both sides and finds that it is appropriate to rule.

The Court has jurisdiction of the subject matter and the parties to this proceeding pursuant to 28 U.S.C. §§ 157 and 1334(b). This is a core proceeding pursuant to 28 U.S.C. § 157(b)(2)(B).

On Schedule C of the their joint bankruptcy petition, the Debtors claimed that $250,000 in equity in their homestead was exempt under the Article X § 4(a)(2) of the Florida Constitution and *Florida Statutes* §§ 220.01 and 222.02. The Trustee objected to the Debtors' claimed exemption on the grounds that it violated 11 U.S.C. § 522, *Fla. Stat.* § 222.20 and the Fla. Const. Art. X § 4.

The Debtors acquired their homestead property in September of 2003. The Debtors filed for protection under chapter 13 of the United States Bankruptcy Code on November 11, 2006

[CP 1]. Because the Debtors acquired their homestead fewer than 1215 days prior to the filing of their bankruptcy petition, the Debtors fall within the exemption cap of 11 U.S.C. § 522(p), which restricts the homestead exemption to $125,000. The question raised by this case is whether the joint Debtors are entitled to a homestead exemption of $125,000 in total or are they each entitled to a $125,000 exemption which they can then stack to reach a total of $250,000 in homestead exemptions.

Judge Williamson in the Middle District of Florida dealt with this precise issue in *In re Rasmussen,* 349 B.R. 747 (Bankr.M.D.Fla.2006). *Rasmussen* held that "as a result of the application of section 522(m) to the new section 522(p), each Debtor in this joint case may claim $125,000 of the Homestead for a total exemption in their joint case of $250,000." *Id.* at 758. This Court finds that the reasoning and conclusion of the *Rasmussen* court are persuasive and adopts them *in toto.* The joint Debtors are each entitled to a $125,000 homestead exemption which they can aggregate for a total $250,000 exemption.

Accordingly, it is ORDERED that the Trustee's objection to the Debtors' claim of exemption as to their homestead is OVERRULED.

All Citations

370 B.R. 859, 20 Fla. L. Weekly Fed. B 435

End of Document

441 B.R. 135
United States Bankruptcy Appellate Panel
of the Tenth Circuit.

In re Mark Charles NESTLEN and
Catherine Anne Nestlen, Debtors.
Dykstra Exterior, Inc., Appellant,
v.
Mark Charles Nestlen and
Catherine Anne Nestlen, Appellees.

BAP No. WO–10–030.
|
Bankruptcy No. 09–16838.
|
Dec. 21, 2010.

Synopsis

Background: Creditor objected to state law homestead exemption claimed by Chapter 7 debtors and asserted that, because debtors increased their equity in homestead by more than $136,875 during the 1,215 days preceding petition date, debtors' state law homestead exemption rights were limited by bankruptcy statute. The United States Bankruptcy Court for the Western District of Oklahoma overruled creditor's objection, on theory that statutory limitation was triggered only if debtors acquired title to homestead property within 1,215 days of petition date and not if they simply increased their equity in previously owned homestead property. Creditor appealed.

[Holding:] The Bankruptcy Appellate Panel, Rasure, J., held that, even if bankruptcy court erred in not considering increase in debtors' equity in homestead during the relevant 1,215-day period, statutory cap was doubled in joint Chapter 7 case filed by married debtors.

Affirmed.

Procedural Posture(s): On Appeal.

West Headnotes (8)

[1] **Bankruptcy** Conclusions of law; de novo review

Whether Chapter 7 debtors were entitled to the full homestead exemption rights accorded to them under state law, or whether debtors, by making improvements, paying down mortgage debt, and thus increasing their equity in homestead during the 1,215 days preceding petition date, had thereby triggered statutory cap on their state law homestead exemption rights, were legal questions, that Bankruptcy Appellate Panel (BAP) would review de novo on appeal. 11 U.S.C.A. § 522(m, p).

1 Cases that cite this headnote

[2] **Bankruptcy** Joint Cases
Bankruptcy Waiver or Loss of Exemption

Even assuming that statutory cap on debtor's ability to claim state law homestead exemption for any interest in property acquired within 1,215 days of petition date applied not just when debtor acquired legal title to property within this 1,215-day period, but also when debtor increased his equity in property to which he already held title, such as by paying down mortgage or making improvements, statutory cap of $136,875 was doubled in joint Chapter 7 case filed by married debtors, such that, as long as the total amount by which debtors' equity increased as result of their mortgage payments and improvements during the 1,215 days preceding petition date did not exceed $273,750 ($136,875 x 2), debtors state law homestead exemption rights were not limited by bankruptcy statute. 11 U.S.C.A. § 522(m, p).

2 Cases that cite this headnote

[3] **Bankruptcy** Right of review and persons entitled; parties; waiver or estoppel
Bankruptcy Scope of review in general

Appellate court may affirm judgment on any legal theory adequately supported by the record before it, even if appellee has not participated in appeal.

[4] **Bankruptcy** Right of review and persons entitled; parties; waiver or estoppel

Bankruptcy Scope of review in general

While, on appeal by creditor from bankruptcy court order allowing Chapter 7 debtors to claim their homestead as entirely exempt and not limiting their state law homestead exemption based on fact that, by making improvements and paying down mortgage debt, they had increased their equity in homestead by more than $136,875 during the 1,215-day period preceding petition date, debtors did not cross-appeal bankruptcy court's apparent determination that, to extent that this $136,875 statutory cap applied, cap was not doubled in their joint bankruptcy case, the Bankruptcy Appellate Panel (BAP) was nonetheless free to rely on this "doubling" theory as basis for upholding bankruptcy court's decision given that issue was fully developed below, and that debtors, as parties who obtained complete relief from bankruptcy court, had no standing to appeal. 11 U.S.C.A. § 522(p).

1 Cases that cite this headnote

[5] **Bankruptcy** Right of review and persons entitled; parties; waiver or estoppel

Prevailing party generally is not aggrieved, and thus lacks standing to appeal.

[6] **Bankruptcy** Right of review and persons entitled; parties; waiver or estoppel

In most instances, cross-appeal of particular issue decided against the prevailing party is unnecessary and inappropriate, and cross-appeals are disfavored because they increase complexity and cost of appeal.

[7] **Bankruptcy** Scope of review in general

Appellate courts are free to affirm on any grounds for which there is a record sufficient to permit conclusions of law, even grounds not relied upon by lower court, and may affirm even though lower court reached its conclusions from a different or even erroneous course of reasoning, as long as parties had fair opportunity to develop the record and to address grounds upon which appellate court relies.

[8] **Bankruptcy** Joint Cases

Bankruptcy Waiver or Loss of Exemption

State law was irrelevant to whether statutory cap on debtor's ability to claim state law exemption for interest in homestead property acquired within 1,215 days of petition date was doubled in case of married debtors filing a joint petition; whether statutory cap should be doubled for joint debtors was purely a question of federal law. 11 U.S.C.A. § 522(p).

2 Cases that cite this headnote

Attorneys and Law Firms

***136** Submitted on the briefs: * Brent A. Austin and Tom M. Moore of Metzer & Austin, P.L.L.C., Edmond, OK, for Appellant.

Before NUGENT, RASURE, and ROMERO, Bankruptcy Judges.

Opinion

RASURE, Bankruptcy Judge.

Creditor Dykstra Exterior, Inc. ("Dykstra") appeals an order of the Bankruptcy Court for the Western District of Oklahoma overruling Dykstra's objection to the homestead exemption claimed by Debtors ***137** Mark and Catherine Nestlen (the "Nestlens"). [1] We AFFIRM.

I. BACKGROUND

The Nestlens filed a voluntary petition for relief under Chapter 7 of the Bankruptcy Code on December 1, 2009 (the "Petition Date"). [2] On their amended Schedule C, they claimed their homestead, which they valued at $275,000, as fully exempt under Oklahoma law. [3] Dykstra objected to the exemption, arguing that the Nestlens had increased their equity in the property during the 1,215–day period prior to

the Petition Date, and therefore their homestead exemption was limited in amount to $136,875 by virtue of 11 U.S.C. § 522(p) (the "Objection"). [4]

Prior to the hearing on the Objection, the parties stipulated to the relevant facts [5] and fully briefed the legal issues, [6] and at the hearing, the parties presented oral argument and the bankruptcy court entered its bench ruling. [7] The bankruptcy court concluded that § 522(p) [8] did not apply under the facts of this case, overruled the Objection, and allowed the Nestlens' homestead exemption in full. [9]

The following facts were uncontested. The Nestlens purchased their home in 1999 for $152,117.80 and claimed it as their homestead (the "Homestead"). [10] No mortgage was granted in connection with the purchase. [11] In 2002, however, the Nestlens mortgaged the Homestead to secure a loan in the approximate principal amount of $183,000.00 (the "2002 Mortgage"). [12]

In 2001 or 2002, the Nestlens hired Dykstra to install some landscaping. The Nestlens disputed Dykstra's bill, and Dykstra filed a lawsuit against the Nestlens to collect the amount owed on the project. [13] In 2009, judgment was entered in Dykstra's favor in the amount of $26,772.54 (the "State Court Judgment"), and Dykstra was awarded approximately $64,000.00 in attorney fees and costs (the "Attorney Fee Award"). [14]

Within the 1,215–day period prior to the Petition Date, the Nestlens fully paid the $180,886.18 balance of the loan secured by the 2002 Mortgage, of which $169,344.00 was principal and $11,542.18 was accrued ***138** interest. [15] The Nestlens also spent $80,000.00 to $100,000.00 to repair and add improvements to the Homestead (the "Improvements") during that period. [16]

Thereafter, the Nestlens obtained an equity line of credit secured by a mortgage against the Homestead, from which they drew funds sufficient to satisfy the State Court Judgment. [17] On the Petition Date, the Nestlens still owed $32,921.00 on the equity line of credit. [18]

Arguing that the Nestlens were not entitled to exempt the entire value of their Homestead, Dykstra invoked § 522(p)(1), which provides that a debtor may not exempt "any amount of interest [in a homestead] that was acquired by the debtor during the 1215–day period preceding the date of the filing of the petition that exceeds in the aggregate $136,875 in value." [19] In cases interpreting § 522(p), the phrase "interest that was acquired" has been assigned at least two interpretations, [20] and Dykstra advocated the so-called "equity view." Specifically, Dykstra argued that by investing non-exempt funds in their Homestead within the 1,215–day prepetition period (the "Lookback Period"), the Nestlens increased their equity in the Homestead in an amount in excess of the $136,875 ceiling established by § 522(p), and therefore the equity exceeding $136,875 was not exempt. [21]

In their response to the Objection and in oral argument before the bankruptcy court, the Nestlens presented several ***139** grounds for denying Dykstra's § 522(p) objection. In opposition to Dykstra's assertion that the phrase "interest that was acquired" included an increase in *equity* during the Lookback Period, the Nestlens contended that the phrase was limited to situations where the debtor purchased and acquired *title* to the homestead during the Lookback Period. [22] Thus, they argued, the § 522(p) exemption limitation did not apply at all in their case since they had acquired title to the Homestead in 1999, which was outside the Lookback Period.

In the alternative, the Nestlens argued that even if the bankruptcy court adopted the "equity view," the equity they arguably acquired during the Lookback Period did not exceed the § 522(p) cap because the cap of $136,875 is doubled for joint debtors pursuant to § 522(m). [23] Because the amount of equity Dykstra contended the Nestlens acquired within the Lookback Period did not exceed $273,750, § 522(p) did not apply to reduce the value of their homestead exemption. [24]

At the hearing held on April 27, 2010, the bankruptcy court concluded that § 522(m) did not double the cap, but nevertheless overruled Dykstra's Objection, holding that the "interest" referred to in § 522(p) should be construed to mean title rather than equity. [25] Accordingly, because the Nestlens acquired title to the Homestead prior to the Lookback Period, the bankruptcy court concluded that §

522(p) was inapplicable, and the Homestead was fully exempt. Dykstra filed a timely appeal.

II. APPELLATE JURISDICTION

This Court has jurisdiction to hear timely filed appeals from "final judgments, orders, and decrees" of bankruptcy courts within the Tenth Circuit, unless one of the parties elects to have the district court hear the appeal.[26] A decision is considered final "if it 'ends the litigation on the merits and leaves nothing for the court to do but execute the judgment.' "[27] Here, the bankruptcy court's order granting the Nestlens' claim of homestead exemption is a final decision for purposes of review.[28] Neither party elected to have this appeal heard by the United States District Court for the Western District of Oklahoma, and thus appellate review by this Court is by consent.

II. STANDARD OF REVIEW

[1] The parties stipulated to all the relevant facts. The issue on appeal is whether the bankruptcy court correctly applied § 522 to the stipulated facts, which presents a legal issue subject to *de novo* review.[29]

*140 IV. DISCUSSION

[2] We affirm the bankruptcy court's decision that § 522(p) does not limit the Nestlens' homestead exemption, albeit on a ground not relied upon by the bankruptcy court. We conclude that because § 522(m) provides that all sections of § 522 "apply separately with respect to each debtor in a joint case," § 522(p)'s exemption cap of $136,875 must be doubled in this joint case.[30] Even if we concurred with Dykstra that the equity the Nestlens accumulated during the Lookback Period is the proper measure of "interest acquired" for purposes of § 522(p), Dykstra's own calculation of the net equity acquired in the Lookback Period does not exceed the doubled § 522(p) cap.[31] Accordingly, the bankruptcy court's ultimate conclusion that the Nestlens' homestead exemption is not limited by § 522(p) was correct.

A. *Appellate courts may affirm on any theory supported by the record.*

[3] [4] As an initial matter, we acknowledge that the Nestlens did not appeal the bankruptcy court's apparent ruling that § 522(m) does not have "the effect of doubling the cap,"[32] nor did they, as appellees, file a brief in this appeal arguing that the bankruptcy court could be affirmed on a ground other than the one relied upon by the bankruptcy court. However, appellate courts may affirm a judgment on any legal theory adequately supported by the record before it, even if the appellee has not participated in the appeal.

[5] [6] First, we observe that as parties that received complete relief (*i.e.,* allowance of their homestead exemption in full), the Nestlens lacked standing to appeal the bankruptcy court's determination of the § 522(m) issue.[33] Moreover, because it was unnecessary for the bankruptcy court to address the doubling issue in light of its ultimate determination that § 522(p) did not apply at all since the Nestlens did not acquire title to their Homestead within the Lookback Period, the bankruptcy court's commentary on the effect of § 522(m) on § 522(p) constituted dicta. Thus, the fact that the Nestlens did not appeal the bankruptcy court's § 522(m) ruling does not prevent us from considering whether § 522(m) applies in this case.

Second, even though the Nestlens did not file a brief in this appeal arguing that § 522(m) doubles the § 522(p) homestead exemption cap in a joint case, an appellee, again as a prevailing party below, is not required to file an appellate brief.[34] In ***141** their briefing and oral argument before the bankruptcy court, however, the Nestlens did assert that § 522(m) doubled the § 522(p) exemption cap in a joint case,[35] and Dykstra argued that it did not. Thus the issue was fully developed below, and the record on the issue is complete.

[7] Appellate courts are "free to affirm ... on any grounds for which there is a record sufficient to permit conclusions of law, even grounds not relied upon" by the lower court,[36] and may affirm "even where the lower court reached its conclusions from a different or even erroneous course of reasoning."[37] The caveat to this rule is that the parties must have had a "fair opportunity to develop the record and to address the ground on which we rely."[38] The purpose of requiring presentation of the issue in the lower court is "to ensure that litigants may not be surprised on appeal by

final decision there of issues upon which they have had no opportunity to introduce evidence or to present whatever legal arguments they may have."[39] Furthermore, even if neither party addressed the correct governing statute, case, or legal principle in its appellate brief, as is the case here, an appellate court may affirm a judgment as a matter of law.[40]

Accordingly, the fact that the Nestlens failed to argue, either by filing a brief or on cross-appeal, for affirmance based on § 522(m) does not bar this Court from considering the effect of § 522(m) in this case. Moreover, Dykstra fully briefed and orally argued its opposition to the Nestlens' interpretation of § 522(m) as it relates to § 522(p) in the bankruptcy court,[41] and thus had a "fair opportunity to develop the record and to address the ground on which we rely."[42]

B. *Application of § 522(m).*

Section 522(m) provides that all sections of § 522 "apply separately with respect to each debtor in a joint case," subject only to any limitation provided by § 522(b).[43] Section 522(b) governs whether a debtor must claim exemptions under state law or may opt to claim exemptions set forth in § 522(d) of the Bankruptcy Code.[44] Residents of Oklahoma may not opt to exempt property from the bankruptcy estate under § 522(d), but instead are limited to claiming exemptions under Oklahoma ***142** law.[45] Under the Oklahoma Constitution and Oklahoma statutes, Oklahoma debtors are entitled to protect the entire value of their homestead from claims of creditors.[46]

The Nestlens claimed the full value of their Homestead exempt under Oklahoma's unlimited exemption. If the § 522(p) cap is applicable in this case, as Dykstra argues, the issue is whether the cap is $136,875, or whether the cap "appl[ies] separately" to each of the Nestlens, resulting in a cap of $273,750. In its briefs and oral argument below, Dykstra relied on the Oklahoma Supreme Court case of *In re Arnold*[47] in contending that under Oklahoma law, a married couple may claim only one homestead and therefore Oklahoma joint debtors are not entitled to double the § 522(p) cap.

In *Arnold*, the issue was whether, under Oklahoma's homestead exemption law which limits the acreage "any person" may claim as rural homestead to 160 acres, a husband and wife could each claim 160 acres as homestead, thus exempting a total of 320 acres.[48] The Oklahoma Supreme Court concluded that the "any person" language in the statute meant that both the husband and wife could claim homestead protection on the same 160 acres, even if the homestead was owned by only one spouse, but they could not each claim a separate 160 acre homestead.[49] The court cited a Tenth Circuit case, *Pruitt v. Wilson (In re Pruitt)*, which applied Colorado homestead law, as supportive of the principle that "homestead is a property right rather than a personal right, and whether realty is held jointly or singly there is only one homestead right which attaches to realty."[50] Thus, the Oklahoma Supreme Court held that the Arnolds could not double the number of acres protected as homestead by claiming two separate homesteads.

The Nestlens are not attempting to claim two separate 160–acre parcels as their homestead as the debtors in the *Arnold* case were, and thus the *Arnold* case does not address the issue presented here. The issue in this case is not whether the homestead of a married couple may be limited in size, but to what extent the homestead exemption may be limited in value. Neither Oklahoma's Constitution[51] nor its homestead exemption statutes[52] place any limit on the *value* of the homestead one spouse or both spouses jointly may exempt from execution by creditors.[53] The Bankruptcy Code, however, does place a ceiling on an Oklahoma debtor's homestead exemption in very limited circumstances. Relevant to this case, § 522(p)(1) prohibits a debtor from exempting any interest acquired in the Lookback Period to the extent it exceeds $136,875.[54]

Some courts examine state law to determine whether the § 522(p) homestead exemption ***143** cap should be doubled under § 522(m) for joint debtors. For example, in the case of *In re Rasmussen*, a Florida bankruptcy court discussed at length the concept of "stacking" exemptions, and concluded that state law governed whether a married couple is permitted to "stack" homestead exemptions and thus double the § 522(p) cap.[55] Following *Rasmussen*,

Florida bankruptcy courts have consistently held that because each spouse is entitled to claim a homestead exemption under Florida law, the § 522(p) cap is doubled for Florida joint debtors. [56]

[8] We conclude, however, that state law is irrelevant to the application of § 522(m) to § 522(p). The § 522 cap is purely a federal concept. Moreover, because Oklahoma protects every dollar of the value of a debtor's homestead, there is no reason why an Oklahoma legislature or court would ever address whether married couples could "stack" or double the *value* of their homestead exemption. Two times infinity is still infinity. Moreover, we cannot conceive of any reason why joint debtors in different states should be subject to different federal caps, *i.e.,* why Florida joint debtors possessing an otherwise unlimited homestead exemption should be entitled to exempt $273,750 of the value of their homestead in bankruptcy, but Oklahoma joint debtors also possessing an otherwise unlimited exemption would be entitled to exempt and retain only $136,875 of the value of their home.

For these reasons, we conclude that state law does not govern whether the § 522(p) cap is doubled by virtue of § 522(m). Because the potential diminution of an Oklahoma debtor's unlimited homestead exemption for bankruptcy purposes is imposed by federal law and not by Oklahoma law, whether the § 522(p) cap should be doubled for joint debtors is a question of federal law. Therefore, we conclude that the Oklahoma Supreme Court's decision in the *Arnold* case—that a married couple cannot claim two homesteads—has no bearing on whether the § 522(p) ceiling on the value that may be claimed as exempt homestead in bankruptcy should be doubled in cases involving joint debtors.

Because § 522(m) provides that § 522 "shall apply separately with respect to each debtor in a joint case," [57] § 522(p) is modified by § 522(m), and the § 522(p) exemption cap is doubled in a joint case. Therefore, the ceiling applicable to the value of the Nestlens' homestead exemption, if applicable at all, is $273,750.

C. *The equity Dykstra contends the Nestlens acquired in the Lookback Period does not exceed the § 522(p) cap.*

Even if we assume (without deciding) that the phrase "interest that was acquired by the debtor" in § 522(p) refers in this case to the net increase in equity in the Homestead resulting from paying off the 2002 Mortgage and adding the Improvements during the Lookback Period, [58] and even if we accept the calculation of net equity during the Lookback Period exactly as set forth in Dykstra's appellate brief, ***144** we conclude that the Nestlens' exemption is not limited by § 522(p).

From the stipulated facts, Dykstra calculates the "aggregated 'amount' of 'interest,' *i.e.,* net equity, added by the Nestlens to their homestead in the 1,215–day lookback period [as] $232,532.66 (net principal payments of $136,423 [59] plus home improvements of $96,109.66 [60])." [61] Dykstra contends that this net equity figure exceeds the § 522(p) cap of $136,875 by $95,657.66, and therefore we should allow the Nestlens' homestead exemption in the amount of $136,875 and disallow it in the amount of $95,657.66. [62]

Because the Nestlens are joint debtors, however, their § 522(p) cap is $273,750, and the net equity of $232,532.66 that was arguably acquired by the Nestlens during the Lookback Period does not exceed the § 522(p) cap. Accordingly, even after giving complete credit to Dykstra's "equity" interpretation of § 522(p) and its calculation of net equity, the value of the Nestlens' homestead exemption is still not limited by § 522(p).

V. CONCLUSION

The bankruptcy court's order declaring the Nestlens' Homestead fully exempt is AFFIRMED.

All Citations

441 B.R. 135, Bankr. L. Rep. P 81,915

Footnotes

* The parties did not request oral argument, and after examining the briefs and appellate record, the Court has determined unanimously that oral argument would not materially assist in the determination of this appeal. *See* Fed. R. Bankr.P. 8012. The case is therefore ordered submitted without oral argument.

1 *Order Granting Debtors' Claim of Homestead Exemption, in* Appellant's Appendix ("App.") at 77–78.

2 *Stipulations of Fact Between Debtors and Creditor, Dykstra Exterior, Inc. Regarding Objection to Debtors' Homestead Exemption ("Stipulation")* at 3, ¶ 8, *in* App. at 54.

3 *Id. at 3,* ¶ 9 *in* App. at 54.

4 *Dykstra Exterior, Inc.'s Objection to Debtors' Homestead Exemption and Brief in Support, in* App. at 12–25.

5 *Stipulation, in* App. at 52–54.

6 *Debtors' Response to Dykstra Exterior, Inc.'s Objection to Debtors' Claim of Homestead Exemption ("Nestlens' Response Brief"), in* App. at 26–41; *Dykstra Exterior, Inc.'s Reply Brief in Support of Objection to Debtors' Homestead Exemption* ("Dykstra's Reply Brief"), *in* App. at 42–51.

7 *Transcript of Proceedings conducted on April 27, 2010* (*"Transcript"*), *in* App. at 57–76.

8 Unless otherwise stated, all statutory references in the text refer to the Bankruptcy Code, Title 11 of the United States Code.

9 *Order Granting Debtors' Claim of Homestead Exemption, in* App. at 77–78.

10 *Stipulation* at 1, ¶ 2, *in* App. at 52.

11 *Id.*

12 *Id.* at 2, ¶ 4, *in* App. at 53.

13 *Id.* at 1, ¶ 3, *in* App. at 52.

14 *Id.*

15 *Id.* at 2, ¶ 5, *in* App. at 53.

16 *Id.* at 2, ¶ 6, *in* App. at 53. Mr. Nestlen sold a business in 2007 which generated the funds used to retire the 2002 Mortgage and pay for the Improvements. *Id.* at 2, ¶ 5, *in* App. at 53.

17 *Id.* at 2, ¶ 7, *in* App. at 53. The Nestlens did not pay Dykstra the Attorney Fee Award and that claim remained unpaid on the Petition Date.

18 *Id.*

19 11 U.S.C. § 522(p)(1); *see also* 11 U.S.C. § 104(b) (requiring the Judicial Conference of the United States to publish the applicable dollar amounts in the *Federal Register* at three year intervals) and *Revision of Certain Dollar Amounts in the Bankruptcy Code Prescribed Under Section 104(b) of the Code,* 72 Fed. Reg. 7802–01 (Feb. 7, 2007).

20 These two interpretations have been denominated the "title view" and the "equity view." *See, e.g., See In re Greene,* 583 F.3d 614, 623 n. 8 (9th Cir.2009) (concluding that the word "acquire" in § 522(p) means "gaining possession or control by purchasing or gaining an *ownership interest,* either legal or equitable," and therefore § 522(p) applies only if the debtor acquired *title* during the relevant period) (emphasis added) (internal quotation marks omitted); *Parks v. Anderson,* 406 B.R. 79, 95 (D.Kan.2009) (equity (*i.e.,* value in excess of secured debt) accrued in the homestead during the 1,215–day period constituted an "interest ... acquired by a debtor"), *rev'g In re Anderson,* 374 B.R. 848 (Bankr.D.Kan.2007) (which adopted the "title view").

The Fifth Circuit has been presented with the § 522(p) "title versus equity" issue twice. In both instances, the bankruptcy court and the district court adopted conflicting theories, but the Fifth Circuit was able to resolve the appeals without deciding the conflict. *See In re Rogers,* 513 F.3d 212 (5th Cir.2008) (bankruptcy court below adopted "title view" while district court adopted "equity view"); *In re Fehmel,* 372 Fed.Appx. 507 (5th Cir.2010) (same).

A recent law review article analyzes a collection of additional lower court cases that have addressed the "interest acquired" language of § 522(p). *See* Gloria J. Liddell and Pearson Liddell, Jr., *So He Huffed and He Puffed ... But Will the Home(stead) Fall Down: The Applicability of Section 522(p)(1) of the United States Bankruptcy Code to Varying Interest Accumulations of the Debtor in Homestead Property,* 57 Drake L. Rev. 729 (2009).

21 *See Objection* at 2–4, *in* App. at 13–15; *Dykstra's Reply Brief* at 4, *in* App. at 45; *Transcript* at 4–12, *in* App. at 60–68.

22 *Nestlens' Response Brief* at 8–12, *in* App. at 33–37; *Transcript* at 13–16, *in* App. at 69–72.

23 *Nestlens' Response Brief* at 13–15, *in* App. at 38–40; *Transcript* at 16–17, *in* App. at 72–73.

24 *Nestlens' Response Brief* at 14, *in* App. at 39.

25 *Transcript* at 19, *in* App. at 75.

26 28 U.S.C. § 158(a)(1), (b)(1), and (c)(1); Fed. R. Bankr.P. 8002; 10th Cir. BAP L.R. 8001–3.

27 *Quackenbush v. Allstate Ins. Co.,* 517 U.S. 706, 712, 116 S.Ct. 1712, 135 L.Ed.2d 1 (1996) (quoting *Catlin v. United States,* 324 U.S. 229, 233, 65 S.Ct. 631, 89 L.Ed. 911 (1945)).

28 *See In re Brayshaw,* 912 F.2d 1255, 1256 (10th Cir.1990) ("[g]rant or denial of a claimed exemption is a final appealable order from a bankruptcy proceeding"); *In re Carlson,* 303 B.R. 478, 480 (10th Cir. BAP 2004).

29 *See In re Padgett,* 408 B.R. 374, 377 (10th Cir. BAP 2009).

30 11 U.S.C. § 522(m).

31 Because the application of § 522(m) resolves this appeal regardless of whether Congress intended "interest that was acquired" to mean title or equity, we need not weigh in on the title versus equity debate.

32 *Transcript* at 18, *ll.* 10–11, *in* App. at 74.

33 A prevailing party generally is not aggrieved, and thus lacks standing to appeal. *See, e.g., In re Turner,* 156 F.3d 713, 716–17 (7th Cir.1998). Further, in most instances, a cross-appeal of a particular issue decided against the prevailing party is "not necessary or appropriate," and cross-appeals are disfavored because they increase the complexity and cost of an appeal. *Leprino Foods Co. v. Factory Mut. Ins. Co.,* 453 F.3d 1281, 1290 (10th Cir.2006) (cross-appellant was ordered to bear the costs of the unnecessary cross-appeal). *See also Moss v. Kopp,* 559 F.3d 1155, 1161 n. 6 (10th Cir.2009) ("appellee may, without taking a cross-appeal, urge in support of a decree any matter appearing in the record, although his argument may involve an attack upon the reasoning of the lower court or an insistence upon a matter overlooked or ignored by it") (quoting *United States v. Am. Ry. Express Co.,* 265 U.S. 425, 435, 44 S.Ct. 560, 68 L.Ed. 1087 (1924)).

34 The Tenth Circuit allows appellees to "rest on their briefs filed with the district court." *McLamore v. Thornburgh,* 944 F.2d 911, 1991 WL 180155, at *1 n. 2 (10th Cir.1991).

35 *See Nestlens' Response Brief* at 13–15, *in* App. at 38–40; *Transcript* at 16–17, *in* App. at 72–73.

36 *Griess v. Colo.,* 841 F.2d 1042, 1047 (10th Cir.1988) (internal quotation marks omitted).

37 *Hertz v. Luzenac Am., Inc.,* 370 F.3d 1014, 1017 (10th Cir.2004) (quoting *Abuan v. Level 3 Commc'ns,* 353 F.3d 1158, 1171 n. 3 (10th Cir.2003)). *See also Reynolds v. United States,* 643 F.2d 707, 710 (10th Cir.1981) ("we are reminded of our well established appellate maxim that if a trial court's decision is correct upon any proper theory, we will uphold that decision") (quoting *Pound v. Ins. Co. of N. Am.,* 439 F.2d 1059, 1062 (10th Cir.1971)).

38 *Ctr. for Native Ecosystems v. Cables,* 509 F.3d 1310, 1324 (10th Cir.2007) (citation omitted).

39 *Id.* (quoting *Anixter v. Home–Stake Prod.,* 77 F.3d 1215, 1228 (10th Cir.1996)).

40 *See, e.g., Griffith v. Colo.,* 17 F.3d 1323, 1328–29 (10th Cir.1994) (judgment affirmed based on rule established in a Supreme Court case that neither party cited or argued in their appellate briefs).

41 *Dykstra's Reply Brief* at 5–6, *in* App. at 46–47; *Transcript* at 17–18, *in* App. at 73–74.

42 *Cables,* 509 F.3d at 1324 (citation omitted).

43 11 U.S.C. § 522(m).

44 11 U.S.C. § 522(b).

45 Okla. Stat. tit. 31, § 1(B).

46 Okla. Const. art. XII, § 1–3; Okla. Stat. tit. 31, §§ 1(A)(1) and 2.

47 73 P.3d 861 (Okla.2003).

48 *Id.* at 862.

49 *Id.* at 862–63.

50 *Id.* at 864 (citing 829 F.2d 1002 (10th Cir.1987)).

51 Okla. Const. art. XII, § 1–3.

52 Okla. Stat. tit. 31, §§ 1(A)(1) and 2.

53 *See, e.g.,* Okla. Stat. tit. 31, § 1(A)(1) (home is exempt from attachment, execution and forced sale). A limitation on the value of the urban homestead exemption arises *only* if more than 25% of the total square footage of the improvements on the claimed homestead is used for business purposes, in which case the exemption is limited to $5,000. *See* Okla. Stat. tit. 31, § 2(C).

54 11 U.S.C. § 522(p)(1).

55 349 B.R. 747, 754–55 (Bankr.M.D.Fla.2006).

56 *See, e.g., Miller v. Burns (In re Burns),* 395 B.R. 756, 765 (Bankr.M.D.Fla.2008); *In re Limperis,* 370 B.R. 859, 860 (Bankr.S.D.Fla.2007).

57 11 U.S.C. § 522(m).

58 As stated above, if the bankruptcy court was correct in adopting the "title view" of § 522(p), then the § 522(p) cap is not applicable at all because the Nestlens acquired title to their homestead outside the Lookback Period that triggers the cap.

59 Dykstra calculated "net principal payments" by subtracting the home equity loan balance of $32,921 from the $169,344 of mortgage principal payments made during the Lookback Period. *Brief of Appellant, Dykstra Exterior, Inc.* at 20.

60 *Id.* at 21. Dykstra extrapolated the increase in equity attributable to the $80,000 to $100,000 in Improvements from the original purchase price, the amount of the original mortgage, the cost of the improvements made by Dykstra, the cost of other improvements, and the Nestlens' valuation of the property.

61 *Id.* at 23.

62 *Id.*

End of Document

Entered on Docket July 6, 2022

Below is a Memorandum Decision of the Court.

Mary Jo Heston
U.S. Bankruptcy Judge

(Dated as of Entered on Docket date above)

UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT OF WASHINGTON AT TACOMA

In re:

LESTER STEVEN DAVIS, and

KATHERINE LYNNE DAVIS,

Debtors.

Case No. 22-40279-MJH

MEMORANDUM DECISION ON TRUSTEE'S OBJECTIONS TO HOMESTEAD EXEMPTION AND DEBTORS' MOTION TO COMPEL ABANDONMENT (ECF NOS. 11 & 14)

This matter came before the Court on June 23, 2022, on Chapter 7 trustee, Brian Budsberg's ("Trustee"), objections to Lester Steven Davis and Katherine Lynne Davis's ("Debtors") homestead exemption and the Debtors' motion to compel the Trustee to abandon real property located at 18932 131st Street Court East, Bonney Lake, Washington ("Real Property"). The Court having considered the arguments of counsel and pleadings in the record hereby makes the following findings of fact and conclusions of law.

I. PROCEDURAL BACKGROUND AND UNDISPUTED FACTS

The facts supporting this decision are undisputed. On November 23, 2020, the Debtors acquired the Real Property as community property. On March 10, 2022, the Debtors filed their Chapter 7 case. The Debtors valued the Real Property in their original bankruptcy schedules at $584,535.50 and originally claimed a homestead exemption in the Real Property pursuant to RCW 6.13.030 in the amount of $170,350. Schedule C, ECF No. 1. The Debtors listed a

deed of trust against the Real Property in favor of Pennymac Loan Services, LLC in the amount of $447,279.00. Schedule D, ECF No. 1.

On April 12, 2022, the Trustee conducted the Debtors' meeting of creditors pursuant to 11 U.S.C. § 341.[1] On May 6, 2022, the Trustee objected to the claimed homestead exemption, arguing that the Debtors acquired the Real Property within 1,215 days of filing the petition and therefore their exemption is capped at $170,350 pursuant to § 522(p)(1). ECF No. 11. On May 12, 2022, the Debtors amended their Schedule C to claim a homestead exemption of $340,700 pursuant to the application of § 522(m) on the exemption cap of § 522(p)(1). Amended Schedule C, ECF No. 13. On May 16, 2022, the Debtors filed a motion to compel the Trustee to abandon the Real Property pursuant to § 554(b). The Debtors argued that the Real Property is of inconsequential value to the estate because the equity does not exceed the § 522(p)(1) cap as the cap is doubled for joint debtors pursuant to § 522(m). Additionally, the Debtors contend that nearly all the increase in value is due to market appreciation, which the Debtors argue is excluded from the cap. The Trustee opposed the motion, arguing that the Real Property has value to the estate because the Debtors' equity likely exceeds $170,350 and § 522(m) does not allow joint debtors to double the $170,350 cap imposed by § 522(p)(1).

At the hearing held on June 6, 2022, the Trustee conceded that if the Court determined that each Debtor is entitled to claim the cap of $170,350 pursuant to § 522(m), the Real Property is of inconsequential value to the estate and he would stipulate to the abandonment of the Real Property. Based on this representation, the Court continued the hearing to permit the parties to brief the dispositive legal issue of whether § 522(m) allows joint debtors to double the exemption cap imposed by § 522(p) when claiming a homestead exemption up to the amount allowed under RCW 6.13.030.[2]

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[1] Unless otherwise indicated, all chapter, section and rule references are to the Federal Bankruptcy Code, 11 U.S.C. §§ 101–1532, and to the Federal Rules of Bankruptcy Procedure, Rules 1001–9037.

[2] In Washington, the allowed homestead exemption is based upon the median sale price of a single-family home in the preceding calendar year. For Pierce County, where the Real Property is located, the relevant homestead value at the time of filing is $508,300. A single Washington homestead is available where the parties are married or in a state registered domestic partnership. Here, the Debtors are married and therefore

II. DISCUSSION

In relevant part, § 522(p) provides:

> [A]s 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 interest that was acquired by *the debtor* during the 1215-day period preceding the date of filing the petition that exceeds in the aggregate $170,350[3] in value in–
>
> (A) real or personal property that the debtor or a dependent of the debtor uses as a residence.

§ 522(p) (emphasis added).

Section 522(m) provides: "[s]ubject to the limitation in subsection (b), this section shall apply separately with respect to each debtor in a joint case." The parties do not dispute that the Real Property was acquired within 1,215 days before the filing of the petition and that accordingly, the cap imposed by § 522(p)(1) applies. Their disagreement instead lies in whether the $170,350 cap should apply to each debtor up to the amount allowed under the state homestead exemption statute.

The Trustee argues that § 522(m) does not allow the Debtors to double the § 522(p)(1) exemption cap because § 522(m) is limited by RCW 6.13.020, which does not allow joint debtors to double their homestead exemption. The Trustee reasons that § 522(m) is subject to "the limitation in subsection (b)." Further, "the limitation in subsection (b)" refers to § 522(b)(2), which states ". . . unless the State law that is applicable to the debtor under paragraph (3)(A) specifically does not so authorize."

The Debtors argue that the language of § 522(m) is clear and entitles joint debtors to double the § 522(p)(1) cap and that "the limitation in subsection (b)" refers to subsection (b)(1), which prohibits the stacking of the federal and state homestead exemptions. The Debtors reason that the limitation refers to subsection (b)(1) because subsection (b)(2) relates to whether a state can opt out of the federal exemptions. The Debtors further argue that § 522(m)

Washington law allows the Debtors to claim a single homestead exemption on the Real Property, not to exceed $508,300.

[3] The amount of the cap is subject to automatic adjustments under § 104.

does not double the state homestead amount or create two state homestead exemptions, instead it doubles the federal limitation on what could otherwise be claimed under state law. To support their argument, the Debtors cite *In re Nestlen*, 441 B.R. 135 (10th Cir. BAP 2010).

In *Nestlen*, joint debtors claimed a homestead exemption under Oklahoma state law. *Id.* at 137. The real property at issue was subject to the exemption cap imposed under § 522(p)(1) and the debtors sought to double the exemption cap pursuant to § 522(m). *Id.* at 142. A creditor objected to the debtors' claimed exemption, arguing that under Oklahoma law, a married couple may claim only one homestead and therefore Oklahoma joint debtors are not entitled to double the § 522(p) cap. *Id.* The Bankruptcy Appellate Panel for the Tenth Circuit held that pursuant to § 522(m), the Oklahoma joint debtors were entitled to double the § 522(p)(1) exemption cap. *Id.* at 142–43.

The Panel reasoned that § 522(p) is a federal limitation on a state law right that applies separately to each debtor under subsection (m). The Panel concluded that although the debtors could only claim one exemption under Oklahoma law, "the § 522 cap is purely a federal concept" and therefore, "whether the § 522(p) cap should be doubled for joint debtors is a question of federal law." *Id.* at 143. Accordingly, the Panel further concluded that "state law is irrelevant to the application of § 522(m) to § 522(p)," reasoning that if state law governed whether the § 522(p) exemption cap could be doubled, the federal cap would apply differently to debtors in different states. The Panel stated that it "cannot conceive of any reason why joint debtors in different states should be subject to different federal caps." *Id.*

The Trustee tries to distinguish *Nestlen*, noting that unlike Oklahoma, Washington does not have an unlimited homestead exemption or allow joint debtors to each claim separate homestead exemptions. For the reasons set forth below, the Trustee's reading of § 522(m) is incorrect.

In interpreting the meaning of a statute, a court must start "with the language of the statute itself." *United States v. Ron Pair Enters., Inc.*, 489 U.S. 235 (1989). If the language is clear,

the court's inquiry ends, and the court will enforce the statute according to its terms. *See id.* at 241.

Section 522(m) provides that § 522 "*shall* apply separately with respect to each debtor in a joint case" subject only to any limitation provided in § 522(b). § 522(m) (emphasis added). Section 522(b)(1) allows debtors to elect to exempt property in accordance with either state or federal law provided that debtors in joint cases must make the same election. Section 522(b)(2) allows states to "opt out" of the federal exemption scheme, thereby requiring their residents to exempt property under state law. Washington is not an opt-out state. Section 522(b)(3) allows debtors to claim the state law exemptions of their domicile if certain criteria is met.

The language of § 522(m) is clear and requires the cap imposed by § 522(p) to be applied separately to joint debtors, effectively doubling the $170,350 cap when each debtor has an ownership interest.[4] The Court agrees with the Debtors that § 522(m)'s use of "the limitation in subsection (b)" refers to the requirement that joint debtors elect either federal or state exemptions, but not both. Nothing under the facts of this case violates this statute's mandate. The Court sees no reason to distinguish *Nestlen* and finds the reasoning of that case to be persuasive.[5] Both Washington and Oklahoma allow joint debtors to claim only one homestead

[4] If one of the joint debtors does not have an ownership interest, the debtor cannot double the available exemption under § 522(m). *See*, *In re Gorski*, 85 B.R. 371, 372–73 (Bankr. W.D. Pa. 1988) (where husband transferred his joint tenancy interest to wife and therefore no longer had an ownership interest in the property, debtors were not entitled to double the exemption under § 522(m)); *In re Cotton*, No. 21-40847-MJH, 2022 WL 198859 (Bankr. W.D. Wash. Jan. 21, 2022) (Section 522(m) did not allow joint debtors to double the exemption cap imposed by § 522(q)(1)(A) where wife transferred her entire interest to husband and therefore no longer had an ownership interest in the property).

[5] Courts in other jurisdictions have made similar holdings to the Court's holding in this case and have also followed similar reasonings as *Nestlen*. *See, e.g.*, *In re Gentile*, 483 B.R. 50 (Bankr. D. Mass. 2012) (holding that Massachusetts homestead exemption was capped by § 522(p)(1) but joint debtors may "stack" the capped exemption under § 522(m)); *In re Limperis*, 370 B.R. 859 (Bankr. S.D. Fla. 2007) (holding that where the homestead exemption was limited by § 522(p), joint debtors could double the limitation under § 522(m)); *In re Rasmussen*, 349 B.R. 747 (Bankr. M.D. Fla. 2006) (As a result of application of § 522(m) to § 522(p), each debtor in a joint case may claim the cap amount as exempt); *In re Rich*, No. 12-10357, 2013 WL 1628723 (Bankr. D. Kan. Apr. 16, 2013) (holding that § 522(m) allows joint debtors to stack the § 522(p) exemption cap limit).

exemption. Whether a state allows for a homestead exemption to be unlimited or up to a specific value is irrelevant to the legal issue before this Court.

Here, the Debtors own the Real Property as community property, thus, both Debtors have an ownership interest. The Debtors are not seeking to claim separate homestead exemptions, nor are they seeking to exempt more than what Washington law allows. Instead, the Debtors seek to claim a single exemption equaling the aggregate value of the caps imposed upon each Debtor pursuant to § 522(p)(1). Under the facts of this case, this "doubling" of the § 522(p) cap is allowed under § 522(m). While RCW 6.13.030 allows Debtors to claim a maximum homestead exemption of $508,300, § 522(p) creates a federal limitation on the value of the state exemption in bankruptcy. Subsection (m) applies that cap to each Debtor, meaning that each Debtor's share of the homestead is value-capped at $170,350. Accordingly, Debtors' aggregate homestead exemption is capped at $340,700 pursuant to § 522(p)(1).[6]

III. CONCLUSION

The Debtors acquired the Real Property within 1,215 days of filing their petition and the $170,350 exemption cap imposed by § 522(p)(1) applies. The Debtors filed a joint case and own the Real Property as community property. Section 522(m) entitles the Debtors to double the § 522(p)(1) exemption cap to $340,700. The Trustee concedes that an exemption cap of $340,700 leaves no value to which the Trustee or the unsecured creditors might stake a claim. Accordingly, the Trustee's objections to the Debtors' claim of exemption are overruled and the Debtors' motion to compel the Trustee to abandon the Real Property is granted.

/ / / End of Memorandum Decision / / /

[6] As Debtors' equity in the Real Property does not exceed the cap imposed by § 522(p)(1), the issue of whether the cap includes the increase in value due to market appreciation is moot. Accordingly, the Court need not reach this issue.

Both individuals and corporations in subchapter V of chapter 11 are barred from discharging debts that are nondischargeable under Section 523(a).

Corporate Debtors in Subchapter V Can't Discharge Nondischargeable Debts, Circuit Says

Debts that are nondischargeable as to *individuals* under Section 523(a) cannot be discharged by *corporate debtors* in Subchapter V of chapter 11, according to the Fourth Circuit.

Resolving what it called a "close" question, the Fourth Circuit believes that "fairness and equity" require making the debts nondischargeable since a small business debtor in Subchapter V has an easier road to confirmation given the absence of the absolute priority rule.

Corporations saddled with debts that would be nondischargeable under Section 523(a) must undergo the rigors of an "ordinary" chapter 11 case to discharge those debts, if the Fourth Circuit's opinion is accepted nationwide.

The Judgment for Willful and Malicious Injury

A creditor won a $4.7 million judgment in state court for tortious interference with contract. More specifically, the jury found that the debtor had stolen customer information from the creditor.

The debtor filed a small business petition under Subchapter V of chapter 11, intending to discharge the judgment under Section 1192. The plan would have paid the creditor about 3% of its claim over five years.

Asserting that the judgment was not dischargeable under Section 523(a)(6) as a "willful and malicious" injury to its property, the creditor filed a complaint seeking a declaration that the judgment would not be discharged under Section 1192(2).

Deciding that the debt was dischargeable, the bankruptcy court dismissed the complaint in what Circuit Judge Paul V. Niemeyer called a "nicely crafted opinion." The bankruptcy court authorized a direct appeal, which the Fourth Circuit accepted.

The 'Discordant' Statutes

The appeal called for an interpretation of two statutes which Judge Niemeyer called "a bit discordant — or perhaps more accurately, clumsy."

Applicable only in Subchapter V cases, Section 1192 discharges debts, "except any debt . . . (2) of the kind specified in section 523(a) of this title."

Section 523(a) provides that a "discharge under section . . . 1192 . . . does not discharge an individual debtor from any debt . . . (6) for willful and malicious injury by the debtor to another entity or to the property of another entity."

In his June 7 opinion, Judge Niemeyer relied on a "textual review" along with "practical and equitable considerations" in holding that the debt was nondischargeable in Subchapter V despite "a certain lack of clarity in the relationship between § 1192(2) and § 523(a)."

Textual Analysis and Policy

Before focusing on dischargeability, Judge Niemeyer said that one of the "main features" of Subchapter V is the elimination of the absolute priority rule that otherwise governs confirmation of chapter 11 plans. It enables "the owners of a Subchapter V debtor . . . to retain their equity in the bankruptcy estate despite creditors' objections," he said.

Turning to dischargeability and focusing on Section 1192(2) alone, Judge Niemeyer said it "provides for the discharge of debts for *both* individual and corporate debtors." [Emphasis in original.]

"Still," Judge Niemeyer said, the question remains "whether the exception to such discharges — based on § 1192(2)'s reference to § 523(a) — applies to both individuals and corporations or to only individuals."

To answer the question, Judge Niemeyer focused on Section 1192(2) because it "specifically" governs dischargeability in Subchapter V. He paraphrased the section by saying it excepts from discharge "'any *debt . . . of the kind* specified in section 523(a).'" [Emphasis in original]. To his way of thinking, the use of the word "debt" was "decisive, as it does not lend itself to encompass the 'kind' of *debtors* discussed in the language of § 523(a)." [Emphasis in original.]

Judge Niemeyer concluded that "the combination of the terms 'debt' and 'of the kind' indicates that Congress intended to reference only the *list of nondischargeable debts* found in § 523(a)." [Emphasis in original.] He said that use of the words "of the kind" was statutory "shorthand to avoid listing all 21 types of debts."

Judge Niemeyer held that "*the debtors* covered by the discharge language of § 1192(2) — *i.e.*, both individual and corporate debtors — remain subject to the 21 *kinds of debt* listed in § 523(a)." [Emphasis in original.] He was persuaded in part by the idea that the specific governs the general.

Having construed the statutory language alone, Judge Niemeyer looked at similar provisions in the Code. He said it would be difficult to reconcile Section 523(a) with Section 1141(d)(6).

Judge Niemeyer also referred to Section 1228(a) of chapter 12 and its language "that is virtually identical" to Section 1192(2). Section 1228(a), he said, has been interpreted by two bankruptcy courts to mean that exceptions to discharge apply to both individual and corporate debtors.

Judge Niemeyer ended his opinion by discussing "fairness and equity" and the ability of a chapter 12 debtor to confirm a cramdown plan without satisfying the absolute priority rule. He said that "Congress understandably applied limitations on the discharge of debts to provide an additional layer of fairness and equity to creditors to balance against the altered order of priority that favors the debtor."

Reversing and remanding, Judge Niemeyer said that a small business debtor "should not especially benefit from the discharge of debts incurred in circumstances of fraud, willful and malicious injury, and the other violations of public policy reflected in § 523(a)'s list of exceptions" when that debtor is immune from the absolute priority rule.

Questions

Congress decided to make virtually all debts dischargeable in chapter 11 because a finding of nondischargeability would injure the greater body of creditors. Similarly, Congress created Subchapter V because the rigors and expense of traditional chapter 11 was hurting creditors as well as the owners of small businesses.

Given the history and tradition of broad dischargeability in chapter 11, is the language in Section 1192 sufficiently clear to swim against the tide? Is the plain meaning of Section 523(a) overcome by the less than clear meaning of Section 1192(2)?

The opinion is *Cantwell-Cleary Co. v. Clearly Packaging LLC (In re Cleary Packaging LLC)*, 21-1981 (4th Cir. June 7, 2022).

36 F.4th 509
United States Court of Appeals, Fourth Circuit.

IN RE: CLEARY PACKAGING, LLC, Debtor.
Cantwell-Cleary Co., Inc., Plaintiff - Appellant,
v.
Cleary Packaging, LLC, Defendant - Appellee.
Public Justice Center; Legal Aid Justice Center; Mountain State Justice; North Carolina Justice Center; Casa; Centro de los Derechos del Migrante; National Black Worker Center; National Employment Law Project; Farm Labor Organizing Committee, AFL-CIO; United States of America, Amici Supporting Appellant.

No. 21-1981
|
Argued: March 10, 2022
|
Decided: June 7, 2022

Synopsis

Background: Judgment creditor filed adversary complaint against debtor, a limited liability company (LLC) that had elected to proceed under Subchapter V of Chapter 11 as a "small business debtor," seeking declaration that $4.7 million debt arising from its state-court judgment for intentional interference with contracts and tortious interference with business relations was nondischargeable as a debt for "willful and malicious injury." Debtor moved to dismiss for failure to state a claim. The United States Bankruptcy Court for the District of Maryland, Michelle M. Harner, J., 630 B.R. 466, granted motion. Judgment creditor appealed, and its appeal was certified for direct appeal to the Fourth Circuit.

[Holding:] Addressing a matter of apparent first impression for the court, the Court of Appeals, Niemeyer, Circuit Judge, held that the discharge exceptions in Subchapter V of Chapter 11 apply to both individual debtors and corporate debtors.

Reversed and remanded with instructions.

West Headnotes (16)

[1]	**Bankruptcy**Construction and Operation
	A limited liability company (LLC) is a "corporation" within the meaning of the Bankruptcy Code. 11 U.S.C.A. § 101(9)(A).

[2]	**Bankruptcy**Debts and Liabilities Discharged

	Section of the Bankruptcy Code setting forth the general exceptions to discharge applies to a range of Code discharge provisions and provides that discharges in those specified provisions do not discharge an "individual debtor" from a list of 21 types of debt. 11 U.S.C.A. § 523(a).

[3]	**Bankruptcy**Effect as discharge
	Section of Bankruptcy Code governing Subchapter V discharge applies to individual and corporate debtors alike, Code provides for court to grant Subchapter V debtor a discharge of all debts except "any debt" "of the kind specified in" section of Code setting forth the general exceptions to discharge, and although introductory language in that general provision limits its discharge exceptions to "individual" debtors, implying that corporations are not subject to the discharge exceptions, combination of terms "debt" and "of the kind" in Subchapter V discharge provision indicates that Congress intended to reference only the list of nondischargeable debts found in Code's general exception-to-discharge provision, not the class of debtors addressed therein, and to the extent there is tension between the two provisions, Subchapter V provision, as the more specific, governs. 11 U.S.C.A. §§ 101(41), 523(a), 1182(1), 1192(2).

[4]	**Bankruptcy**Fairness and Equity; "Cram Down."
	In a traditional Chapter 11 proceeding, debtor submits and the court approves a plan of reorganization for distribution of debtor's estate; if creditors withhold their consent, any such plan must be fair and equitable in that it must comply with priority rules that establish a hierarchy of creditor classes for the order in which each class of creditor is to be paid.

[5]	**Bankruptcy**Preservation of priority

	Pursuant to the absolute priority rule, under any Chapter 11 plan to which creditors have not consented, higher priority creditors are to be paid in full before payment is made to lower priority creditors. 11 U.S.C.A. § 1129(b)(2)(B)(ii).

[6]	**Bankruptcy**Preservation of priority
	As a general matter, any non-consensual Chapter 11 plan violating the absolute priority rule may not be approved, nor may a discharge of debts be granted. 11 U.S.C.A. § 1129(b)(2)(B)(ii).

[7]	**Bankruptcy**In general; nature and purpose
	Congress enacted Subchapter V of Chapter 11 in the Small Business Reorganization Act of 2019 in order to streamline reorganizations for small business debtors. Pub. L. No. 116-54, 133 Stat. 1079.

[8]	**Bankruptcy**Feasibility in general
	One of the main features of a proceeding under Subchapter V of Chapter 11 is its authorization of plans that are not consented to by creditors and that depart from the Bankruptcy Code's absolute priority rule; instead, under the governing rules of a Subchapter V proceeding, the bankruptcy court need only find that such a plan provide that all of the debtor's projected disposable income is paid to creditors for a three-to-five-year period and that it be feasible, thus enabling the owners of a Subchapter V debtor to retain their equity in the bankruptcy estate despite creditors' objections. 11 U.S.C.A. §§ 1129(b), 1191(c)(2)(A) and (3).

[9]	**Bankruptcy**Effect as discharge

	Under the specific rules for discharge provided in Subchapter V of Chapter 11, a court is required to grant discharge of all debts after approval of the plan except (1) any debt payable after the three-to-five-year period specified for payment, and (2) any debt "of the kind specified in" the section of the Bankruptcy Code setting forth the general exceptions to discharge. 11 U.S.C.A. §§ 523(a), 1192.

[10]	**Bankruptcy**Effect as discharge
	Subchapter V of Chapter 11 of the Bankruptcy Code provides for the discharge of debts for both individual and corporate debtors. 11 U.S.C.A. § 1192(2).

[11]	**Statutes**General and specific terms and provisions; ejusdem generis
	To the extent that tension exists between two statutory provisions, the more specific provision should govern over the more general.

[12]	**Bankruptcy**Discharge
	In establishing the different Bankruptcy Code chapters, Congress conscientiously defined and distinguished the kinds of debtors covered by each provision; for example, Chapter 7 discharges are explicitly limited to individuals, as are Chapter 13 discharges. 11 U.S.C.A. §§ 109(e), 727(a)(1), 1328.

[13]	**Bankruptcy**Effect as discharge

	With respect to traditional Chapter 11 proceedings, Congress explicitly distinguished the discharges of individual debtors from the discharges of corporate debtors, excluding a different array of debts from discharge for each. 11 U.S.C.A. § 1141(d).

[14]	**Bankruptcy**Farmers
	Under the Bankruptcy Code, Chapter 12 proceedings are limited to family farmers and family fishermen, whether they be individuals or corporations. 11 U.S.C.A. §§ 101(18), 101(19A).

[15]	**Bankruptcy**In general; nature and purpose
	Congress enacted Subchapter V of the Bankruptcy Code with the primary goal of simplifying Chapter 11 reorganizations for small businesses and reducing the administrative costs for those businesses. Pub. L. No. 116-54, 133 Stat. 1079.

[16]	**Bankruptcy**Preservation of priority **Bankruptcy**Fairness and Equity; "Cram Down."
	Subchapter V proceeding involves a non-consensual plan, that is, a "cram-down" proceeding, in which stakeholders in the bankruptcy estate are treated differently than they would be in traditional Chapter 11 proceedings under the absolute priority rule. 11 U.S.C.A. §§ 1129(b), 1191(c).

***511** Appeal from the United States Bankruptcy Court for the District of Maryland, at Baltimore. Michelle W. Harner, Bankruptcy Judge. (21-10765; 21-00056)

Attorneys and Law Firms

ARGUED: Justin Philip Fasano, MCNAMEE HOSEA, P.A., Greenbelt, Maryland, for Appellant. Robert Joel Branman, UNITED STATES DEPARTMENT OF JUSTICE, Washington, D.C., for Amicus United States. Paul Sweeney, YUMKAS,

VIDMAR, SWEENEY & MULRENIN, LLC, Columbia, Maryland, for Appellee. ON BRIEF: Steven L. Goldberg, MCNAMEE HOSEA, P.A., Greenbelt, Maryland, for Appellant. James R. Schraf, YUMKAS, VIDMAR, SWEENEY & MULRENIN, LLC, Columbia, Maryland, for Appellee. Michael R. Abrams, Murnaghan Appellate Advocacy Fellow, PUBLIC JUSTICE CENTER, Baltimore, Maryland, for Amici The Public Justice Center; The Legal Aid Justice Center; Mountain State Justice; The North Carolina Justice Center; CASA; Centro de los Derechos del Migrante; The Farm Labor Organizing Committee, AFL-CIO; The National Black Worker Center; and The National Employment Law Project. David A. Hubbert, Deputy Assistant Attorney General, Joan I. Oppenheimer, Tax Division, UNITED STATES DEPARTMENT OF JUSTICE, Washington, D.C.; Erek L. Barron, United States Attorney, OFFICE OF THE UNITED STATES ATTORNEY, Baltimore, Maryland, for Amicus United States.

Before NIEMEYER, MOTZ, and KING, Circuit Judges.

Opinion

Reversed and remanded with instructions by published opinion. Judge Niemeyer wrote the opinion, in which Judge Motz and Judge King joined.

NIEMEYER, Circuit Judge:

[1]When Cleary Packaging, LLC, filed a petition in bankruptcy under Subchapter V of Chapter 11 as a "small business debtor," seeking to discharge a $4.7 million judgment that Cantwell-Cleary Co., Inc. had obtained against it for intentional interference with contracts and tortious interference with business relations, Cantwell-Cleary opposed the effort. It argued that 11 U.S.C. § 1192(2), which falls within Subchapter V, provides that small business ***512** debtors are not entitled to discharge "any debt ... of the kind specified in section 523(a) of this title," *id.* § 1192(2), and that § 523(a) in turn lists 21 categories of debt that are non-dischargeable, including debts "for willful and malicious injury by the debtor to another entity or to the property of another entity," *id.* § 523(a)(6). Cleary Packaging argued, however, that because § 523(a)'s list of exceptions to dischargeability is applicable only to "individual debtor[s]," its $4.7 million debt as the debt of a corporation was not covered by the exception contained in § 1192(2) and therefore was indeed dischargeable.[1] Cantwell-Cleary responded that because the language of § 1192(2) incorporates *only the list* of debts — debts "*of the kind* specified in section 523(a)" — and *not the class of debtors* addressed by § 523(a), the $4.7 million debt is non-dischargeable as a debt for willful and malicious injury.

The bankruptcy court, in a nicely crafted opinion, agreed with Cleary Packaging and concluded that its $4.7 million debt was indeed dischargeable, reasoning that the exceptions to dischargeability that were incorporated into § 1192(2) from § 523(a) applied only to *individual* debtors. The court relied heavily on the reasoning of *Gaske v. Satellite Restaurants Inc. Crabcake Factory USA (In re Satellite Restaurants Inc. Crabcake Factory USA)*, 626 B.R. 871 (Bankr. D. Md. 2021), which was dismissed on appeal. While the question is a close one, we nonetheless disagree with the bankruptcy court, as explained herein. Accordingly, we reverse the court's ruling and remand.

I

Cantwell-Cleary is a Maryland corporation engaged as a wholesaler of office-related products, particularly packaging supplies, janitorial and sanitation supplies, and paper products. Vincent Cleary Jr., who was on the board of directors of Cantwell-Cleary and its former president and CEO, left the company in June 2018 following a long-running family dispute involving divorce proceedings and internal disagreements over control of the company. He thereafter formed Cleary Packaging, LLC. He took with him numerous employees covered by noncompetition agreements and sensitive customer information and began the new business in competition with Cantwell-Cleary. Shortly thereafter, Cantwell-Cleary commenced an action in the Circuit Court for Anne Arundel County, Maryland, for intentional interference with contracts, tortious interference with business relations, and related claims. On the jury's verdict in favor of Cantwell-Cleary, the state court entered judgment in January 2021 against Cleary Packaging and Vincent Cleary Jr. in the aggregate amount of $4,715,764.98.

Cleary Packaging thereafter filed a petition under Chapter 11 of the Bankruptcy Code, electing to proceed under Subchapter V as a small business enterprise. In its plan for reorganization, it proposed to pay Cantwell-Cleary 2.98 percent of its

judgment in biannual installments over a period of five years, for a total of $140,489.77. If the plan were to be approved, the remainder of Cleary Packaging's debt to Cantwell-Cleary would be discharged.

Cantwell-Cleary filed a complaint in the bankruptcy court, seeking a declaratory judgment that the $4.7 million judgment is not dischargeable under ***513** 11 U.S.C. §§ 1192(2) and 523(a). It also sought, by motion for summary judgment, a judgment giving preclusive effect in the bankruptcy court to its state judgment. On Cleary Packaging's motion, the bankruptcy court dismissed Cantwell-Cleary's declaratory judgment action, finding that the discharge exceptions in § 1192(2) and § 523(a) do not apply to *corporate* debtors because of limiting language in § 523(a). Specifically, it held that the § 523(a) list of exceptions to dischargeability applies only to *individual* debtors. Because Cleary Packaging was not an individual, but rather a corporation (in this case, a limited liability company), its debt was therefore not excepted from discharge under § 523(a). Consequently, the court also dismissed Cantwell-Cleary's motion for summary judgment as moot.

On Cantwell-Cleary's motion, the bankruptcy court certified a direct appeal to this court of its "Section 523 Opinion and Order," pursuant to 28 U.S.C. § 158(d)(2)(A)(i), and we authorized the appeal by order dated September 8, 2021. The sole question on appeal, therefore, is whether Cleary Packaging, as a Subchapter V corporate debtor, can discharge its $4.7 million debt to Cantwell-Cleary "for willful and malicious injury."

II

[2]In filing its Chapter 11 petition, Cleary Packaging elected to proceed under Subchapter V, and accordingly its discharge of debts is specifically governed by 11 U.S.C. § 1192(2). That section provides: "If the plan of the debtor is confirmed ... the court shall grant the debtor a discharge of all debts ... except any debt ... of the kind specified in section 523(a) of this title." Section 523(a), which applies to a range of bankruptcy code discharge provisions, including § 1192, provides that discharges in those specified sections "do[ ] not discharge an *individual debtor* from" a list of 21 types of debt, including a debt "for willful and malicious injury," *implying* that such exceptions do not apply to corporate debtors. 11 U.S.C. § 523(a) (emphasis added).

The parties do not dispute that Cleary Packaging's $4.7 million debt created by entry of the state judgment was "for willful and malicious injury" and therefore would qualify as the type of debt that § 523(a) makes non-dischargeable. *See* 11 U.S.C. § 523(a)(6). Rather, the dispute centers on conflicting interpretations of the two relevant provisions — § 1192(2) and § 523(a) — relating to the *kind of debtor* subject to the discharge exceptions listed in § 523(a). Cleary Packaging, focusing on § 523(a), argues that it limits § 1192(2) discharges with respect to the 21 categories of debt only as to *individual debtors*, and therefore corporate debts of the kind listed remain dischargeable. Cantwell-Cleary, on the other hand, focuses on § 1192(2), which applies to both individual and corporate debtors, and argues that the section excludes from discharge *debts of the kind* listed in § 523(a), regardless of the *class of debtor*, whether individual or corporate. Because § 1192(2) is the specific provision governing discharges in Subchapter V proceedings, Cantwell-Cleary argues that if there is any inconsistency, we should give § 1192(2) precedence over the more general § 523(a) and thereby except Cleary Packaging's $4.7 million debt from a discharge, as it is a type of debt listed in § 523(a).

[3]While we recognize a certain lack of clarity in the relationship between § 1192(2) and § 523(a), we conclude, based on our textual review, the provisions' context in the Bankruptcy Code, and practical and equitable considerations, that Cantwell-Cleary makes the more persuasive argument.

***514** A

[4] [5] [6]First, by way of background, we note that in a traditional Chapter 11 proceeding, the debtor submits and the court approves a plan of reorganization for the distribution of the debtor's estate. And when the creditors withhold their consent, any such plan must be fair and equitable in that it must comply with priority rules that establish a hierarchy of creditor classes for the order in which each class of creditor is to be paid. Thus, higher priority creditors are paid in full before payment is made to lower priority creditors. The rule began with judicial construction and, beginning in 1978, was included in the Bankruptcy Code. *See Norwest Bank Worthington v. Ahlers*, 485 U.S. 197, 202, 108 S.Ct. 963, 99 L.Ed.2d 169 (1988). Known as the "absolute priority rule," it requires that any plan, to which creditors have not consented, must provide that "a dissenting class of unsecured creditors [be paid] in full before any junior class can receive [payment]." *Id.* (citation omitted); *In re Maharaj*, 681 F.3d 558, 562 (4th Cir. 2012); 11 U.S.C. § 1129(b)(2)(B)(ii). And, as a general matter, any non-consensual

plan violating the absolute priority rule may not be approved, nor may a discharge of debts be granted. *See* 11 U.S.C. § 1129(b)(2)(B)(ii). It can be readily recognized, however, that this strict priority rule could preclude reorganizations in which continuing management of the bankruptcy estate by a business's owners would be essential to a successful reorganization because such owners' retention of estate property would violate the priority rule.

[7] [8]Apparently in response to the problem, at least in part, Congress enacted Subchapter V in the Small Business Reorganization Act of 2019, Pub. L. No. 116–54, 133 Stat. 1079, to streamline reorganizations for small business debtors — defined during the relevant time period as those debtors whose debt is not more than $7.5 million, *see* 11 U.S.C. § 1182(1) (2020). One of the main features of a Subchapter V proceeding is its authorization of plans that are not consented to by creditors and that depart from the absolute priority rule of § 1129(b). Under the governing rules of a Subchapter V proceeding, the bankruptcy court need only find that such a plan provide that all of the debtor's projected disposable income is paid to creditors for a 3-to 5-year period and that it be feasible. 11 U.S.C. § 1191(c)(2)(A) and (3). Thus, the owners of a Subchapter V debtor are able to retain their equity in the bankruptcy estate despite creditors' objections.

[9]Subchapter V also provides specific rules for discharge, requiring a court to grant discharge of all debts after approval of the plan except (1) any debt payable *after* the 3- to 5-year period specified for payment, and (2) any debt "of the kind specified in section 523(a)." 11 U.S.C. § 1192.

B

[10]We now turn to the text of § 1192(2), which specifically governs Cleary Packaging's discharge, to determine the debts dischargeable under Subchapter V. First, we point out that § 1192(2) provides for granting *debtors* a discharge of all debts, subject to stated exceptions. For the purpose of Subchapter V, the term "debtor" was defined during the relevant time period to mean "a *person* engaged in commercial or business activities" that has debt of not more than $7.5 million. 11 U.S.C. § 1182(1) (2020) (emphasis added). "[P]erson" is in turn defined to include both individuals and corporations, *see id.* § 101(41), and "corporation[s]" include limited liability companies, *id.* § 101(9)(A). We thus conclude that § 1192(2) provides for the discharge of ***515** debts for *both* individual and corporate debtors.

Still, even though § 1192(2) applies to both individual and corporate debtors, the question remains whether the exception to such discharges — based on § 1192(2)'s reference to § 523(a) — applies to both individuals and corporations or to only individuals. And that question arises because the introductory language in § 523(a) limits its discharge exceptions to *individual* debtors. Specifically, § 523(a) provides that § 1192, along with five other discharge sections of the Bankruptcy Code, "does not discharge *an individual debtor*" from a list of 21 specified debts, including "any debt ... for willful and malicious injury,"11 U.S.C. § 523(a)(6) (emphasis added), implying that corporations are not subject to the discharge exceptions.

To address the question, we begin by focusing on § 1192(2) as the provision specifically governing discharges in a Subchapter V proceeding and on the scope of its incorporation of § 523(a). Section 1192(2) excepts from discharge "any *debt ... of the kind* specified in section 523(a)." 11 U.S.C. § 1192(2) (emphasis added). The section's use of the word "debt" is, we believe, decisive, as it does not lend itself to encompass the "kind" of *debtors* discussed in the language of § 523(a). This is confirmed yet more clearly by the phrase modifying "debt"— i.e., "of the kind." Thus, the combination of the terms "debt" and "of the kind" indicates that Congress intended to reference only the *list of non-dischargeable debts* found in § 523(a). As the U.S. Government's amicus brief notes, this interpretation of "of the kind" is in line "with the ordinary meaning of the word 'kind' as 'category' or 'sort. ' " (Citing American Heritage Dictionary of the English Language (online ed.) (" '[a] group of individuals or instances sharing common traits; a category or sort' "); Merriam-Webster Dictionary (online ed.) (" 'a group united by common traits or interests: CATEGORY' ")). In short, while § 523(a) does provide that discharges under various sections, including § 1192 discharges, do not "discharge *an individual debtor* from any debt" of the kind listed, § 1192(2)'s cross-reference to § 523(a) does not refer to any *kind of debtor* addressed by § 523(a) but rather to a *kind of debt* listed in § 523(a). By referring to the *kind of debt* listed in § 523(a), Congress used a shorthand to avoid listing all 21 types of debts, which would indeed have expanded the one-page section to add several additional pages to the U.S. Code. Thus, we conclude that *the debtors* covered by the discharge language of § 1192(2) — i.e., both individual and corporate debtors — remain subject to the 21 *kinds of debt* listed in § 523(a).

[11]We add — to the extent that one might find tension between the language of § 523(a) addressing individual debtors and the language of § 1192(2) addressing both individual and corporate debtors — that the more specific provision should govern over the more general. *See, e.g., S.W. Ga. Farm Credit, Aca v. Breezy Ridge Farms, Inc. (In re Breezy Ridge Farms, Inc.)*, No.

09-1011, 2009 WL 1514671, at *2 (Bankr. M.D. Ga. May 29, 2009) ("If the two provisions may not be harmonized, then the more specific will control over the general" (quoting *Universal Am. Mortg. Co. v. Bateman (In re Bateman)*, 331 F.3d 821, 825 (11th Cir. 2003))). Thus, while § 523(a) references numerous discharge provisions of the Bankruptcy Code, § 1192(2) is the more specific, addressing only Subchapter V discharges.

C

[12] [13]The context of § 1192(2) within the Bankruptcy Code and the Bankruptcy Code's structure further support our interpretation. ***516** It is readily apparent from a review of different Bankruptcy Code chapters that Congress conscientiously defined and distinguished the kinds of debtors covered by each provision. For example, Chapter 7 discharges are explicitly limited to individuals, *see* 11 U.S.C. § 727(a)(1), as are Chapter 13 discharges, *see id.* §§ 109(e), 1328. More tellingly, as to traditional Chapter 11 proceedings, Congress explicitly distinguished the discharges of individual debtors from the discharges of corporate debtors in § 1141(d), excluding a different array of debts from discharge for each. *Compare id.* § 1141(d)(2), (5) (addressing the scope of discharge for individuals) *with id.* § 1141(d)(6) (addressing the scope of discharge for corporations). Yet Congress purposefully addressed both individual and corporate debtors when defining the right of discharge in Subchapter V proceedings. *Id.* § 1192.

Cleary Packaging's interpretation would also create difficulty in reconciling § 523(a) with § 1141(d)(6). Section 523(a) includes in its scope § 1141, just as it includes § 1192 and several other sections, and therefore under Cleary Packaging's interpretation, the list of exceptions to discharge in a traditional Chapter 11 proceeding would govern only individuals by reason of § 523(a)'s limiting language. Yet, § 1141 incorporates specified debts listed in § 523(a) to apply *to corporate debtors*, excluding from discharge debts "of a kind specified in paragraph (2)(A) or (2)(B) of section 523(a)." 11 U.S.C. § 1141(d)(6)(A). Cleary Packaging has been unable to reconcile its method for applying § 523(a) to § 1192 with any consistency as to how it would apply § 523(a) to § 1141(d)(6).

[14]Yet more telling is Congress's importation of language into Subchapter V from the conceptually similar Chapter 12 proceedings, which are limited to family farmers and family fishermen, whether they be individuals or corporations. *See* 11 U.S.C. § 101(18), (19A); *see also, e.g., In re Trepetin*, 617 B.R. 841, 848 (Bankr. D. Md. 2020) (recognizing that "[s]everal aspects of Subchapter V are premised on the provisions of chapter 12 of the Code for family farmers and fishermen").

In addressing the scope of discharge, Chapter 12 provides, in relevant part, that "the court shall grant the debtor a discharge of all debts provided for by the plan ... except any debt ... *of a kind specified in section 523(a)* of this title." 11 U.S.C. § 1228(a) (emphasis added). This language in Chapter 12 is virtually identical to the language included in § 1192(2).[2] Moreover, § 523(a) specifically references § 1228(a) discharges, just as it does § 1192 discharges. Yet, the courts construing the scope of § 1228(a) have concluded that § 1228(a)'s discharge exceptions apply *to both individual debtors and corporate debtors*. *See, e.g., Breezy Ridge Farms*, 2009 WL 1514671, at *1–2; *New Venture P'ship v. JRB Consol., Inc. (In re JRB Consol., Inc.)*, 188 B.R. 373 (Bankr. W.D. Tex. 1995). Interpreting language virtually identical to that in § 1192(2), the bankruptcy court in *JRB Consolidated* stated that "[t]he wording in § 1228(a)(2) describing 'debts of the kind' specified in § 523(a) does not naturally lend itself to also incorporate the meaning 'for debtors of the kind' referenced in § 523(a)." 188 B.R. at 374. Instead, it stated, "[d]ebts of the kind easily seems to be limited to the subparagraphs of § 523(a) which identify the types of debts which are eligible to be excepted from discharge." *Id.*; *see also Breezy Ridge Farms*, 2009 WL 1514671, at *2 (finding that Congress used the reference to ***517** § 523(a) in § 1228 "as shorthand to define the scope of a Chapter 12 discharge for corporations as well as individuals"). Thus, prior interpretations of § 1228(a) support our interpretation of § 1192(2)'s virtually identical language. *See Hall v. United States*, 566 U.S. 506, 519, 132 S.Ct. 1882, 182 L.Ed.2d 840 (2012) ("[I]dentical words and phrases within the same statute should normally be given the same meaning" (citations omitted)). To give different interpretations to the same language in the same statute would ignore the rationality of using the same language in describing a different proceeding of the Bankruptcy Code, as was done with the adoption of Subchapter V.

[15]Finally, our interpretation of § 1192(2) in Subchapter V makes particular sense when considering that subchapter's juxtaposition in Chapter 11 with traditional Chapter 11 provisions, reflecting its distinctive purpose within that Chapter. Congress enacted Subchapter V as part of the Small Business Reorganization Act of 2019 with the primary goal of simplifying Chapter 11 reorganizations for small businesses and reducing the administrative costs for those businesses. To do so, Congress deliberately altered the general provisions of traditional Chapter 11 proceedings by, among other things, eliminating the absolute priority rule and limiting the applicability of § 1141(d) to Subchapter V proceedings. Section 1141(d), in particular, sets forth debts that are eligible for discharge in a traditional Chapter 11 proceeding, making distinctions between individual debtors and corporate debtors. *See Breezy Ridge Farms*, 2009 WL 1514671, at *2; *cf. JRB*

Consol., 188 B.R. at 374. In contrast, § 1192 provides benefits to small business debtors, regardless of whether they are individuals or corporations. Thus, an important purpose for Subchapter V would be frustrated were we to adopt Cleary Packaging's interpretation of §§ 1192(2) and 523(a), which would treat individuals and corporations differently.

[16]And as to fairness and equity, it should be recognized that a Subchapter V proceeding involves a non-consensual plan — i.e., a "cram-down" proceeding — in which stakeholders in the bankruptcy estate are treated differently than they would be in traditional Chapter 11 proceedings under the absolute priority rule. Under a Subchapter V plan, owners of a debtor can retain ownership interests to continue conducting the reorganization at the expense of and over the objection of creditors. Given the elimination of the absolute priority rule, Congress understandably applied limitations on the discharge of debts to provide an additional layer of fairness and equity to creditors to balance against the altered order of priority that favors the debtor. To this end, *all Subchapter V debtors* are textually subject to the discharge limitations described in § 523(a), not just *individual* Subchapter V debtors. To make a distinction between individuals and corporations for how Subchapter V is applied would not only undermine that balance, but would also make no sense and indeed would create perverse incentives. But most importantly, it would violate the text of § 1192(2).

III

At bottom, while we recognize that the relationship between § 523(a) and § 1192 might be a bit discordant — or perhaps more accurately, clumsy — we find more harmony from following a close textual analysis and contextual review of § 1192(2) and thus conclude that it provides discharges to small business debtors, *whether they are individuals or corporations*, except with respect to the 21 kinds of debts listed in § 523(a). We would find it difficult to conceive of giving § 523(a) the additional ***518** role of defining *the debtors* covered by § 1192(2) in conflict with § 1192(2)'s own language. That function is actually and better carried out by § 1192, which is the specific provision governing discharges in Subchapter V proceedings and which applies to individual and corporate debtors alike. Finally, we conclude that our interpretation serves fairness and equity in circumstances where *a small business corporate debtor* in particular is given greater priority over creditors than would ordinarily apply and thus should not especially benefit from the discharge of debts incurred in circumstances of fraud, willful and malicious injury, and the other violations of public policy reflected in § 523(a)'s list of exceptions.

* * *

Accordingly, we reverse the bankruptcy court's certified order and remand the case for further proceedings, including consideration of Cantwell-Cleary's motion for summary judgment.

REVERSED AND REMANDED

All Citations

36 F.4th 509

Footnotes	
1	While, for convenience, we use the terms "individual debtor" and "corporate debtor" in a binary fashion, we recognize that Cleary Packaging is a limited liability company under Maryland law. The Bankruptcy Code, however, includes within its definition of "corporation" limited liability companies. See 11 U.S.C. § 101(9)(A).
2	There is one inconsequential difference — § 1228(a) refers to debt "of a kind specified," while § 1192(2) refers to debt "of the kind specified."

End of Document	

628 B.R. 262
United States Bankruptcy Court, N.D. Texas, Dallas Division.

IN RE: NATIONAL RIFLE ASSOCIATION OF AMERICA and Sea Girt LLC, Debtors.

Case No. 21-30085 (HDH) (Jointly Administered)
|
Signed May 11, 2021

Synopsis
Background: In the jointly administered Chapter 11 cases of debtors, a charitable not-for-profit firearms advocacy organization and an entity formed as a transition vehicle to facilitate organization's relocation from New York to Texas, director of organization filed motion seeking appointment of examiner with special duties and powers to investigate organization's governance and the actions of its management. Shortly thereafter, organization's former vendor, as well as attorney general of New York, who had conducted investigation of organization and filed lawsuit seeking its dissolution, and others, filed motions to dismiss case or, in the alternative, to appoint a Chapter 11 trustee. Director objected to dismissal motions, and trial was held.

Holdings: The Bankruptcy Court, Harlin D. Hale, J., held that:

[1] organization, whose primary purpose in seeking Chapter 11 relief was to avoid potential dissolution in the New York enforcement action, did not file for bankruptcy in good faith, such that there was "cause" for dismissal, and

[2] the appointment of a trustee or examiner would not, at this time, be in the best interests of creditors and the estate.

Motions to dismiss granted; examiner motion denied as moot.

West Headnotes (9)

[1]	**Bankruptcy**In General; Grounds in General
	In cases where the debtor is a nonprofit organization, the court may not convert a case under Chapter 11 to a case under Chapter 7 unless the debtor requests such a conversion. 11 U.S.C.A. § 1112(c). 1 Cases that cite this headnote

[2]	**Bankruptcy**In General; Grounds in General

	Section of the Bankruptcy Code governing conversion or dismissal of a Chapter 11 case contains a non-exclusive list of what constitutes "cause" for purposes of dismissal. 11 U.S.C.A. § 1112(b)(4).

[3]	**Bankruptcy**Proceedings
	After movant seeking "for cause" dismissal of Chapter 11 case on "lack of good faith" grounds satisfies initial burden of making prima facie showing of lack of good faith in filing petition, burden shifts to debtor to demonstrate good faith. 11 U.S.C.A. § 1112(b). 1 Cases that cite this headnote

[4]	**Bankruptcy**"Good faith."
	Chapter 11 petition is not filed in good faith unless it serves valid bankruptcy purpose. 11 U.S.C.A. § 1112(b).

[5]	**Bankruptcy**Dismissal or suspension **Bankruptcy**Discretion
	If court finds cause for dismissal of Chapter 11 case, it must dismiss the case unless court determines that appointment of trustee or examiner is in the best interests of creditors and the estate. 11 U.S.C.A. §§ 1104(a), 1112(b).

[6]	**Bankruptcy**"Bad faith."

	Under the totality of the circumstances, charitable not-for-profit firearms advocacy organization chartered in New York, whose primary purpose in seeking Chapter 11 relief was to avoid potential dissolution in enforcement action brought against it by attorney general of New York, did not file for bankruptcy in good faith, such that there was "cause" for dismissal of case; organization, which was financially healthy, commenced case to gain unfair litigation advantage in New York enforcement action, as well as to avoid New York regulatory scheme, and although preserving a debtor as a going concern was a very common good-faith reason for filing bankruptcy, there was difference between lawsuit in which party seeks monetary judgment that would pose existential threat to a debtor and situation here, where dissolution of debtor was sought as remedy in state regulatory action, and was not the type of dissolution against which the Bankruptcy Code was meant to protect. 11 U.S.C.A. § 1112(b)(1); N.Y. Not-For-Profit Corp. Law §§ 1101, 1102. 2 Cases that cite this headnote

[7]	**Bankruptcy**"Bad faith."
	While bankruptcy courts may, in some circumstances, apply state regulatory law, a Chapter 11 case filed for the purpose of avoiding a regulatory scheme is not filed in good faith and should be dismissed. 11 U.S.C.A. § 1112(b).

[8]	**Bankruptcy**Necessity or grounds

	Upon determination of "cause" for dismissal of jointly administered Chapter 11 case of charitable not-for-profit firearms advocacy organization, appointment of a trustee or examiner would not have been in the best interests of creditors and the estate; it would not have been easy to find suitable individual to serve in role of trustee or examiner with expanded powers, given that organization's mission was, at times, political and polarizing, and it did not sell goods or services, organization was financially healthy and it was likely that creditors would be paid sooner outside of bankruptcy than if they had to wait for plan confirmation, members and other donors were less likely to support organization if trustee or examiner were appointed, and, although there was evidence of organization's past and present misconduct, there also was evidence that it had made progress with its "course correction" and understood the importance of regulatory compliance. 11 U.S.C.A. §§ 1104(a), 1112(b)(1).

[9]	**Bankruptcy**Proceedings
	Appointment of Chapter 11 trustee is extraordinary remedy, that requires movant to meet its burden of proof by clear and convincing evidence. 11 U.S.C.A. § 1104(a).

Attorneys and Law Firms

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Scott P. Drake, Norton Rose Fulbright US LLP, Kristian W. Gluck, Nick J. Hendrix, Laura Lynn Smith, Louis R. Strubeck, Jr., Norton Rose Fulbright US LLP, Dallas, TX, for Creditor Committee.

ORDER GRANTING MOTIONS TO DISMISS

Harlin DeWayne Hale, United States Bankrupty Judge

The National Rifle Association of America (the "NRA") is a 150-year-old organization with approximately five million members that is dedicated to the rights of Americans to own and safely use firearms for their personal protection and recreational use. The mission and function of ***264** the NRA is focused on gun safety, and the NRA asserts it is "the nation's foremost defender" of the Second Amendment of the United States Constitution. In recent years, however, it has become apparent that the NRA was suffering from inadequate governance and internal controls.

The attorney general for the state of New York conducted a fifteen-month-long investigation of the NRA that revealed, the New York attorney general claims, widespread misuse of assets by the NRA's executive vice president and his circle of insiders for their personal benefit. Nine months ago, the New York attorney general filed a lawsuit seeking dissolution of the NRA based on allegations that (1) the NRA has exceeded the authority conferred upon it by New York law and has conducted its business in a persistently illegal manner and abused its powers contrary to the public policy of the state of New York by operating without effective oversight or control by its officers and directors, and (2) the directors or members in control of the NRA have looted or wasted the corporate assets, have perpetuated the corporation solely for their personal benefit, or have otherwise acted in an illegal, oppressive, or fraudulent manner.

The NRA filed this case seeking the protection of the Bankruptcy Code to preserve itself as a going concern in the face of litigation that, it argues, poses an existential threat. Debtors commonly file bankruptcy when faced with a judgment that has, or will, render them insolvent, but the threat against the NRA differs from the classic scenario in that dissolution would not be a collateral effect of litigation but rather the intended relief sought in a state's regulatory action. And in this instance, dissolution could only occur after judicial consideration of whether dissolution is in the best interest of the public.

The question the Court is faced with is whether the existential threat facing the NRA is the type of threat that the Bankruptcy Code is meant to protect against. The Court believes it is not. For the reasons stated herein, the Court finds there is cause to dismiss this bankruptcy case as not having been filed in good faith both because it was filed to gain an unfair litigation advantage and because it was filed to avoid a state regulatory scheme. The Court further finds the appointment of a trustee or examiner would, at this time, not be in the best interests of creditors and the estate.

I. Jurisdiction and Venue

This Court has jurisdiction to consider this matter under 28 U.S.C. §§ 157 and 1334. This is a core proceeding under 28 U.S.C. § 157(b)(2)(A). Venue is proper in this District under 28 U.S.C. §§ 1408 and 1409.

II. Relevant Background

The NRA is a charitable not-for-profit corporation chartered by special act of the New York State Legislature on November 17, 1871. The NRA has approximately five million members, almost 500 employees, and annual revenue of approximately $300 million. The NRA is primarily supported by dues from members and private contributions from donors.

Around the middle of 2017, NRA Board Member Tom King received a phone call from Eric Schneiderman, who at the time was the New York attorney general.[1] According to Mr. King, Mr. Schneiderman told him that investigations into the NRA were being opened and they should "prepare for the worst."[2] Mr. King shared this ***265** message with Wayne LaPierre,[3] the NRA's executive vice president.[4] In response to this warning, Mr. LaPierre testified that he decided the "NRA ought to take a look at everything, a 360-degree look to make sure we were in total compliance with New York State not-for-profit law, and if we weren't, we needed to fix things."[5] This was the beginning of what the NRA now refers to as its course correction.[6]

As part of its course correction, the NRA hired the law firm Morgan, Lewis & Bockius LLP to provide advice regarding tax and nonprofit governance matters.[7] The NRA also hired Brewer, Attorneys & Counselors (the "Brewer Firm") in early 2018 to aid with the course correction process and potential upcoming litigation.[8] Since that time, in addition to becoming the NRA's primary litigation counsel, the Brewer Firm appears to have become involved in many aspects of the NRA.

In March 2018, the NRA hired Craig Spray as its new chief financial officer.[9] Before joining the NRA, Mr. Spray served as

the chief financial officer for two different companies, one of which was a publicly traded company valued at over $1 billion.

On April 19, 2018, the New York Department of Financial Services sent letters to insurers and financial institutions encouraging them to review their relationships with the NRA and consider whether such relationships harm their corporate reputations and jeopardize public safety (the "NY DFS Letter"). Less than a month later, the NRA, with the assistance of the Brewer Firm, filed a complaint in federal court in the Northern District of New York against the governor of New York and the New York Department of Financial Services regarding their alleged attempts "to deprive the NRA and its constituents of their First Amendment rights to speak freely about gun-related issues and defend their Second Amendment freedoms against encroachment."[10]

In July 2018, several whistleblowers came forward with the encouragement of Mr. Spray and presented a memo to the NRA Audit Committee regarding their top concerns (the "Whistleblower Memo").[11] That list included concerns related to (1) financial conflicts of interest of senior management and board members, (2) senior management override of internal controls relating to, among other things, accounts payable procedures, travel and expense reporting, and procurement/contracts policy, ***266** (3) management making decisions in the best interests of vendors instead of the NRA, (4) vague and deceptive billing practices of vendors, (5) improper reimbursement for apartments and living expenses of certain employees, and (6) lack of control over vehicle leases obtained by senior management.[12]

Following the presentation of the Whistleblower Memo to the Audit Committee, the NRA took several actions, including examining related party transactions and reviewing vendor contracts.[13] As a result of this review process, the NRA required the inclusion of specific metrics in all contracts[14] and improved documentation and recordkeeping.[15] One of the more significant actions taken in response to the Whistleblower Memo was to send letters to the NRA's vendors notifying them of the rules regarding proper invoicing.[16] While most vendors complied with these new measures, some did not.[17] As a result, some contracts with vendors were re-negotiated, and some were terminated.[18]

This process caused a rift between the NRA and one of its most significant vendors, Ackerman McQueen, Inc. ("Ackerman"). Ackerman had very close ties with the NRA and had been the NRA's marketing and public relations firm for decades, but several of the concerns expressed in the Whistleblower Memo related to the NRA's relationship with Ackerman.[19] The disagreements that came from discussions regarding billing practices and their business relationship escalated and have spawned four overlapping lawsuits—three in Virginia state court and one in federal court in the Northern District of Texas.

On August 6, 2020, following a fifteen-month investigation, the New York attorney general (the "NYAG") filed a complaint in New York state court against the NRA seeking, among other relief, dissolution of the NRA (the "NYAG Complaint" commencing the "NYAG Enforcement Action").[20] The NYAG Complaint also named four individual defendants: (1) Mr. LaPierre; (2) John Frazer, the NRA's general counsel; (3) the NRA's former treasurer and chief financial officer; and (4) the NRA's former chief of staff. The allegations in the 163-page NYAG Complaint are extensive but, in very general terms, accuse Mr. LaPierre of (i) exploiting the NRA for his financial benefit and the benefit of a close circle of NRA staff, board members, and vendors, (ii) intimidating, punishing, and expelling anyone at a senior level who raised concerns about his conduct, (iii) hiring and retaining individuals in senior positions at the NRA, or as NRA contractors, whom he believed would aid and enable him to control the organization, regardless of their skills, experience, integrity, or contribution to the charitable ***267** mission, and (iv) entering into post-employment agreements with departing officers and employees that provided excessive payments in exchange for little, if any, services and non-disclosure/non-disparagement agreements. Other of the individual defendants were accused of (i) ignoring, overriding, or otherwise violating the bylaws and internal policies and procedures they were charged with enforcing, resulting in charitable assets being diverted to benefit NRA insiders and favored vendors, (ii) instituting a practice whereby millions of dollars in entertainment and travel expenses incurred by NRA executives were billed to the NRA as disbursements by the NRA's largest vendor, and (iii) circumventing internal controls, condoning or partaking in expenditures that were an inappropriate and wasteful use of charitable assets, and concealing or misreporting relevant information, rendering the NRA's annual reports filed with the NYAG materially false and misleading. The NYAG Complaint, in addition to dissolution of the NRA, seeks (i) restitution of certain funds paid to current and former officers, which would be returned to the NRA, (ii) a ban on certain former and current officers, including Mr. LaPierre and Mr. Frazer, from serving as fiduciaries of any New York charity, and (iii) voiding of certain transactions.[21]

On September 10, 2020, Carolyn Meadows (the NRA's President) created a Special Litigation Committee to oversee (i) the NYAG Enforcement Action, (ii) a lawsuit filed against the NRA and the NRA Foundation by the District of Columbia attorney general, (iii) the NRA's pending lawsuit against the NYAG, and (iv) any future proceedings that arise out of or relate to the previously-identified matters. In an e-mail sent to the board of directors, Ms. Meadows explained that the creation of the Special Litigation Committee was done on the advice of counsel to avoid the appearance of any conflict because Mr. LaPierre and Mr. Frazer were named as individual defendants in the NYAG Enforcement Action.[22] The Special Litigation Committee's members were Ms. Meadows, Charles Cotton (the NRA's First Vice President), and Colonel Willes Lee (the

NRA's Second Vice President).

On November 18, 2020, the NRA filed its IRS Form 990 signed by Mr. LaPierre.[23] This form is an annual informational tax return filed by a nonprofit to justify maintaining its tax-exempt status. In the Form 990, the NRA disclosed several excess benefit transactions entered into by individuals at the NRA, including Mr. LaPierre.

On November 23, 2020, the NRA hired the Neligan Law Firm to advise on bankruptcy and restructuring options.[24] The next day, Sea Girt, LLC was formed as a transition vehicle to facilitate the NRA's relocation to Texas.[25]

On January 7, 2021, the NRA held a board meeting. At this meeting, the board of directors adopted a resolution formalizing the Special Litigation Committee.[26] The board of directors also passed a resolution approving an employment agreement ***268** for Mr. LaPierre.[27] Significantly, Mr. LaPierre's employment agreement contained language permitting Mr. LaPierre to "exercise corporate authority in furtherance of the mission and interests of the NRA, including without limitation to reorganize or restructure the affairs of the Association for the purposes of cost-minimization, regulatory compliance or otherwise."[28] Throughout the entirety of the board meeting, both in the general and executive sessions, no discussion of bankruptcy, Chapter 11, or the possible reorganization of the NRA occurred.[29] The board of directors was not informed that the language cited above could authorize Mr. LaPierre to unilaterally authorize a petition for bankruptcy relief for the NRA. In fact, the board of directors was not informed that the NRA was considering filing for bankruptcy at all.[30]

On January 15, 2021, the NRA and Sea Girt, LLC filed voluntary petitions for relief under Chapter 11 of the Bankruptcy Code. The cases are being jointly administered.[31] On February 8, 2021, Judge Phillip Journey,[32] a longtime member, donor, and director of the NRA, filed a motion seeking the appointment of an examiner with special duties and powers under section 1104(c) of the Bankruptcy Code to investigate the governance of the NRA and the actions of its management (the "Examiner Motion").[33] The Examiner Motion was originally set for hearing on March 9, 2021.[34]

On February 10, 2021, Ackerman, now a former vendor and current litigation adversary of the NRA, filed a motion to dismiss the Chapter 11 case or, in the alternative, appoint a Chapter 11 trustee pursuant to section 1104(a) of the Bankruptcy Code.[35] The motion to dismiss filed by Ackerman was quickly followed by similar motions filed by the NYAG[36] and the District of Columbia attorney general[37] (the "Motions to Dismiss") and a joinder filed by Christopher W. Cox, a former executive director of the NRA Institute for Legislative Action.[38] Because of the overlapping ***269** facts and interrelated relief being requested in the Examiner Motion and the Motions to Dismiss, the Court chose to set them for trial together after a brief period of time for expedited discovery.

In the following weeks, the many parties involved in this case—each with different interests, perspectives, and goals—engaged in discovery and began to take positions on the motions filed and the various relief requested therein. Judge Journey filed an objection to the Motions to Dismiss but amended his previous request for an examiner to include an expanded role for the proposed examiner.[39] The Official Committee of Unsecured Creditors (the "Committee") took the position that while the NRA is in need of major changes to its governance, current management should not be displaced by a Chapter 11 trustee, but if a trustee is appointed, they should have limited powers. The Committee also took the position that the NRA should retain a chief restructuring officer and that the appointment of an examiner was not necessary because the Committee was already fulfilling that role.[40]

The NRA opposed all of the motions but did eventually consent to the appointment of a chief restructuring officer.[41]

David Dell'Aquila, a member of the Committee and the plaintiff in a purported class action against the NRA, filed a partial joinder opposing dismissal but supporting the appointment of a Chapter 11 trustee with limited authority.[42]

The United States Trustee did not initially express an opinion regarding the underlying motions but did express views on several of the options the parties had discussed.[43] Specifically, the United States Trustee took the position that there is no such entity as a limited purpose trustee under the Bankruptcy Code, and if the Court orders the appointment of a Chapter 11 trustee, the trustee must have full statutory ***270** powers. The United States Trustee also took the position that while an examiner may be granted expanded powers, the Bankruptcy Code does not permit a chief restructuring officer to usurp the powers of a Chapter 11 trustee.[44]

Sixteen states, as *amici curiae*, filed a brief in support of the NRA,[45] and the state of Texas submitted its own brief in support of the NRA.[46]

Trial commenced on April 5, 2021 and continued over twelve days with twenty-three witnesses. On April 7, 2021, the NRA filed an application to employ a chief restructuring officer,[47] which the Court heard concurrently with the ongoing trial. Closing arguments took place on May 3, 2021, after which the Court took the matters under advisement.

III. Applicable Legal Standard

[1] [2]The movants generally seek three forms of relief: dismissal of the bankruptcy cases, the appointment of a Chapter 11 trustee, or the appointment of an examiner. Pursuant to section 1112(b) of the Bankruptcy Code, the court shall dismiss a case under this chapter for cause unless the court determines that the appointment under section 1104(a) of a trustee or an examiner is in the best interests of creditors and the estate.[48] Section 1112(b)(4) contains a non-exclusive list of what constitutes "cause" for purposes of dismissal, but the Fifth Circuit Court of Appeals has held that the term "cause" affords flexibility to the bankruptcy courts and can include a finding that the debtor's filing for relief is not in good faith. *In re Little Creek Dev. Co.*, 779 F.2d 1068, 1072-73 (5th Cir. 1986); *In re Humble Place Joint Venture*, 936 F.2d 814, 816-17 (5th Cir. 1991).

[3] [4]After the movant satisfies the initial burden of making a prima facie showing of a lack of good faith in filing, the burden shifts to the debtor to demonstrate good faith. *In re Mirant Corp.,* 2005 WL 2148362, at *7 n.20, 2005 Bankr. LEXIS 1686, at *27 n.20 (Bankr. N.D. Tex. Jan. 26, 2005) (noting that some courts hold that the burden of showing good faith is on the debtor while other courts hold that the movant has an initial burden to present a prima facie case of a lack of good faith before the burden shifts to the debtor to show good faith); *In re Sherwood Enters., Inc.*, 112 B.R. 165, 170-71 (Bankr. S.D. Tex. 1989). Furthermore, courts have held that a Chapter 11 petition is not filed in ***271** good faith unless it serves a valid bankruptcy purpose. *Off. Comm. of Unsecured Creditors v. Nucor Corp. (In re SGL Carbon Corp.)*, 200 F.3d 154, 165 (3d Cir. 1999).

[5]If a court finds cause for dismissal, it must dismiss the case unless the court determines that the appointment under section 1104(a) of a trustee or an examiner is in the best interests of creditors and the estate. Pursuant to section 1104(a), at any time after the commencement of the case but before confirmation of a plan, on request of a party in interest or the United States Trustee, and after notice and a hearing, 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 the debtor; or (2) if such appointment is in the interests of creditors, any equity security holders, and other interests of the estate, without regard to the number of holders of securities of the debtor or the amount of assets or liabilities of the debtor.

Pursuant to section 1104(c), if the court does not order the appointment of a trustee, then at any time before the confirmation of a plan, on request of a party in interest or the United States Trustee, and after notice and a hearing, the court shall order the appointment of an examiner to conduct such an investigation of the debtor as is appropriate, including an investigation of any allegations of fraud, dishonesty, incompetence, misconduct, mismanagement, or irregularity in the management of the affairs of the debtor of or by current or former management of the debtor, if (1) such appointment is in the interests of creditors, any equity security holders, and other interests of the estate or (2) the debtor's fixed, liquidated, unsecured debts, other than debts for goods, services, or taxes, or owing to an insider, exceed $5,000,000.

IV. Discussion

Because of the structure of the relevant provisions of the Bankruptcy Code, the Court will first determine whether there is cause for dismissal and, specifically, whether the NRA filed for bankruptcy in good faith.

The NRA's Stated Reasons for Filing Bankruptcy

At various times in this case, the NRA has provided the Court with several—and at times slightly different—reasons for why this bankruptcy case was filed.[49] In an informational brief filed on January 20, 2021, the NRA explained that it "instituted

this chapter 11 reorganization proceeding to establish a centralized, neutral forum in which it can streamline, resolve, and address all outstanding claims and preserve its ability to pursue its constitutionally protected mission as a going concern" and that it "intends to restructure through a plan of reorganization that provides for the reorganized NRA to emerge from these chapter 11 cases as a Texas nonprofit entity."[50] The NRA went on to explain that "separate and apart from the on-going disputes with the NYAG, the NRA seeks to avail itself of the protections of the Bankruptcy Code in order to continue its efforts to reduce operating costs and to address ***272** the ever-increasing litigation being filed against the NRA" and that "[c]ontrary to the NYAG's press releases, the NRA is not seeking to evade regulatory oversight; rather it seeks, and is entitled, to being treated fairly by regulators providing that oversight."[51] Finally, the NRA announced its intention to propose a plan of reorganization that will (1) pay all of the allowed claims of the NRA's creditors in full, (2) provide a mechanism for adjudicating and/or resolving the claims of the NYAG and any other creditor with contingent, unliquidated, and disputed claims, and (3) allow the NRA to exit Chapter 11 as a Texas nonprofit organization.[52]

Counsel for the NRA reiterated these reasons at the hearing held on January 20, 2021, with a particular emphasis on (1) the cost of ongoing litigation and the time and effort of the NRA management team being spent on litigation, (2) the need for a breathing spell and an opportunity to centralize litigation, and (3) the NRA's desire to emerge from bankruptcy as a company domiciled in Texas.[53] Counsel for the NRA went so far as to say that "absent being able to streamline discovery and have all of this litigation, or much of it, handled in a centralized forum, the NRA was indeed facing the adage, death by a thousand cuts."[54]

In the Examiner Motion and the Motions to Dismiss, the other parties offered different opinions on the true purpose of the NRA's bankruptcy. Judge Journey took the position that if the NRA was able to successfully terminate its corporate existence in New York and reconstitute the organization under Texas law, the NRA wishes to "avoid the ongoing challenges to its corporate charter brought by the State of New York and other ongoing litigation."[55] Ackerman accused the NRA of primarily using the bankruptcy filing to escape civil prosecution and avoid regulatory oversight from the NYAG, but also to stall litigation.[56] The NYAG agreed with Ackerman that the NRA's purpose in filing bankruptcy was to evade regulatory oversight.[57]

In its brief in opposition to the Examiner Motion and the Motions to Dismiss, the NRA again summarized its reasons for filing bankruptcy, but in a slightly more expansive way:

> On January 15, 2021, the Debtors filed their chapter 11 petitions with a series of goals:
>
> a. The Debtors seek to streamline the barrage of litigation they are facing. Although the Debtors expect to ultimately prevail on the merits in many pending cases, the disruption and expense of such litigation creates significant burdens for the NRA.
>
> b. The organizational structure of the NRA is based on a 150-year-old charter that has not been updated in over a century. Given the size and impact that the NRA now has, the ***273** organization would benefit from the modernization to ensure its continued existence as a going concern for the benefit of the NRA's creditors and members.
>
> c. While this case is certainly unique, ultimately, the NRA is not unlike a typical chapter 11 debtor grappling with the typical operational strains with which chapter 11 is designed to assist. The NRA seeks to reduce operating expenses, address burdensome executory contracts and unexpired leases, maintain its employees and operations, and institute and effectuate a streamlined claims process to address the multitude of claims and repayment through a confirmed plan of reorganization.
> d. The NRA seeks to move its corporate domicile and its principal place of business to Texas which, as has been widely reported, welcomes the NRA with open arms.[58]

Later in the brief, the NRA acknowledged that there is no judgment against it and no impending trial but expressed the belief that it faces existential threats:

> The NRA filed for protection under chapter 11 in good faith, not to circumvent judgments in other courts (in fact, no judgments have been rendered), nor to escape an impending trial (because there is none), but because it is in a situation where it must be able to continue its operations in the face of existential threats, in order to maximize the value of its estate and to protect the interests of its members, employees, vendors, and legitimate creditors.[59]

In its briefing, the Committee seemed to agree that the NRA's primary goal was to avoid dissolution in the NYAG Enforcement Action but did not find this to be an improper motive and also saw other benefits for the NRA in bankruptcy:

> In seeking the dismissal of these Chapter 11 Cases, the Moving Parties conflate the concept of litigation gamesmanship with prudent liability management. The Debtors filed these bankruptcy cases not to gain a tactical litigation advantage, but to implement a strategy ***to survive*** in the event of a potential adverse ruling in the NYAG Action. As described below, there

> could not be a more fundamental and proper use of the federal bankruptcy laws than preservation of and as a going-concern.
>
> ....
>
> In addition to protecting the NRA from dissolution, these Chapter 11 Cases also offer the NRA an opportunity to implement corporate governance changes that will promote transparency and increase public confidence in the way the NRA handles its finances, conducts business with vendors and customers, and safeguards against future mismanagement.[60]

***274** In the NRA's opening statement at trial, the stated reasons for filing bankruptcy were significantly narrower than in the NRA's briefing and appeared to focus heavily on the NYAG Enforcement Action:

> The exclusive testimony as to good faith will be we had three goals in mind. First, avoid the death penalty. Avoid dissolution. Two, avoid a receiver in a New York state court that would deny us the ability to file. And third, we wholly embrace our third goal. Our third goal is to [...] remove ourselves from New York and relocate ourselves to Texas.[61]

It is against this backdrop that the Court evaluates the evidence presented at trial regarding the NRA's reasons for filing bankruptcy.

Evidence of the NRA's Reasons for Filing Bankruptcy

The parties elicited testimony from several witnesses regarding the NRA's reasons for filing bankruptcy, but the way in which the Court has weighed that evidence is based on the somewhat unusual way in which this case was filed. There was no vote on whether the NRA should file for bankruptcy, and therefore there is no need to resolve inconsistent or conflicting reasoning and motivations of individuals who all had an equal say in the decision. Rather, the ultimate decision to file for bankruptcy was made solely by Mr. LaPierre.[62] As a result, Mr. LaPierre's testimony is the most direct, and, since the Court finds it credible on this topic, the most compelling evidence for why the NRA filed for bankruptcy, but it is not the only evidence to consider.[63] Mr. LaPierre consulted the three members of the Special Litigation Committee about the decision to file bankruptcy before it was made,[64] so their knowledge of the decision-making process is also relevant. The only other person within the NRA who appears to have known about the decision to file bankruptcy prior to the actual filing was the NRA spokesman,[65] but he did not testify. Neither the NRA's treasurer and then-CFO nor the NRA's current acting CFO were consulted about the decision to file bankruptcy, and they only learned of the decision after bankruptcy was filed.[66] Nevertheless, they were both able to offer helpful testimony regarding potential reasons for the bankruptcy, including the cost of litigation and the financial condition of the NRA. The NRA's general counsel also ***275** offered testimony regarding reasons for the NRA to file for bankruptcy, but he did not participate in the actual decision-making process and did not know about the decision to file bankruptcy until bankruptcy had already been filed.[67]

There was a general consensus among the witnesses that, as the NRA has consistently represented to the Court and to its members, the NRA is in its strongest financial condition in years[68] and intends to pay creditors all allowed claims in full.[69] The CFO at the time of the bankruptcy filing, Mr. Spray, testified that there was no financial reason for the NRA to file bankruptcy,[70] but he later qualified that testimony by noting that he did not have any information about potential litigation outcomes.[71] The current acting CFO, Ms. Rowling, gave supporting testimony regarding the financial strength of the NRA and its ongoing ability to pay its creditors[72] and testified that the NRA has sufficient funds to prosecute and defend its current litigation.[73] Ms. Rowling also testified, however, that it was her opinion that the NRA was in bankruptcy because of potential litigation losses that could severely impact the organization's financial position.[74]

The testimony of the NRA's general counsel, Mr. Frazer, on the reasons for filing bankruptcy was, in some respects, a bit difficult to reconcile. Despite not being involved in the decision to file for bankruptcy and not knowing about the decision until after bankruptcy was filed,[75] Mr. Frazer was designated as the corporate representative of the NRA as to the reasons, both financial and non-financial, for the NRA seeking protection under Chapter 11 of the Bankruptcy Code.[76] During his deposition, the only reasons for filing bankruptcy that Mr. Frazer identified were to streamline litigation, consolidate the claims against the NRA, and reorganize in Texas.[77] Mr. Frazer did not identify avoiding dissolution or avoiding receivership as reasons for the NRA filing bankruptcy at that time.[78] Nevertheless, Mr. Frazer testified at trial that he agreed the bankruptcy filing allowed the NRA to seek ***276** protection from regulators in New York.[79]

With regard to the threats of dissolution or a receiver being appointed, it is clear that the NYAG was seeking dissolution of the NRA.[80] Nevertheless, Mr. Frazer was not sure if a trial date is currently set in the NYAG Enforcement Action but anticipated a trial early next year and acknowledged that dissolution is not imminent.[81] Mr. Frazer also acknowledged having

no personal knowledge of an imminent threat of a receiver being appointed over the NRA.[82] With regard to streamlining litigation, Mr. Frazer reaffirmed that it is one of the NRA's reasons for filing bankruptcy[83] but acknowledged that he has not conducted an analysis, and was not aware of anyone else conducting an analysis, of the cost of proceeding with litigation outside of bankruptcy versus the cost of the bankruptcy and proceeding with the litigation in the bankruptcy case.[84] Mr. Frazer also testified that the NRA previously filed a motion for centralization of four pending actions that was denied by the United States Judicial Panel on Multidistrict Litigation on the basis that they were not persuaded that centralization was necessary for the convenience of the parties and witnesses or to further the just and efficient conduct of the litigation.[85]

The Court received testimony from all three members of the Special Litigation Committee, but their testimony did not explore the reasons for filing bankruptcy in much depth. The parties offered excerpts of the deposition of Ms. Meadows, but those excerpts did not include a discussion of why the NRA filed for bankruptcy. Colonel Lee testified that he understood the NYAG had sought the appointment of a receiver to seize the NRA's assets and that if a receiver were appointed over the NRA, it would be disastrous.[86] Mr. Cotton testified that he believed there was a risk that the NYAG could attempt to put the NRA into receivership because the first cause of action in the NYAG Complaint was for dissolution.[87] Mr. Cotton further testified that dissolution in the NYAG Enforcement Action was a legitimate risk that the NRA was concerned about.[88]

During trial, Mr. LaPierre was questioned several times regarding why the NRA filed for bankruptcy. In response to a question of whether the NRA filed bankruptcy to leave New York, Mr. LaPierre testified that the NRA filed bankruptcy to look for a fair legal playing field where the NRA could prosper and grow in a fair legal environment[89] and later testified that the NRA needs the approval of a federal ***277** court to move to a new state.[90] At one point, Mr. LaPierre was presented with a series of communications informing the NRA's members, the NRA's board of directors, and the general public that the NRA had filed for bankruptcy and asked if the contents of those communications were accurate, which Mr. LaPierre testified they were.[91] The communications, which were prepared by the NRA's Managing Director of Public Affairs working with a member of the Brewer Firm,[92] described a variety of reasons for why the NRA filed bankruptcy, including leaving New York and reincorporating in Texas, seeking protection from New York officials, streamlining legal and financial affairs, organizing pending litigation in a coordinated and structured manner, and realizing other financial and strategic advantages. In one of the communications, a question and answer page posted on the NRA's website, the NRA states: "This action is necessitated primarily by one thing: the unhinged and political attack against the NRA by the New York Attorney General."[93] With regard to the risk of a receiver being appointed, Mr. LaPierre testified that the NRA has not been put on notice that the NYAG intends to seek a receivership and he does not have any facts to suggest that there is an imminent threat of a receiver being appointed.[94]

The most helpful testimony from Mr. LaPierre came during an exchange when counsel for one of the movants was attempting to discern which of the many reasons for filing for bankruptcy that have been discussed was the real driving force behind Mr. LaPierre's decision. A few very valuable pieces of information came from that exchange. After establishing that the bankruptcy filing was not related to the NRA's financial condition,[95] Mr. LaPierre acknowledged that although the cost of defending the NYAG Enforcement Action was significant, the cost of bankruptcy is high as well.[96] Mr. LaPierre then confirmed that if the NRA's bankruptcy case is dismissed, the NRA would be able to pay its debts in full and meet its obligations.[97] The exchange continued:

> Q: Okay. So it comes down to the reason you filed Chapter 11 is because you have this New York attorney general enforcement action which is asking for dissolution of the NRA; is that correct?
>
> [Counsel for the NRA]: Objection; misstates his testimony.
>
> [Counsel for the Movant]: Well --
>
> THE COURT: Well, I'm going to go ahead and let him answer that. Try to give an answer to that, Mr. LaPierre.
>
> THE WITNESS: Yes, Your Honor. Yes, we filed the Chapter 11 to -- because the New York State attorney general is seeking dissolution of the NRA and [seizure of] its assets, and we believe it's not a fair, level playing field.
>
> ***278** ....
>
> Q: So really what we're down to is that it's -- the New York attorney general action is the reason you believe you need to be in bankruptcy, and, really, solvency and all your other litigation, those are not issues that would require you to be in bankruptcy; is that correct?
>
> A: That's correct.

Transcript of Hearing Held April 8, 2021 [Docket No. 654] at 33:19-34:20.

The Court's Determination of the NRA's Primary Reason for Filing Bankruptcy

The evidence does not support a finding that the purpose of the NRA's bankruptcy filing was to reduce operating costs, to address burdensome executory contracts and unexpired leases, to modernize the NRA's charter and organization structure, or to obtain a breathing spell. While some of these could be added benefits of going through a bankruptcy process, they do not appear to have been significant considerations for the NRA.

There was some evidence that the NRA wants to streamline litigation and control litigation costs, but this does not appear to have been the real purpose behind filing for bankruptcy. Ms. Rowling testified that she believes the NRA is in bankruptcy because of potential litigation losses, but this concern did not appear to be shared by Mr. LaPierre or supported by other evidence. The testimony regarding the ongoing cost of litigation was that the NRA is currently able to afford to pay its legal fees and that there has not been an analysis of the cost of proceeding with litigation outside of bankruptcy versus the cost of the bankruptcy and proceeding with the litigation in the bankruptcy case. Furthermore, Mr. LaPierre testified that but for the NYAG Enforcement Action, it would not have been necessary to file for bankruptcy.

Whether the NRA's desire to leave New York and reincorporate in Texas was a true reason for filing bankruptcy is a closer call, but the evidence weighs in favor of a finding that it was not the real purpose for filing for bankruptcy. Several witnesses testified that New York is a hostile environment for the NRA,[98] but the testimony was that individuals within the organization had been interested in leaving New York and reincorporating in Texas for a long time.[99] The choice to attempt to do so now —and to do so through a bankruptcy reorganization—appears to have been a means of achieving the more specific purpose of avoiding dissolution in the NYAG Enforcement Action.

In closing arguments at the conclusion of trial, there was a suggestion that part of the desire to move to Texas, and therefore part of the reason for filing bankruptcy, was due to the NRA having increasing difficulty with its relationships with financial institutions because of the NY DFS Letter.[100] The specific evidence on this topic came from Mr. Spray, who testified that he "didn't know exactly what the catalyst was for their angst," but that the NRA's relationships with banks when Mr. Spray joined the NRA were tenuous and he had ***279** to find more enthusiastic banking support.[101] Mr. Spray also testified that it was becoming difficult to get insurance when he joined the NRA and that problem has only gotten worse.[102] Counsel for the NRA characterized this as an existential threat that the NRA was facing before the NYAG Enforcement Action was pending and a reason for filing bankruptcy to move to Texas. There are a few reasons the Court is skeptical of this argument. The first is one of timing. The NY DFS Letter was sent in April 2018, and the NRA filed its lawsuit over alleged interference with its banking and insurance relationships in May 2018. The speed with which the NRA sought relief by filing a complaint in the Northern District of New York and the delay in filing bankruptcy, over two years later, suggests the purpose of the bankruptcy was related to something else. Moreover, the general testimony was that financial reasons did not drive the bankruptcy filing. The Court understands how this might not fall into the category of current financial health when asking most people at the NRA, but even Mr. Spray, who was fully aware of the banking and insurance relationships, testified that he was not aware of any reasons to file for bankruptcy. If the deterioration of banking and insurance relationships is an existential threat and an important reason for filing bankruptcy, one would think Mr. Spray would have been consulted, but he was not consulted on—or even informed of—the decision to file for bankruptcy.

With regard to receivership, there was no evidence to suggest that it was an imminent threat, and the witnesses only appear to have been concerned about receivership in the context of dissolution being granted. In other words, the witnesses appeared to be conflating the appointment of a receiver and dissolution when dissolution was the real concern. As far as the Court can tell, the appointment of a receiver was never requested by the NYAG in the NYAG Complaint or elsewhere. There was a statement in a press conference held by the NYAG that she may attempt to freeze assets,[103] but this comment appeared to relate to finding hidden assets and, in any event, none of the witnesses testified that this caused them concern that a receiver would be appointed. It is possible that if the NYAG had become aware that the NRA was preparing to file for bankruptcy, the NYAG could have attempted to have a receiver appointed on an expedited basis, but that would only be a reason for the NRA to go to extreme lengths to avoid leaks about its intention to file bankruptcy and not a reason for the bankruptcy filing itself.

Though articulated slightly differently, the remaining reasons for filing bankruptcy, such as preserving the NRA as a going concern, can be grouped under the general reason of avoiding dissolution in the NYAG Enforcement Action. Based on the statements of counsel and the evidence in the record, the Court finds that the primary purpose of the bankruptcy filing was to avoid potential dissolution in the NYAG Enforcement Action.

Analysis of Whether the NRA Filed Bankruptcy to Achieve a Valid Bankruptcy Purpose

[6]Having identified the purpose of the NRA's bankruptcy filing, the Court must now decide whether it was a valid purpose for bankruptcy such that the ***280** bankruptcy was filed in good faith. The Fifth Circuit Court of Appeals has offered guidance on how courts should approach the good faith inquiry:

> Determining whether the debtor's filing for relief is in good faith depends largely upon the bankruptcy court's on-the-spot evaluation of the debtor's financial condition, motives, and the local financial realities. Findings of lack of good faith in proceedings based on §§ 362(d) or 1112(b) have been predicated on certain recurring but non-exclusive patterns, and they are based on a conglomerate of factors rather than on any single datum.

In re Little Creek Dev. Co., 779 F.2d 1068, 1072 (5th Cir. 1986).[104] The Third Circuit Court of Appeals has stated that almost every federal Court of Appeals follows some variation of this "totality of the circumstances" approach to the good faith filing requirement for Chapter 11 petitions. *In re 15375 Mem'l Corp.*, 589 F.3d 605, 618 n.7 (3d Cir. 2009). In that same case, the Third Circuit went on to note that they focus on two inquiries that are particularly relevant to the question of good faith: (1) whether the petition serves a valid bankruptcy purpose and (2) whether the petition is filed merely to obtain a tactical litigation advantage. *Id.* at 618.

The Court has great concern about this case because its purpose is to avoid dissolution that is being sought as a remedy in a state regulatory action. It has been asserted that this case is about preserving the NRA as a going concern, which is a very common good faith reason for filing bankruptcy. There is a difference, however, between a lawsuit in which a party seeks a monetary judgment that would pose an existential threat to a debtor and one where the attorney general of a state is specifically seeking dissolution of a debtor under the state's laws and therefore required to satisfy standards and requirements that specifically justify dissolution.

The New York Legislature constructed a regulatory system under which charities would be dissolved under certain circumstances. In this situation, the NRA is financially healthy, and the only way that the NRA will be dissolved is if it is determined in the New York court system that the requirements in Article 11 of the New York Not-For-Profit Corporation Law have been met. The NYAG has requested dissolution of the NRA under two different statutory provisions and acknowledged the high burden that it must meet:

> But New York law does not allow the NYAG to summarily dissolve a charity, but rather place[s] a burden upon the NYAG to prove to a court that dissolution is called for under the law in a given circumstance.
>
> With respect to N-PCL § 1101, the Attorney General must show a regulated entity's misconduct "has produced, or tends to produce, injury to the public. The transgression must not be merely formal or incidental, but material and serious, and such as to harm or menace the public welfare." *People v. Oliver Schools, Inc.*, 206 A.D.2d 143, 145 [619 N.Y.S.2d 911] (4th Dep't 1994) (interpreting BCL § 1101, from which N-PCL § 1101 is derived) (quoting *People v. North River Sugar Refining Co.*, 121 N.Y. 582, 609 [24 N.E. 834] (1890))....
>
> With respect to Dissolution under N-PCL § 1102, the Attorney General stands in the shoes of the NRA's members and, as relevant here, must prove ***281** that the "directors or members in control of [the NRA] have looted or wasted the corporate assets, have perpetuated the corporation solely for their personal benefit, or have otherwise acted in an illegal, oppressive or fraudulent manner." N-PCL § 1102(a)(2)(D); 112(a)(7).

The State of New York's Omnibus Reply to Debtors' Opposition and the Committee's Response to Motion to Dismiss or Appoint a Trustee [Docket No. 459] at ¶ 17. A dissolution that requires this showing is not the type of dissolution that the Bankruptcy Code is meant to protect against. The Court is not in any way saying it believes the NYAG can or cannot make the required showing to obtain dissolution of the NRA, but the Court is saying that the Bankruptcy Code does not provide sanctuary from this kind of a threat.

For this reason, the Court believes the NRA's purpose in filing bankruptcy is less like a traditional bankruptcy case in which a debtor is faced with financial difficulties or a judgment that it cannot satisfy and more like cases in which courts have found bankruptcy was filed to gain an unfair advantage in litigation or to avoid a regulatory scheme. The purpose of this bankruptcy filing may not have been to end the NYAG Enforcement Action immediately, but it was to deprive the NYAG of the remedy of dissolution, which is a distinct litigation advantage. This differs materially from the prescribed parallel proceedings structure for regulatory actions where regulators can obtain monetary judgments in one forum and then are required to have any claims treated through a bankruptcy process in that it is the NRA's goal to avoid dissolution and subvert the remedy provided for under New York law entirely through this Chapter 11 case. The Court does not know what specific mechanism the NRA plans to use,[105] but its intention is clearly to "take dissolution off the table."[106]

Courts have consistently held that a bankruptcy case filed for the purpose of obtaining an unfair litigation advantage is not filed in good faith and should be dismissed. *See Antelope Techs., Inc. v. Lowe (In re Antelope Techs, Inc.)*, 431 F. App'x. 272 (5th Cir. 2011) (affirming dismissal for cause based on finding that "the purpose of the petition was not primarily to reorganize or respond to financial crisis but instead was to gain unfair advantage in the shareholder derivative action"); *Investors Group, LLC v. Pottorff*, 518 B.R. 380, 383-84 (N.D. Tex. 2014) (affirming dismissal of a bankruptcy case for being filed in bad faith based on a finding that the primary purpose for filing the bankruptcy petition was to gain an advantage in pending litigation); *In re Alexandra Trust*, 526 B.R. 668, 679-680 (Bankr. N.D. Tex. 2015) (citing cases).

[7]Using the bankruptcy process to avoid dissolution in the NYAG Enforcement Action is also problematic because it deprives the state of New York of the ability to regulate not-for-profit corporations in accordance with its laws. There is a regulatory scheme for evaluating whether a New York charity should continue in existence under Article 11 of the New York Not-For-Profit Corporation Law. While bankruptcy courts can, in some circumstances, ***282** apply state regulatory law,[107] a bankruptcy case filed for the purpose of avoiding a regulatory scheme is not filed in good faith and should be dismissed. *See In re First Plus Fin. Enters., Inc.*, 99 B.R. 751, 755-56 (Bankr. W.D. Tex. 1989) (finding cause for dismissal under section 1112(b) because the case was filed in bad faith where "the obvious purpose in this case is to use the Chapter 11 filing as a litigation strategy and leverage in order to defeat the Texas regulatory scheme for the receivership and conservatorship of insolvent life insurance companies"); *In re Forest Hill Funeral Home & Mem'l Park-East, LLC*, 364 B.R. 808, 822-23 (Bankr. E.D. Okla. 2007) (finding cause for dismissal under section 1112(b) because the case was not filed in good faith for several reasons, including that it was filed to evade the regulatory authority of the state of Tennessee); *cf. Halo Wireless, Inc. v. Alenco Commc'ns Inc. (In re Halo Wireless, Inc.)*, 684 F.3d 581, 587-88 (5th Cir. 2012) (noting that section 362(a)(4) assists with the goal of discouraging debtors from submitting bankruptcy petitions either primarily or solely for the purpose of evading impending governmental efforts to invoke the governmental police powers to enjoin or deter ongoing debtor conduct that would seriously threaten the public safety and welfare).

The Court would also like to discuss some of the NRA's other stated reasons for filing bankruptcy. The Court understands that the NRA wants to leave New York for a variety of reasons, not least of which being what it perceives to be a generally hostile environment. While the Court does not find that reincorporating in Texas was the true purpose of the bankruptcy filing, the Court would have concerns even if it were. Reincorporating in Texas could be accomplished outside of bankruptcy pursuant to applicable regulations for New York not-for-profit organizations,[108] which begs the question of what the Bankruptcy Code is being used for. If the goal is moving to Texas, the purpose of the bankruptcy would still appear to be avoidance of the regulatory scheme in New York that would be required for such a transition outside of bankruptcy, or at least avoidance of the New York regulators.

While the Court also does not find potential adverse judgments in litigation other than the NYAG Enforcement Action to have been a purpose for filing bankruptcy, the Court notes that based on the evidence, the NRA is financially healthy and potentially adverse litigation outcomes are too attenuated to justify a good faith bankruptcy filing. *See Off. Comm. of Unsecured Creditors v. Nucor Corp. (In re SGL Carbon Corp.)*, 200 F.3d 154, 163 (3d Cir. 1999) (holding that dismissal was appropriate where bankruptcy filing was based on litigation because the record was replete with evidence of the debtor's financial strength, there was no evidence that a judgment was imminent, and an assessment that pending litigation might result in a judgment causing financial and operational ruin was premature).

In closing arguments, counsel for the NRA raised several additional arguments that the Court would like to address. One of those arguments was that if avoiding dissolution is found to be an inappropriate bankruptcy purpose, this would allow a state to block a debtor's right to file for ***283** bankruptcy simply by filing an action seeking dissolution, and this would be tantamount to allowing a state to preempt federal law. This argument is based on the misconception that the state of New York has blocked access to bankruptcy relief just by filing a complaint with the word dissolution in it. The Court has not announced a *per se* rule that a pending dissolution action renders an entity ineligible for bankruptcy. Rather, the Court is evaluating the debtor's good faith or lack thereof in filing bankruptcy based on the totality of the circumstances of this specific case. The NRA is a solvent and growing organization using this bankruptcy as a tool to win its dissolution lawsuit, and that is not an appropriate use of bankruptcy.

Counsel for the NRA also, as the Court understands it, made the following argument. Section 1129(d) of the Bankruptcy Code states that the court may not confirm a plan over the objection of a governmental unit if the principal purpose of the plan is the avoidance of the application of section 5 of the Securities Act of 1933. Section 5 of the Securities Act of 1933 is an exercise of police power. Therefore, counsel argues, Congress has implicitly instructed that it is acceptable to file a bankruptcy petition for the purpose of avoiding any exercise of police power other than section 5 of the Securities Act of 1933. The Court does not understand this provision of the Bankruptcy Code to make such a sweeping endorsement of using bankruptcy for the principal purpose of avoiding the exercise of police power. Just because Congress has provided a guard rail for confirmation does not relieve the Court of its duty to conduct a fact-intensive inquiry to determine where a particular

petition for bankruptcy relief falls along the spectrum ranging from the clearly acceptable to the patently abusive. *See In re 15375 Mem'l Corp.*, 589 F.3d 605, 618 (3d Cir. 2009) (discussing the duties of courts in examining whether bankruptcy petitions are filed in good faith).

Finally, the Court notes that even if it agreed with one or more of the NRA's arguments regarding eligibility or confirmation standards, the Fifth Circuit Court of Appeals has already given clear instruction to examine cases to determine whether they were filed in good faith and to dismiss those that were not. *See In re Humble Place Joint Venture*, 936 F.2d 814, 817 (5th Cir. 1991) ("Because *Little Creek* explicitly treated the question of good faith dismissals under § 1112, the case settles any statutory or constitutional question about that procedure.").

The Court finds, based on the totality of the circumstances, that the NRA's bankruptcy petition was not filed in good faith but instead was filed as an effort to gain an unfair litigation advantage in the NYAG Enforcement Action and as an effort to avoid a regulatory scheme. This constitutes cause for dismissal under section 1112(b)(1) of the Bankruptcy Code.

Consideration of the Appointment of a Trustee or Examiner

[8] [9]Having found cause for dismissal, section 1112(b)(1) requires that the Court now consider whether appointment under section 1104(a) of a trustee or an examiner is in the best interests of creditors and the estate. The appointment of a Chapter 11 trustee is an extraordinary remedy that requires a movant to meet their burden of proof by clear and convincing evidence. *In re Patman Drilling Int'l, Inc.,* 2008 WL 724086, at *6, 2008 Bankr. LEXIS 715, at *15-16 (Bankr. N.D. Tex. Mar. 14, 2008). As mentioned previously, there is nothing approaching a consensus from the parties on what should be done.

As counsel for the NRA acknowledged on the record, there were cringeworthy facts during this trial. The movants have presented evidence of the NRA's past misconduct. ***284** Some facts regarding the NRA's past conduct were not available to this Court because the NRA's former treasurer asserted his rights under the Fifth Amendment during large swaths of his deposition.

Some of the conduct that gives the Court concern is still ongoing. The NRA appears to have very recently violated its approval procedures for contracts in excess of $100,000. Mr. LaPierre is still making additional financial disclosures. There are also lingering issues of secrecy and a lack of transparency. For example, even after hearing testimony from several witnesses, it is still very unclear why Mr. Spray, an officer everyone seemed to hold in high regard for his talent and integrity, parted ways with the NRA two weeks into this bankruptcy case. What is clear is that Mr. Spray's departure was precipitated by a call from Mr. LaPierre without involvement of the board of directors.

What concerns the Court most though is the surreptitious manner in which Mr. LaPierre obtained and exercised authority to file bankruptcy for the NRA. Excluding so many people from the process of deciding to file for bankruptcy, including the vast majority of the board of directors, the chief financial officer, and the general counsel, is nothing less than shocking.

The determination of whether appointment of a trustee or an examiner is in the best interests of creditors and the estate in this case, however, is complicated for a variety of reasons. The NRA has a mission that is, at times, political and polarizing. The NRA does not sell goods or services, and it would not be easy to find a suitable individual to serve in the role of trustee or examiner with expanded powers.[109]

In an odd twist for a bankruptcy case, the NRA is financially healthy, and undisputed creditors are likely to be paid sooner in the ordinary course outside of bankruptcy than they would if they must wait for confirmation of a plan of reorganization. On the other hand, if a trustee or an examiner with expanded powers were appointed, the Court believes the members and other donors who provide financial support to the NRA may not continue to support the organization.

While there is evidence of the NRA's past and present misconduct, the NRA has made progress since 2017 with its course correction. Whether it is yet complete or not, there has been more disclosure and self-reporting since 2017. Both Ms. Rowling and Mr. Erstling, the NRA's Director of Budget and Financial Analysis, testified that the concerns they expressed in the 2017 Whistleblower Memo are no longer concerns.[110] Mr. Frazer testified regarding the compliance training program that the NRA now has for employees.[111] Mr. Spray testified credibly that the change that has occurred within the NRA over the past few years could not have occurred without the active support of Mr. LaPierre.[112] It is also an encouraging fact that Ms. Rowling has risen in the ranks of the NRA to become the acting chief financial officer, both because of her former status as a whistleblower and because of the Court's impression of her from her testimony as a champion of compliance.

***285** In short, the testimony of Ms. Rowling and several others suggests that the NRA now understands the importance of compliance. Outside of bankruptcy, the NRA can pay its creditors, continue to fulfill its mission, continue to improve its governance and internal controls, contest dissolution in the NYAG Enforcement Action, and pursue the legal steps necessary to leave New York. While the Court appreciates the way in which some of the parties have presented the appointment of an examiner as a compromise that could provide some benefits without taking too much control from the NRA, the Court finds that the reasons discussed above weigh against keeping this case in bankruptcy with the appointment of a trustee or an examiner. For these reasons, the Court finds appointment of a trustee or an examiner would not be in the best interests of creditors and the estate.

Analysis of the Unusual Circumstances Exception Under Section 1112(b)(2)

The NRA did not allege unusual circumstances under section 1112(b)(2) of the Bankruptcy Code in their briefing but did discuss them during closing arguments at the conclusion of trial. Section 1112(b)(2) states:

> The court may not convert a case under this chapter to a case under chapter 7 or dismiss a case under this chapter if the court finds and specifically identifies unusual circumstances establishing that converting or dismissing the case is not in the best interests of creditors and the estate, and the debtor or any other party in interest establishes that—
>
> (A) there is a reasonable likelihood that a plan will be confirmed within the timeframes established in sections 1121(e) and 1129(e) of this title, or if such sections do not apply, within a reasonable period of time; and
>
> (B) the grounds for converting or dismissing the case include an act or omission of the debtor other than under paragraph (4)(A)—
>
> (i) for which there exists a reasonable justification for the act or omission; and
>
> (ii) that will be cured within a reasonable period of time fixed by the court.

While there are certainly unusual circumstances in this case, the Court does not find that they establish that dismissing the case is not in the best interests of creditors and the estate. This is true for many of the reasons discussed above. In addition, no party has established the requirement of section 1112(b)(2)(A). At trial, the Court was aware that the NRA intended to file a plan that would pay creditors in full, but the plan was not filed before the close of evidence. It was also clear from the evidence that the NRA could face substantial challenges in confirming a plan depending on how the NRA would be willing to structure it. The Court is aware that the NRA has now filed a plan of reorganization, but that plan was not offered into evidence and is not properly before the Court.

V. Conclusion

There are several aspects of this case that still trouble the Court, including the manner and secrecy in which authority to file the case was obtained in the first place, the related lack of express disclosure of the intended Chapter 11 case to the board of directors and most of the elected officers, the ability of the debtor to pay its debts, and the primary legal problem of the debtor being a state regulatory action. The Court agrees with the NYAG that the NRA is using this bankruptcy case to address a regulatory enforcement problem, not a financial one.

The Court finds that the NRA did not file the bankruptcy petition in good faith because this filing was not for a purpose intended or sanctioned by the Bankruptcy ***286** Code. Therefore, cause exists under section 1112(b) to dismiss this case, which the Court finds is in the best interests of creditors and the estate.

The Court is not dismissing this case with prejudice,[113] but should the NRA file a new bankruptcy case, this Court would immediately take up some of its concerns about disclosure, transparency, secrecy, conflicts of interest of officers and litigation counsel, and the unusual involvement of litigation counsel in the affairs of the NRA, which could cause the appointment of a trustee out of a concern that the NRA could not fulfill the fiduciary duty required by the Bankruptcy Code for a debtor in possession.

IT IS THEREFORE ORDERED that the Motions to Dismiss are **GRANTED** and the above-captioned cases are dismissed without prejudice;

IT IS FURTHER ORDERED that the Examiner Motion is **DENIED** as moot; and

IT IS FURTHER ORDERED that the CRO Motion is **DENIED** as moot.

All Citations

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Footnotes	
1	Transcript of Hearing Held April 21, 2021 [Docket No. 670] at 79:3-80:7; Transcript of Hearing Held April 6, 2021 [Docket No. 499] at 62:12-16.
2	Transcript of Hearing Held April 21, 2021 [Docket No. 670] at 79:18-80:1.
3	Transcript of Hearing Held April 21, 2021 [Docket No. 670] at 80:19-81:2.
4	In the NRA's organizational structure, the executive vice president is the functional equivalent of a chief executive officer. See Ackerman Exhibit 10 (NRA Bylaws, Article V, section 2(c)).
5	Transcript of Hearing Held April 8, 2021 [Docket No. 654] at 41:25-42:14.
6	Transcript of Hearing Held April 6, 2021 [Docket No. 499] at 62:8-11.
7	Transcript of Hearing Held April 8, 2021 [Docket No. 654] at 43:17-44:1; Transcript of Hearing Held April 6, 2021 [Docket No. 499] at 62:19-63:12.
8	Transcript of Hearing Held April 6, 2021 [Docket No. 499] at 67:13-16; Transcript of Hearing Held April 21, 2021 [Docket No. 670] at 81:3-9; Transcript of Hearing Held April 23, 2021 [Docket No. 697] at 148:16-19.
9	The board of directors also elected Mr. Spray as the treasurer of the NRA in September 2018.
10	NRA Exhibit 663.
11	Transcript of Hearing Held April 8, 2021 [Docket No. 654] at 95:1-21; NYAG Exhibit 72.
12	NYAG Exhibit 72.
13	Transcript of Hearing Held April 23, 2021 [Docket No. 697] at 90:4-19.
14	Transcript of Hearing Held April 13, 2021 [Docket No. 578] at 69:22-70:2.
15	Transcript of Hearing Held April 7, 2021 [Docket No. 700] at 24:24-25:9; Transcript of Hearing Held April 13, 2021 [Docket No. 578] at 157:6-20.

16	Transcript of Hearing Held April 23, 2021 [Docket No. 697] at 90:4-19; Transcript of Hearing Held April 7, 2021 [Docket No. 700] at 25:10-25; Transcript of Hearing Held April 6, 2021 [Docket No. 499] at 91:8-17.
17	Transcript of Hearing Held April 6, 2021 [Docket No. 499] at 91:8-92:4.
18	Transcript of Hearing Held April 23, 2021 [Docket No. 697] at 91:2-9.
19	NYAG Exhibit 72.
20	NYAG Exhibit 107.
21	Id.
22	NYAG Exhibit 1.
23	NYAG Exhibit 8.
24	Transcript of Hearing Held April 7, 2021 [Docket No. 700] at 98:9-99:25; NYAG Exhibit 298.
25	Transcript of Hearing Held April 7, 2021 [Docket No. 700] at 89:3-10; NYAG Exhibit 347.
26	NYAG Exhibits 2, 3.
27	NYAG Exhibit 3.
28	NYAG Exhibit 50.
29	Transcript of Hearing Held April 13, 2021 [Docket No. 584] at 92:1-93:10; Transcript of Hearing Held April 6, 2021 [Docket No. 692] at 76:15-21; Transcript of Hearing Held April 8, 2021 [Docket No. 544] at 92:24-93:4.
30	Transcript of Hearing Held April 5, 2021 [Docket No. 497] at 118:8-16; Transcript of Hearing Held April 8, 2021 [Docket No. 654] at 47:7-10; Transcript of Hearing Held April 6, 2021 [Docket No. 692] at 85:24-86:16.
31	Order Granting Debtors' Emergency Motion for Joint Administration of Chapter 11 Cases [Docket No. 36].
32	Judge Phillip Journey currently serves as the Division 1 Judge of the 18th Judicial District Court of Kansas.
33	Motion for Appointment of Examiner [Docket No. 114].
34	See Notice of Hearing [Docket No. 130].

35	Ackerman McQueen, Inc.'s Motion to Dismiss the Chapter 11 Bankruptcy Petition, or, in the Alternative, Motion for the Appointment of a Chapter 11 Trustee, and Brief in Support [Docket No. 131].
36	The State of New York's Motion to Dismiss, or, in the Alternative, to Appoint a Chapter 11 Trustee [Docket No. 155]; The State of New York's Motion to Dismiss, or, in the Alternative, to Appoint a Chapter 11 Trustee [Docket No. 163].
37	The District of Columbia's Motion in Support in the State of New York's Motion to Appoint Chapter 11 Trustee [Docket No. 214]; The District of Columbia's Motion in Support in the State of New York's Motion to Dismiss [Docket No. 429].
38	Christopher W. Cox's Joinder to (I) the Motions to Dismiss or, in the Alternative, to Appoint a Chapter 11 Trustee Filed by Ackerman McQueen, Inc. and the State of New York, or (II) the Motion of Phillip Journey for Appointment of an Examiner [Docket No. 172].
39	Limited Objection to the Motions to Dismiss or the Appointment of Trustee [Docket No. 306].
40	The Official Committee of Unsecured Creditors' Objection to the Motion for Appointment of an Examiner [Docket No. 354]; The Official Committee of Unsecured Creditors' Omnibus Response to (I) Ackerman McQueen, Inc.'s Motion to Dismiss the Chapter 11 Bankruptcy Petition, or, in the Alternative, Motion for the Appointment of a Chapter 11 Trustee, and Brief in Support, (II) the State of New York's Motion to Dismiss, or, in the Alternative, to Appoint a Chapter 11 Trustee, and (II) the District of Columbia's Motion in Support in the State of New York's Motion to Appoint Chapter 11 Trustee [Docket No. 368].
41	Omnibus Opposition to (1) Ackerman McQueen, Inc.'s Motion to Dismiss the Chapter 11 Bankruptcy Petition, or, in the Alternative, Motion for the Appointment of a Chapter 11 Trustee, (2) the State of New York's Motion to Dismiss or, in the Alternative, to Appoint Chapter 11 Trustee, and (3) the District of Columbia's Motion to Appoint Chapter 11 Trustee [Docket No. 307]; Debtor's Response in Opposition to the Motion for Appointment of an Examiner Filed by Phillip Journey [Docket No. 358].
42	David Dell'Aquila's Partial Joinder to (I) Ackerman McQueen, Inc.'s Motion to Dismiss the Chapter 11 Bankruptcy Petition, or, in the Alternative, Motion for the Appointment of a Chapter 11 Trustee, and Brief in Support, (II) the State of New York's Motion to Dismiss, or, in the Alternative, to Appoint a Chapter 11 Trustee, (III) the District of Columbia's Motion in Support in the State of New York's Motion to Appoint Chapter 11 Trustee, and (IV) the Official Committee of Unsecured Creditors Motion in Response to (I), (II), and (III) [Docket No. 415].
43	In closing arguments following trial, the United States Trustee took the position that the evidence supports dismissal, the appointment of a trustee, or the appointment of an examiner.
44	United States Trustee's Statement Regarding Motions Seeking Appointment of Examiner, Trustee, or Case Dismissal [Docket No. 405].
45	Brief of the States of Arkansas, Alabama, Alaska, Georgia, Idaho, Kentucky, Louisiana, Mississippi, Missouri, Montana, Ohio, Oklahoma, South Carolina, South Dakota, Utah, and West Virginia as Amici Curiae in Support of Debtors; and in Opposition to the State of New York's Motion to Dismiss, or in the Alternative to Appoint a Chapter 11 Trustee [Docket No. 445].
46	Brief of the State of Texas as Amicus Curiae in Support of Debtors; and in Opposition to the State of New York's Motion to Dismiss, or in the Alternative to Appoint a Chapter 11 Trustee [Docket No. 465].

47	Application of the Debtors for an Order Authorizing the Retention and Employment of Ankura Consulting Group, LLC and Appointment of Louis E. Robichaux IV as the Debtors' Chief Restructuring Officer [Docket No. 519] (the "CRO Motion").
48	Section 1112(b) also requires consideration of whether conversion to a case under chapter 7 would be in the best interests of creditors and the estate, but pursuant to section 1112(c), in cases where the debtor is a nonprofit, the court may not convert a case under chapter 11 to a case under chapter 7 unless the debtor requests such a conversion. The NRA has not requested such a conversion, so the Court need not consider it in this case.
49	In its discussion, the Court will focus on the NRA rather than Sea Girt, LLC. Sea Girt, LLC has no employees or operations and was formed to accomplish a shared bankruptcy purpose with the NRA.
50	Debtors' Informational Brief in Connection with Voluntary Chapter 11 Petitions [Docket No. 31] at ¶¶ 3, 6.
51	Id. at ¶ 26.
52	Id. at ¶ 27.
53	Transcript of Hearing Held January 20, 2021 [Docket No. 55] at 11:8-17, 12:1-14:9, 15:2-6.
54	Id. at 12:19-23.
55	Motion for Appointment of Examiner [Docket No. 114] at 2.
56	Ackerman McQueen, Inc.'s Motion to Dismiss the Chapter 11 Bankruptcy Petition, or, in the Alternative, Motion for the Appointment of a Chapter 11 Trustee, and Brief in Support [Docket No. 131] at ¶¶ 2, 29-31.
57	The State of New York's Memorandum of Law and Brief in Support of Motion to Dismiss, or, in the Alternative, to Appoint a Chapter 11 Trustee [Docket No. 156] at ¶¶ 3, 20, 24.
58	Omnibus Opposition to (1) Ackerman McQueen, Inc.'s Motion to Dismiss the Chapter 11 Bankruptcy Petition, or, in the Alternative, Motion for the Appointment of a Chapter 11 Trustee, (2) the State of New York's Motion to Dismiss or, in the Alternative, to Appoint Chapter 11 Trustee, and (3) the District of Columbia's Motion to Appoint Chapter 11 Trustee [Docket No. 307] at p. 13, ¶ 40.
59	Id. at p. 25, ¶ 38.
60	The Official Committee of Unsecured Creditors' Omnibus Response to (I) Ackerman McQueen, Inc.'s Motion to Dismiss the Chapter 11 Bankruptcy Petition, or, in the Alternative, Motion for the Appointment of a Chapter 11 Trustee, and Brief in Support, (II) the State of New York's Motion to Dismiss, or, in the Alternative, to Appoint a Chapter 11 Trustee, and (III) the District of Columbia's Motion in Support in the State of New York's Motion to Appoint Chapter 11 Trustee [Docket No. 368] at ¶¶ 24, 31 (emphasis in original).
61	Transcript of Hearing Held April 5, 2021 [Docket No. 497] at 40:25-41:7.

62	Transcript of Hearing Held April 5, 2021 [Docket No. 497] at 84:8-19; Transcript of Hearing Held April 7, 2021 [Docket No. 700] at 68:1-8, 70:12-72:23.
63	See Elmwood Dev. Co. v. Gen. Elec. Pension Tr. (In re Elmwood Dev. Co.), 964 F.2d 508, 512 (5th Cir. 1992) ("Because the good faith standard is an objective one, the court was not constrained to entertain and give dispositive weight to testimony of the subjective state of mind of [the debtor's] manager."); In re Little Creek Dev. Co., 779 F.2d 1068, 1072-73 (5th Cir. 1986) (stating that in determining whether a debtor's filing for relief is in good faith, courts must consider a conglomerate of factors, including motives).
64	Transcript of Hearing Held April 5, 2021 [Docket No. 497] at 84:8-85:11; Transcript of Hearing Held April 6, 2021 [Docket No. 499] at 36:18-23; NYAG Exhibit 4 at 5-10.
65	Transcript of Hearing Held April 7, 2021 [Docket No. 700] at 72:11-23.
66	Transcript of Hearing Held April 7, 2021 [Docket No. 700] at 70:12-17; Transcript of Hearing Held April 5, 2021 [Docket No. 497] at 119:23-120:1; Transcript of Hearing Held April 6, 2021 [Docket No. 692] at 49:7-11; Transcript of Hearing Held April 13, 2021 [Docket No. 578] at 54:12-21; Transcript of Hearing Held April 8, 2021 [Docket No. 654] at 85:19-22.
67	Transcript of Hearing Held April 5, 2021 [Docket No. 497] at 118:17-119:21; Transcript of Hearing Held April 6, 2021 [Docket No. 692] at 43:19-44:8.
68	Transcript of Hearing Held April 7, 2021 [Docket No. 700] at 78:16-81:2; Transcript of Hearing Held April 8, 2021 [Docket No. 654] at 32:24-33:2; Transcript of Hearing Held April 6, 2021 [Docket No. 692] at 160:24-161:2; Transcript of Hearing Held April 13, 2021 [Docket No. 584] at 33:12-14, 34:13-21; Transcript of Hearing Held April 13, 2021 [Docket No. 578] at 51:21-53:13; NYAG Exhibit 151.
69	Transcript of Hearing Held April 6, 2021 [Docket No. 692] at 32:9-17; Transcript of Hearing Held April 8, 2021 [Docket No. 654] at 52:22-53:5.
70	Transcript of Hearing Held April 13, 2021 [Docket No. 578] at 53:11-13, 129:17-130:20, 132:22-133:4.
71	Transcript of Hearing Held April 16, 2021 [Docket No. 620] at 19:10-16.
72	Transcript of Hearing Held April 13, 2021 [Docket No. 584] at 33:12-14, 34:13-21, 36:17-38:14.
73	Transcript of Hearing Held April 13, 2021 [Docket No. 584] at 39:17-23.
74	Transcript of Hearing Held April 13, 2021 [Docket No. 584] at 34:22-35:1.
75	Transcript of Hearing Held April 6, 2021 [Docket No. 692] at 43:19-44:8, 109:22-24.
76	Transcript of Hearing Held April 7, 2021 [Docket No. 559] at 17:5-14.

77	Transcript of Hearing Held April 7, 2021 [Docket No. 559] at 17:15-20, 57:8-25.
78	Transcript of Hearing Held April 7, 2021 [Docket No. 559] at 20:20-21:1.
79	Transcript of Hearing Held April 6, 2021 [Docket No. 692] at 107:22-108:6; Transcript of Hearing Held April 7, 2021 [Docket No. 559] at 21:12-19.
80	See NYAG Exhibit 107 (NYAG Complaint in which the first two causes of action are labeled "Dissolution of the NRA").
81	Transcript of Hearing Held April 7, 2021 [Docket No. 559] at 29:10-30:6, 30:19-22.
82	Transcript of Hearing Held April 7, 2021 [Docket No. 559] at 33:18-34:11.
83	Transcript of Hearing Held April 6, 2021 [Docket No. 692] at 109:2-11.
84	Transcript of Hearing Held April 6, 2021 [Docket No. 692] at 112:19-113:1.
85	Transcript of Hearing Held April 7, 2021 [Docket No. 559] at 36:20-38:12; Ackerman Exhibit 121.
86	Transcript of Hearing Held April 21, 2021 [Docket No. 673] at 45:10-46:2.
87	Transcript of Hearing Held April 6, 2021 [Docket No. 499] at 37:3-7.
88	Transcript of Hearing Held April 6, 2021 [Docket No. 499] at 38:15-39:10.
89	Transcript of Hearing Held April 7, 2021 [Docket No. 700] at 66:11-23.
90	Transcript of Hearing Held April 8, 2021 [Docket No. 654] at 42:23-43:4.
91	Transcript of Hearing Held April 7, 2021 [Docket No. 700] at 67:14-25 (affirming the accuracy of NYAG Exhibit 153); id. at 86:18-21 (affirming the accuracy of NYAG Exhibit 55); id. at 87:5-18 (affirming the accuracy of NYAG Exhibit 151); id. at 87:22-88:8 (affirming the accuracy of NYAG Exhibit 208).
92	Transcript of Hearing Held April 7, 2021 [Docket No. 700] at 88:1-4.
93	NYAG Exhibit 208.
94	Transcript of Hearing Held April 8, 2021 [Docket No. 654] at 21:8-22:1.

95	Transcript of Hearing Held April 8, 2021 [Docket No. 654] at 32:9-20.
96	Transcript of Hearing Held April 8, 2021 [Docket No. 654] at 32:15-23.
97	Transcript of Hearing Held April 8, 2021 [Docket No. 654] at 32:24-33:2.
98	Transcript of Hearing Held April 7, 2021 [Docket No. 700] at 16:23-25; Transcript of Hearing Held April 21, 2021 [Docket No. 670] at 7:25-8:12; Transcript of Hearing Held April 6, 2021 [Docket No. 499] at 37:14-38:9; Transcript of Hearing Held April 13, 2021 [Docket No. 584] at 146:1-8; Transcript of Hearing Held April 7, 2021 [Docket No. 559] at 22:10-13; Transcript of Hearing Held April 7, 2021 [Docket No. 700] at 66:11-20.
99	Transcript of Hearing Held April 6, 2021 [Docket No. 499] at 37:8-38:14.
100	The NY DFS Letter is attached to NRA Exhibit 663.
101	Transcript of Hearing Held April 13, 2021 [Docket No. 578] at 153:18-154:20.
102	Transcript of Hearing Held April 13, 2021 [Docket No. 578] at 154:21-155:9.
103	NRA Exhibit 675.
104	The Fifth Circuit also identified several conditions that usually exist in filings that are not made in good faith. Id. at 1072-73. Because of the unusual circumstances of this case, the Court considered the Little Creek factors but did not structure its discussion around them.
105	Transcript of Hearing Held April 5, 2021 [Docket No. 497] at 41:22-42:5 (Counsel for the NRA describing different ways in which a plan could be structured to achieve the NRA's goal in this case).
106	Transcript of Hearing Held April 5, 2021 [Docket No. 497] at 49:23-25 (Counsel for the NRA: "We filed, again, for three reasons that constitute good faith. We needed to take dissolution, the equivalent of foreclosure, off the table. ...").
107	See, e.g., In re HHH Choices Health Plan, LLC, 554 B.R. 697 (Bankr. S.D.N.Y. 2016).
108	See Article 9 of the New York Not-For-Profit Corporation Law (governing merger or consolidation); Article 10 of the New York Not-For-Profit Corporation Law (governing non-judicial dissolution).
109	The examiner that has been requested is one with expanded powers, including the power to "independently examine, and the extent necessary, remove management for cause."
110	Transcript of Hearing Held April 23, 2021 [Docket No. 697] at 94:24-95:4.
111	Transcript of Hearing Held April 7, 2021 [Docket No. 700] at 26:15-28:1.

112	Transcript of Hearing Held April 13, 2021 [Docket No. 578] at 156:17-157:5.
113	The movants did not request a prejudice period in their original Motions to Dismiss. While the NYAG did request dismissal with prejudice in a reply brief, it was not discussed in the body of the reply, and the NRA did not have an opportunity to provide responsive briefing to that request.

End of Document	

638 B.R. 403
United States Bankruptcy Appellate Panel of the Ninth Circuit.

IN RE: RS AIR, LLC, Debtor.
NetJets Aviation, Inc.; NetJets Sales, Inc.; NetJets Services, Inc., Appellants,
v.
RS Air, LLC, Appellee.

BAP No. NC-21-1227-BGT
|
Bk. No. 20-51604
|
Argued and Submitted on January 19, 2022 at Pasadena, California
|
APRIL 26, 2022

Synopsis
Background: Creditor appealed from orders of the United States Bankruptcy Court for the Northern District of California, M. Elaine Hammond, J., denying its objection to Chapter 11 debtor's Subchapter V election and later ruling upholding the eligibility decision in confirming the plan.

Holdings: The Bankruptcy Appellate Panel, Brand, J., held that:

[1] debtor was not required to be maintaining its core or historical operations on petition date to be eligible to proceed under Subchapter V of Chapter 11;

[2] profit motive was not required for debtor to be eligible to proceed under Subchapter V of Chapter 11;

[3] debtor, and not objecting party, had burden to prove eligibility to proceed under Subchapter V of Chapter 11;

[4] Bankruptcy Court's error in allocating burden to objecting creditor as to debtor's eligibility to proceed under Subchapter V of Chapter 11 was harmless, because debtor met its burden; and

[5] any error by Bankruptcy Court made in not considering exceptions to law of the case doctrine was harmless.

Affirmed.

West Headnotes (16)

[1]	**Bankruptcy**Interlocutory orders; collateral order doctrine

	Bankruptcy Court's interlocutory order denying creditor's objection to Chapter 11 debtor's Subchapter V election merged into the final confirmation order, for purposes of appeal. 1 Cases that cite this headnote

[2]	**Bankruptcy**Conclusions of law; de novo review **Bankruptcy**Particular cases and issues
	Question of whether a particular activity constitutes "commercial or business activities" for purposes of debtor's eligibility to proceed under Subchapter V of Chapter 11 is a legal question the Bankruptcy Appellate Panel (BAP) reviews de novo, and the bankruptcy court's determination whether debtor engaged in that particular activity is a factual question reviewed for clear error. 11 U.S.C.A. § 1182(1)(A). 1 Cases that cite this headnote

[3]	**Bankruptcy**Clear error
	Bankruptcy court's factual findings are "clearly erroneous" if they are illogical, implausible, or without support in the record.

[4]	**Bankruptcy**Conclusions of law; de novo review
	Whether the bankruptcy court identified and applied the correct burden of proof is a question of law the Bankruptcy Appellate Panel (BAP) reviews de novo. 1 Cases that cite this headnote

[5]	**Bankruptcy**Discretion

	Bankruptcy Appellate Panel (BAP) reviews bankruptcy court's decision whether to apply law of the case doctrine for abuse of discretion.

[6]	**Bankruptcy**Discretion
	Bankruptcy court abuses its discretion if it applies wrong legal standard, or misapplies correct legal standard, or makes factual findings that are illogical, implausible, or without support in inferences that may be drawn from facts in record.

[7]	**Bankruptcy**Reorganization cases
	Generally, a debtor is eligible to elect Subchapter V of Chapter 11 if the debtor: (1) is a "person"; (2) is engaged in commercial or business activities; (3) does not have aggregate debts in excess of the debt limit on the petition date; and (4) at least 50 percent of the debtor's debts arose from its commercial or business activities. 11 U.S.C.A. § 1182(1)(A). 1 Cases that cite this headnote

[8]	**Bankruptcy**Corporations
	A limited liability company (LLC) is a "person," for purposes of determining debtor's eligibility to proceed under Subchapter V of Chapter 11. 11 U.S.C.A. § 1182(1)(A).

[9]	**Bankruptcy**Reorganization cases

	Debtor need not be maintaining its core or historical operations on petition date to be eligible to proceed under Subchapter V of Chapter 11, but it must be presently engaged in some type of commercial or business activities. 11 U.S.C.A. § 1182(1)(A). 1 Cases that cite this headnote

[10]	**Bankruptcy**Reorganization cases
	Profit motive was not required for debtor to be eligible to proceed under Subchapter V of Chapter 11. 11 U.S.C.A. § 1182(1)(A).

[11]	**Bankruptcy**Evidence and fact questions
	Debtor, and not objecting party, had burden to prove eligibility to proceed under Subchapter V of Chapter 11. 11 U.S.C.A. § 1182(1)(A).

[12]	**Bankruptcy**Harmless error
	Bankruptcy Court's error in allocating burden to objecting creditor as to debtor's eligibility to proceed under Subchapter V of Chapter 11 was harmless, because debtor met its burden by demonstrating that it was engaged in commercial or business activities on the petition date, which was the only criterion challenged by creditor on eligibility. 11 U.S.C.A. § 1182(1)(A).

[13]	**Courts**Previous Decisions in Same Case as Law of the Case

	Doctrine of "law of the case" provides that court is generally precluded from reconsidering issue that has already been decided by same court, or higher court in identical case.

[14]	**Courts**Previous Decisions in Same Case as Law of the Case
	To apply doctrine of law of the case, issue in question must have been decided either expressly or by necessary implication in previous disposition.

[15]	**Courts**Previous Decisions in Same Case as Law of the Case **Federal Courts**Effect of Decision in Lower Court
	Court may revisit previously resolved question when: first decision was clearly erroneous; intervening change in law has occurred; evidence on remand is substantially different; other changed circumstances exist; or manifest injustice would otherwise result.

[16]	**Bankruptcy**Harmless error
	Any error by Bankruptcy Court made in not considering exceptions to law of the case doctrine in denying creditor's objection to Chapter 11 debtor's Subchapter V election and later ruling upholding the eligibility decision in confirming the plan was harmless, because no new evidence was presented at the final confirmation trial that the court should have considered or that would have changed the outcome.

***405** Appeal from the United States Bankruptcy Court for the Northern District of California, M. Elaine Hammond, Bankruptcy Judge, Presiding

Attorneys and Law Firms

Kelly Singer of Squire Patton Boggs (US) LLP argued for appellants;

Jennifer C. Hayes of Finestone Hayes LLP argued for appellee.

Before: BRAND, GAN, and TAYLOR, Bankruptcy Judges.

OPINION

BRAND, Bankruptcy Judge:

INTRODUCTION

Appellants NetJets Aviation, Inc., NetJets Sales, Inc., and NetJets Services, Inc. (collectively, "NetJets") appeal an order confirming the chapter 11[1] plan of debtor RS Air, LLC ("RS Air"). Specifically, NetJets appeals the bankruptcy court's prior order denying its objection to RS Air's subchapter V election, and the court's later ruling upholding the eligibility decision in confirming the plan.

NetJets argues that the bankruptcy court erred in determining that RS Air was eligible for subchapter V relief. According to NetJets, since RS Air had no profit motive, it was not "engaged in commercial or business activities" on the petition date pursuant to § 1182(1)(A).[2] NetJets argues that the bankruptcy court further erred by allocating the burden of proof to NetJets to establish that RS Air was not eligible for subchapter V. Finally, NetJets argues that the bankruptcy court erred in ruling that the law of the case doctrine precluded the court from reconsidering RS Air's eligibility for subchapter V when new evidence at the final confirmation trial demonstrated that it was ineligible.

We hold that a profit motive is not required to satisfy § 1182(1)(A). We further hold that the burden is on the debtor to prove subchapter V eligibility. Although the bankruptcy court ruled otherwise on that issue, such error was harmless, because ***406** the record established that RS Air met its burden of establishing its eligibility to proceed under subchapter V. Finally, we conclude that any error the bankruptcy court made regarding its law of the case ruling was harmless, because no new evidence was presented at the final confirmation trial that the court should have considered or that would have changed the outcome. Accordingly, we AFFIRM.

FACTS

RS Air, a Delaware LLC doing business in California, was formed in 2001 by its sole member and manager, Stephen Perlman, for the purpose of using and providing aircraft transportation services, acquiring and selling interests in aircraft, and providing depreciation tax benefits to Perlman. From 2001 to 2017, RS Air's principal source of revenue from business operations was from providing flight services for Perlman and affiliated third parties and flying fragile technology prototypes to prevent damage from baggage handling on commercial flights. RS Air also obtained revenue from acquiring and selling fractional interests in aircraft.

Beginning in 2001, RS Air entered into a series of agreements to purchase or lease from NetJets fractional interests in private jets. NetJets is a private business jet charter company that sells fractional jet interests, charter jet flight time, and aircraft management services. NetJets actively marketed depreciation tax benefits as a key benefit to fractional jet ownership.

The parties had a good business relationship until July 2017, when one of the jets fractionally owned by RS Air was involved in a non-injury runway crash, which RS Air contends NetJets failed to disclose and was caused by a NetJets pilot. RS Air

ceased doing business with NetJets after the accident and was still not engaged in its normal flight operations when it filed for bankruptcy in November 2020. RS Air attributed its lack of operations to NetJets not allowing RS Air to use or sell any jets after the accident and the parties' falling out. Ultimately, the parties ended up in litigation in Ohio, with NetJets filing suit against RS Air for breach of contract and RS Air asserting counterclaims against NetJets for breach of contract and fraud.

B. The bankruptcy case and litigation over subchapter V eligibility

Just before trial was to begin in Ohio, RS Air filed a chapter 11 bankruptcy case and elected to proceed under subchapter V. NetJets is RS Air's largest, non-insider creditor and holds approximately 98% of the total non-insider debt.

1. Objection to subchapter V designation

NetJets objected to RS Air's election as a subchapter V debtor, arguing that RS Air was not eligible for subchapter V because it was not currently "engaged in commercial or business activities" pursuant to § 1182(1)(A). NetJets argued that RS Air had no flight operations since at least 2017, no revenue or income since as early as 2012, and no employees. In fact, argued NetJets, RS Air had never been a revenue-generating business, and its sole purpose was to serve as the intermediary through which Perlman acquired interests in and paid for the availability and use of private jets. NetJets argued that it was RS Air's burden to establish eligibility for subchapter V.

In opposition, RS Air argued that ongoing operations, employees, or historical profitability were not required for subchapter V eligibility. RS Air argued that it was currently engaged in business activities by (1) litigating with NetJets, (2) negotiating with NetJets to sell its fractional ***407** jet interests back to NetJets, (3) paying its aircraft registry fees, (4) remaining in good standing as a Delaware LLC, and (5) keeping its tax obligations current with the state of California and the federal government. RS Air also intended to resume normal flights operations with a different partner once able. RS Air argued that NetJets, as the movant, bore the burden of establishing that RS Air was not eligible for subchapter V.

The bankruptcy court overruled NetJets' objection to RS Air's subchapter V election ("Subchapter V Order"). First, it determined that NetJets, as the party challenging eligibility, had the burden to establish that RS Air was not eligible for subchapter V. Second, it found that RS Air was engaged in commercial or business activities on the petition date because RS Air: (1) transformed its business from flight services to investigation into and litigation with NetJets (its primary contractual party); (2) intended to resume fractional jet ownership with a different partner; (3) paid its aircraft registry fees; (4) remained in good standing as a Delaware LLC; and (5) filed its tax returns and paid taxes as required. The court rejected NetJets' argument that employees are required for eligibility, observing that many small businesses have no employees. Therefore, because NetJets did not meet its burden to establish that RS Air failed to satisfy the eligibility requirements of § 1182, RS Air would proceed as a subchapter V debtor.

2. RS Air's plan of reorganization

At an earlier plan confirmation hearing, Perlman testified that, while some income is generated from providing flights to him or his related entities, RS Air would have no projected disposable income within the next five years, if ever. Instead, the primary financial benefit obtained is a tax deduction for aircraft depreciation that flows through Perlman. As a result, he would pay all administrative expenses and contribute new value of $50,000 (later increased to $100,000), which was more than the expected disposable income of $0.

At the final plan confirmation hearing, RS Air's financial expert testified that the net present value of RS Air's projected disposable income was $8,200. Because RS Air's value in a traditional disposable income analysis was projected to be a large negative number in the three- to five-year period postconfirmation, the financial expert created an alternative model to capture nontraditional kinds of value (e.g., tax benefits and aircraft flight services) that would not be included in a traditional analysis. The expert's alternative model recognized that RS Air was set up primarily to create value as a tax benefit from owning a fractional aircraft share and providing aircraft flight services, not to create value from profit on income.

In opposing confirmation, NetJets again argued that RS Air was not eligible for subchapter V, and therefore the Plan did not meet the good faith requirement of § 1129(a)(3). NetJets argued that RS Air was not a business with income, the expert's

financial projections improperly included indirect items of value such as the depreciation tax benefit, and the expert's financial projections were based on non-GAAP and never-before-seen methodologies. NetJets contended that the real purpose of RS Air's subchapter V bankruptcy was to sustain a facade business with no operations or income to protect Perlman and affiliates and provide him with valuable tax benefits.

In confirming RS Air's third amended plan of reorganization (the "Confirmation Order"), the bankruptcy court found that the disposable income projections of Perlman and RS Air's financial expert were ***408** consistent with NetJets' argument that RS Air was not a business with income, but that whether RS Air generated income was not determinative for confirmation. The court decided that the law of the case doctrine precluded revisiting the issue of RS Air's subchapter V designation. However, the court noted that developing case law, which interpreted broadly the types of commercial or business activities that can satisfy § 1182(1)(A), supported its earlier decision that RS Air was engaged in commercial or business activities on the petition date. NetJets timely appealed the Confirmation Order, which included the prior Subchapter V Order. A motions panel granted NetJets' request for stay of the Confirmation Order pending appeal.

JURISDICTION

[1]The bankruptcy court had jurisdiction under 28 U.S.C. §§ 1334 and 157(b)(2)(L). We have jurisdiction under 28 U.S.C. § 158.[3]

ISSUES

1. Did the bankruptcy court err in determining that RS Air was "engaged in commercial or business activities" on the petition date?

2. Did the bankruptcy court err by allocating the burden to NetJets to prove that RS Air was not eligible for subchapter V?

3. Did the bankruptcy court abuse its discretion in determining that the law of the case doctrine precluded its review of the Subchapter V Order?

STANDARDS OF REVIEW

[2][3]The question of whether a particular activity constitutes "commercial or business activities" under § 1182(1)(A) is a legal question we review de novo, and the bankruptcy court's determination whether the debtor engaged in that particular activity is a factual question we review for clear error. *See**Int'l Ass'n of Firefighters, Local 1186 v. City of Vallejo (In re City of Vallejo)*, 408 B.R. 280, 288-89 (9th Cir. BAP 2009) (we review questions of law and statutory interpretation of the Code de novo and the bankruptcy court's factual findings for clear error) (chapter 9 eligibility); *see also**Watford v. Fed. Land Bank of Columbia*, 898 F.2d 1525, 1527 (11th Cir. 1990) (applying these standards of review to chapter 12 eligibility). Factual findings are clearly erroneous if they are illogical, implausible, or without support in the record. *Retz v. Samson (In re Retz)*, 606 F.3d 1189, 1196 (9th Cir. 2010).

[4]Whether the bankruptcy court identified and applied the correct burden of proof is a question of law we review de novo. *Boruff v. Cook Inlet Energy LLC (In re Cook Inlet Energy LLC)*, 583 B.R. 494, 500 (9th Cir. BAP 2018).

[5][6]We review the bankruptcy court's decision whether to apply the law of the case doctrine for an abuse of discretion. *See**United States v. Lummi Indian Tribe*, 235 F.3d 443, 452 (9th Cir. 2000). A bankruptcy court abuses its discretion if it applies the wrong legal standard, or misapplies the correct legal standard, or makes factual findings that are illogical, implausible, or without support in inferences that may be drawn from the facts in the record. *See**United States v. Hinkson*, 585 F.3d 1247, 1262 (9th Cir. 2009) (en banc).

***409DISCUSSION**

A. The bankruptcy court did not err in determining that RS Air was "engaged in commercial or business activities" on the petition date.

[7][8]Under the Small Business Reorganization Act of 2019, commonly referred to as "subchapter V," Congress authorized eligible persons to avail themselves of streamlined chapter 11 bankruptcy relief designed to help small businesses.[4] Generally, a debtor is eligible to elect subchapter V if the debtor: (1) is a "person;"[5] (2) is "engaged in commercial or business activities;" (3) does not have aggregate debts in excess of the debt limit on the petition date; and (4) at least 50 percent of the debtor's debts arose from its commercial or business activities. § 1182(1)(A).

The only question here is whether RS Air was "engaged in commercial or business activities" within the meaning of § 1182(1)(A). The Bankruptcy Code does not define the phrase and case law is sparse. With one exception, no appellate court has weighed in on the subject. The trial courts that have reviewed it are divided as to its meaning.

A majority of courts have held that a debtor need not be "actively operating" on the petition date, but must be "presently" engaged in commercial or business activities on the petition date to satisfy § 1182(1)(A). *See**Nat'l Loan Invs., L.P. v. Rickerson (In re Rickerson)*, 636 B.R. 416, 424-25 (Bankr. W.D. Pa. 2021); *Lyons v. Family Friendly Contracting LLC (In re Family Friendly Contracting LLC)*, No. 21-14213-TJC, 2021 WL 5540887, at *3 (Bankr. D. Md. Oct. 26, 2021); *In re McCune*, 635 B.R. 409, 418–22 (Bankr. D.N.M. 2021); *In re Vertical Mac Constr., LLC*, No. 6:21-bk-01520-LVV, 2021 WL 3668037, at *2 (Bankr. M.D. Fla. July 23, 2021) ("operations" insinuates a fully functioning business but "activities" includes acts that are business in nature but fall short of an actual operating business); *In re Port Arthur Steam Energy, L.P.*, 629 B.R. 233, 236-37 (Bankr. S.D. Tex. 2021); *In re Blue*, 630 B.R. 179, 189-90 (Bankr. M.D.N.C. 2021); *In re Offer Space, LLC*, 629 B.R. 299, 305-07 (Bankr. D. Utah 2021); *In re Ikalowych*, 629 B.R. 261, 283-84 (Bankr. D. Colo. 2021); *In re Johnson*, No. 19-42063-ELM, 2021 WL 825156, at *6-8 (Bankr. N.D. Tex. Mar. 1, 2021); *In re Thurmon*, 625 B.R. 417, 422-23 (Bankr. W.D. Mo. 2020). Two courts have held that the debtor need not have been engaged in any commercial or business activities on the petition date to qualify for subchapter V, as long as the debtor was engaged in such activities at some point in the past. *See**In re Blanchard*, No. 19-12440, 2020 WL 4032411, at *2 (Bankr. E.D. La. July 16, 2020) (finding that "engaged in" has no temporal limit); ***410***In re Wright*, No. 20-01035-HB, 2020 WL 2193240, at *3 (Bankr. D.S.C. Apr. 27, 2020) (debtor need not be "currently" engaged in commercial or business activities on the petition date). Notably, those courts were two of the first to consider the issue.

[9]We agree with the majority, that the term "engaged in" is inherently contemporary in focus and not retrospective. Thus, a debtor need not be maintaining its core or historical operations on the petition date, but it must be "presently" engaged in some type of commercial or business activities to satisfy § 1182(1)(A).

The next question is, when a debtor is no longer operational, what types of "activities" satisfy the requirement that the debtor be engaged in commercial or business activities. In using the common meanings of the terms and other statutory construction methods, courts generally have held that the scope of commercial or business activities is very broad and apply a "totality of the circumstances" standard. *See**In re Rickerson*, 636 B.R. at 425-26 (reasoning that "winding down" is a business activity and could be enough for § 1182(1)(A) but not deciding the issue because debtor's entities had been inactive for years prepetition, with no assets, no employees, no accounts, and the debtor had no intent to reactivate any of the entities); *In re Vertical Mac Constr., LLC*, 2021 WL 3668037, at *3 (concluding that maintenance of bank accounts, working with insurance adjusters and defense counsel to resolve claims, and selling assets all qualified as commercial or business activities); *In re Port Arthur Steam Energy, L.P.*, 629 B.R. at 237 (concluding that actively pursuing litigation against a third party, collecting outstanding accounts receivable, maintaining its facility, selling an asset, and filing tax returns all qualified as commercial or business activities); *In re Blue*, 630 B.R. at 190 (concluding that debtor was engaged in business activities by working as an IT consultant for a non-related entity and by winding down her former IT business); *In re Offer Space, LLC*, 629 B.R. at 306-07 (while debtor was no longer operating, had no employees, had no intention to reorganize, and intended to liquidate any remaining assets, debtor was engaged in commercial or business activities by having active bank accounts and accounts receivable, exploring counterclaims in a pending lawsuit, managing its stock, and winding down its business and taking steps to pay creditors and realize value for its assets); *In re Ikalowych*, 629 B.R. at 284-85 (concluding that the W-2 wage-earner debtor performing wind down work and dealing with tax accountants and tax issues for his defunct LLC qualified as commercial or business activities).

Suffice it to say, courts are less likely to find sufficient commercial or business activities for purposes of § 1182(1)(A) where

the debtor is an individual who owns a non-operating business, especially where the business has been dissolved under applicable state law. *See*In re Rickerson, 636 B.R. at 425-26 (concluding that individual whose entities had been inactive for years prepetition with no ongoing activity of any type and had no intent to reactivate any of the entities was not engaged in commercial or business activities); *In re Johnson*, 2021 WL 825156, at *7-8 (concluding that individual debtors were not engaged in commercial or business activities where husband's former companies were defunct and both debtors were now W-2 wage earners, even though husband was currently serving as president in a non-related business); *In re Thurmon*, 625 B.R. at 423 (concluding that individual debtors who sold their business prepetition, were retired, and did not intend to return to business were not engaged in commercial or business activities, and keeping their empty shell LLC in ***411** good standing and the existence of accounts receivable was insufficient).

The bankruptcy court found that RS Air was engaged in commercial or business activities on the petition date by litigating with NetJets, paying its aircraft registry fees, remaining in good standing as a Delaware LLC, and filing its tax returns and paying taxes. In addition, RS Air intends to resume fractional jet ownership and flight operations with a different partner once able. We conclude that the activities identified by the bankruptcy court are "commercial or business activities" within the meaning of § 1182(1)(A). And the bankruptcy court correctly found that RS Air was "engaged in" these activities on the petition date. While NetJets wishes to split hairs about the degree of RS Air's involvement in the Ohio litigation prior to and on the petition date, we do not view that factual issue as determinative.

NetJets argues that RS Air was not engaged in commercial or business activities either on or before the petition date because RS Air's activities lacked any motive to generate income or profit. NetJets contends that, to establish eligibility for subchapter V, the debtor must have a profit motive. Thus, the question is whether engaging in commercial or business activities incorporates a "pursuit of profit" requirement.

NetJets cherry-picks cases which it argues support its position that an eligible subchapter V debtor must have the intent to pursue profit. *In re Vertical Mac Constr., LLC*, 2021 WL 3668037, at *3 (noting that the term "commercial" is commonly understood to involve commerce, and includes "occupied with or engaged in commerce or work intended for commerce," "of or relating to commerce," and "viewed with regard to profit"); *In re Port Arthur Steam Energy, L.P.,* 629 B.R. at 236 (same); *In re Blue*, 630 B.R. at 189 (noting that "a person is engaged in commercial or business activities when she participates in the purchasing or selling of economic goods or services for a profit"); *In re Ikalowych*, 629 B.R. at 276 (holding that commercial or business activities means "any private sector actions related to buying, selling, financing, or using goods, property, or services, undertaken for the purpose of earning income"); *In re Johnson*, 2021 WL 825156, at *8 (a person engaged in commercial or business activities is "a person engaged in the exchange or buying and selling of economic goods or services for profit").

In addition to discussing the definition for the word "commercial," the courts above went on to discuss the definition for the word "business," which is defined as "a usually commercial or mercantile activity engaged in as a means of livelihood," or "dealings or transactions especially of an **economic nature**." *Business*, Merriam-Webster Online Dictionary, https://www.merriamwebster.com/dictionary/business (last visited Mar. 29, 2022) (emphasis added). Certainly, the depreciation tax benefits and the revenue generated by RS Air's flight operations or its acquiring and selling of its fractional aircraft interests are "dealings or transactions" of an "economic nature." Although NetJets tries to argue that no real tax benefit exists, that is contrary to its marketing strategy which touted tax benefits as a key advantage for fractional jet ownership.

Further, NetJets fails to note that the *Ikalowych* court went on to observe that § 1182(1)(A) speaks only to whether the debtor was engaged in commercial or business activities – "not whether the [d]ebtor was making a profit, actively operating, or intending to operate in the future." 629 B.R. at 285. That court further heeded:

> Interpretation of statutory phrases can be aided by considering the definitions ***412** of each of the words in a phrase; but simply stringing separate dictionary definitions together is not enough and might lead in the wrong direction. Instead, the Court must consider context and purpose in applying definitions.

Id. at 278. The court in *Blue* was also careful not to limit the meaning of "commercial or business activities" to basic dictionary definitions. 630 B.R. at 188-89.

Finally, the issue of a "profit motive" was not directly addressed in these cases. The few courts that have addressed it have held that § 1182(1)(A) does not require a debtor to be engaged in for-profit business to qualify for subchapter V. In *Ellingsworth Residential Community Association*, 619 B.R. 519, 520 (Bankr. M.D. Fla. 2020), an unsecured creditor argued that the debtor – a nonprofit homeowners association – was not eligible for subchapter V because, as a nonprofit, it did not "engage in commercial or business activities." The bankruptcy court disagreed and found that, based on the plain and unambiguous language of the statute, no profit motive is required. *Id.* at 521. It went on to hold that the many commercial or business activities the nonprofit debtor engaged in fit the "broad" categorization of such activities. *Id.* (e.g., contracting for goods and services, hiring professionals, filing regular tax returns, collecting assessments from its homeowners).

On appeal, the district court affirmed. *Guan v. Ellingsworth Residential Cmty. Ass'n* (*In re Ellingsworth Residential Cmty. Ass'n*), No. 6:20-cv-1243-WWB, 2021 WL 3908525, at *3 (M.D. Fla. Aug. 19, 2021), *appeal dismissed*, No. 21-12970-AA, 2021 WL 6808445 (11th Cir. Nov. 4, 2021). The district court reasoned that, although corporations involved in commerce can, and frequently do, have a profit motivation, the plain and ordinary meaning of the terms "commercial or business activities" does not require it. For support, the district court cited to Black's Law Dictionary, which notes that "business activities" can be either "the carrying out of a series of similar acts for the purpose of realizing a pecuniary benefit, or otherwise accomplishing a goal." *Id.* (quoting *Doing Business*, Black's Law Dictionary (11th ed. 2019)). This broad definition would include not-for-profit businesses, and would not be limited to those having only a benevolent purpose.

The bankruptcy court in *Family Friendly Contracting LLC* also concluded that the plain and ordinary meaning of "commercial or business activities" does not require a profit motivation. 2021 WL 5540887, at *3. In so ruling, the court observed that courts have interpreted the phrase broadly in keeping with the SBRA's purpose and the language of § 1182(1)(A).

We note, and the *Ellingsworth* and *Family Friendly* courts observed, Congress chose not to exclude nonprofits or other persons who lack a profit motive from qualifying for subchapter V. And that makes sense, because churches, hospitals, and other nonprofit businesses are allowed to file for chapter 11 (or 7) relief. *See**JBB Holdings, LLC v. Abundant Life Worship Ctr. of Hinesville, GA, Inc. (In re Abundant Life Worship Ctr. of Hinesville, GA, Inc.)*, No. 20-40959-EJC, 2020 WL 7635272, at *10 n.23 (Bankr. S.D. Ga. Dec. 16, 2020) (a church or other nonprofit entity can be a small business debtor) (citing *In re Ellingsworth Residential Cmty. Ass'n*, 619 B.R. at 521-22); *In re Charles St. African Methodist Episcopal Church of Bos.*, 478 B.R. 73 (Bankr. D. Mass. 2012) (religious corporation's nonprofit status did not disqualify it as a "corporation" eligible for chapter 11); *see also*§ 101(27A) defining "health care business" to include an entity "organized for profit or not for profit"); ***413** 2 Collier on Bankruptcy ¶ 109.02 (Alan N. Resnick & Henry J. Sommer, eds. 16th ed. rev. 2021) ("a nonprofit corporation, like a for-profit corporation, is eligible to file for relief under the Code"). The only persons Congress excluded from subchapter V eligibility (other than by debt limitations) are those whose primary activity is the business of owning single asset real estate, corporate debtors subject to reporting requirements under certain sections of the Securities Exchange Act (15 U.S.C. §§ 78m or 78*o*(d)), or any debtor that is an affiliate of an issuer under 15 U.S.C. § 78c. *See* § 1182(1)(A) & (B).

[10]Accordingly, we conclude that no profit motive is required for a debtor to qualify for subchapter V relief. To hold otherwise would wrongfully exclude nonprofits and other persons that lack such a motive. That RS Air had no profit motive did not render it ineligible for subchapter V.

B. The bankruptcy court erred by allocating the burden to NetJets to prove that RS Air was not eligible for subchapter V.

The parties dispute who had the burden of proof as to RS Air's subchapter V eligibility: RS Air or NetJets. The Bankruptcy Code and Rules are silent on this issue. The bankruptcy court determined that NetJets, as the party challenging eligibility, had the burden. NetJets contends this was error. We agree.

The bankruptcy court rejected the Missouri bankruptcy case cited by NetJets – *In re Thurmon* – as contrary to Ninth Circuit law. *Thurmon* held, based on Eighth Circuit law, that the debtor has the burden to establish subchapter V eligibility. 625 B.R. at 419 n.4. The bankruptcy court believed it was bound by *Scovis v. Henrichsen (In re Scovis)*, 249 F.3d 975 (9th Cir. 2001), which it cited for the proposition that the party challenging chapter 13 eligibility under § 109(e) bears the burden of proof. However, *Scovis* made no express, or even implied, ruling as to who has the burden of proof for establishing eligibility under § 109(e) outside of the context of plan confirmation. The bankruptcy court also relied on BAP cases involving motions to dismiss under § 707 and § 1112. *See**Aspen Skiing Co. v. Cherrett (In re Cherrett)*, 523 B.R. 660, 668 (9th Cir. BAP 2014) (movant bears the burden to establish abusive chapter 7 filing under § 707(b)(1)); *Sullivan v. Harnisch (In re Sullivan)*, 522 B.R. 604, 614 (9th Cir BAP 2014) (movant bears the burden to establish "cause" for dismissal of chapter 11 case under § 1112(b)).

Neither this Panel nor the Ninth Circuit Court of Appeals has decided the issue of who has the burden on subchapter V eligibility. However, in an objection to the debtor's eligibility for chapter 9 relief, we held that the debtor has the burden of establishing eligibility under § 109(c). *In re City of Vallejo*, 408 B.R. at 289 (citing *In re Valley Health Sys.*, 383 B.R. 156, 161 (Bankr. C.D. Cal. 2008)). Other circuit courts, as well as courts within this circuit, have held that the debtor has the burden of establishing eligibility for chapter 12 relief under § 109(f). *See**First Nat'l Bank of Durango v. Woods (In re Woods)*, 743 F.3d 689, 705 (10th Cir. 2014) (citing cases); *Tim Wargo & Sons, Inc. v. Equitable Life Assurance Soc'y of the U.S. (In re*

Tim Wargo & Sons, Inc.), 869 F.2d 1128, 1130 (8th Cir. 1989); *Baker v. Rosenberger (In re Rosenberger)*, No. 20-50093, 2020 WL 6940926, at *3 (Bankr. W.D. Va. Sept. 29, 2020) (debtor must put forward sufficient evidence to allow the court to find that she satisfies § 109(f) eligibility requirements, including the definitional § 101(18) requirement that she was "engaged in a farming operation" on the petition ***414** date); *In re Cooper*, No. 10-66447-fra12, 2011 WL 3882278, at *1 (Bankr. D. Or. Sept. 2, 2011); *In re Powers*, No. 10-14557, 2011 WL 3663948, at *1 (Bankr. N.D. Cal. Aug. 12, 2011) ("The party filing a petition under Chapter 12 bears the burden of proving eligibility."); *In re Pandol*, No. 10-19733-B-12, 2010 WL 9488147, at *1 (Bankr. E.D. Cal. Sept. 29, 2010) (debtor has the burden to establish that he is a "family farmer"). Finally, in involuntary cases, our circuit places the burden of proving eligibility on the petitioning creditors. *Cunningham v. Rothery (In re Rothery)*, 143 F.3d 546, 548 (9th Cir. 1998) ("The filing of an involuntary case requires the petitioning creditor to meet the burden of proof on the main elements under § 303."); *Hayden v. QDOS, Inc. (In re QDOS, Inc.)*, 607 B.R. 338, 343 (9th Cir. BAP 2019).

[11]The reasoning of the courts placing the burden on the debtor to establish eligibility for relief in a chapter 12 case is persuasive for our purposes here, considering that chapter 12 contains the analogous requirement that a "family farmer" be "engaged in a farming operation" to be eligible. *See*§ 101(18). Nearly every court deciding the issue of who bears the burden of proving eligibility for subchapter V has held that it is the debtor. *See In re Rickerson*, 636 B.R. at 422; *In re Family Friendly Contracting LLC*, 2021 WL 5540887, at *2; *In re Vertical Mac Constr.*, 2021 WL 3668037, at *2; *In re Port Arthur Steam Energy, L.P.*, 629 B.R. at 235; *In re Blue*, 630 B.R. at 187; *In re Offer Space, LLC*, 629 B.R. at 304; *In re Ikalowych*, 629 B.R. at 275; *In re Sullivan*, 626 B.R. 326, 330 (Bankr. D. Colo. 2021); *In re Johnson*, 2021 WL 825156, at *4; *In re Thurmon*, 625 B.R. at 419 n.4; *In re Blanchard*, 2020 WL 4032411, at *2; *In re Wright*, 2020 WL 2193240, at *2; *but see In re Body Transit, Inc.*, 613 B.R. 400, 409 n.15 (Bankr. E.D. Pa. 2020) (objecting party is the de facto moving party bearing the burden to prove the debtor is not entitled to subchapter V relief); *Hall L.A. WTS, LLC v. Serendipity Labs, Inc. (In re Serendipity Labs, Inc.)*, 620 B.R. 679, 680 n.3 (Bankr. N.D. Ga. 2020). We agree with the majority view and hold that the burden to prove eligibility for subchapter V should be placed on the debtor, especially considering the many advantages subchapter V offers debtors over a "traditional" chapter 11: total plan exclusivity (including modifications) and no disclosure statement requirement; the ability to obtain a discharge on the effective date; and the inapplicability of the absolute priority rule. It also makes sense to place the burden on the debtor because debtors are in the best position to prove that they are qualified to be in subchapter V.[6]

[12]Nevertheless, the bankruptcy court's error in allocating the burden to NetJets in the objection to eligibility was harmless because RS Air met its burden. RS Air demonstrated that it was engaged in commercial or business activities on the petition date, which was the only criterion challenged by NetJets on eligibility.

***415C. The bankruptcy court failed to recognize the exceptions to the law of the case doctrine, but such error was harmless.**

[13][14][15]The doctrine of law of the case provides that a "court is generally precluded from reconsidering an issue that has already been decided by the same court, or a higher court in the identical case." *Thomas v. Bible*, 983 F.2d 152, 154 (9th Cir. 1993). To apply, "the issue in question must have been decided either expressly or by necessary implication in the previous disposition." *Id.* (cleaned up). But there are exceptions to this discretionary doctrine. A court may revisit a previously resolved question when: (1) the first decision was clearly erroneous; (2) an intervening change in the law has occurred; (3) the evidence on remand is substantially different; (4) other changed circumstances exist; or (5) a manifest injustice would otherwise result. *Id.* at 155 (citations omitted).

NetJets argues that the bankruptcy court abused its discretion by applying law of the case to its earlier ruling that RS Air was eligible for subchapter V, when new evidence presented at the final confirmation hearing defeated RS Air's eligibility. NetJets argues that the bankruptcy court failed to consider new evidence that: (1) RS Air had not reported any income since at least 2004; (2) Perlman's alleged tax benefit flowing from his ownership of RS Air was not a benefit and but rather a loss because the cost of producing the benefit exceeded the amount of the tax benefit itself; (3) the financial model supporting RS Air's income calculations treated expenses as "income," did not comply with GAAP, and was inconsistent with the definition of "disposable income" under the Code; and (4) RS Air's disposable income would be negative using a strict definition of "disposable income." NetJets contends that the bankruptcy court's decision was particularly egregious because the subchapter V designation was an interlocutory ruling. *See Amarel v. Connell*, 102 F.3d 1494, 1515 (9th Cir. 1996) (interlocutory orders are subject to modification at any time prior to final judgment); *Hydranautics v. FilmTec Corp.*, 306 F. Supp. 2d 958, 968 (S.D. Cal. 2003) (court may reconsider and revise an interlocutory decision for any reason, even absent new evidence or an intervening change in the law).

[16]The problem facing NetJets is that all of the alleged new evidence it argues that the bankruptcy court should have considered relates to the fact that RS Air had no net profit. As we stated above, a profit motive or net profit is not required for subchapter V eligibility. In addition, much of this evidence was not "new." In overruling NetJets' initial objection, the bankruptcy court found that RS Air was created to receive a depreciation tax benefit marketed by NetJets rather than to generate a net profit. At a prior confirmation hearing, Perlman testified that RS Air would likely have no projected disposable income within the next five years, if ever. We also find it somewhat disingenuous for NetJets to complain about this purported new evidence that was consistent with its long-standing argument that RS Air was not a business with income, and consistent with RS Air's position that jet share ownership's primary business value is a tax benefit, not income. Accordingly, any failure by the bankruptcy court in not considering the exceptions to law of the case was harmless error.

CONCLUSION

For the reasons stated above, we AFFIRM both the Subchapter V Order and the Confirmation Order.

All Citations

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Footnotes	
1	Unless specified otherwise, all chapter and section references are to the Bankruptcy Code, 11 U.S.C. §§ 101-1532.
2	As relevant here, § 1182(1)(A) provides that the term "debtor" "means a person engaged in commercial or business activities ... that has aggregate noncontingent liquidated secured and unsecured debts as of the date of the filing of the petition or the date of the order for relief in an amount not more than $7,500,000 (excluding debts owed to 1 or more affiliates or insiders) not less than 50 percent of which arose from the commercial or business activities of the debtor." NetJets does not challenge RS Air's eligibility based on debt limits.
3	The interlocutory Subchapter V Order merged into the final Confirmation Order. SeeUnited States v. Real Prop. Located at 475 Martin Lane, 545 F.3d 1134, 1141 (9th Cir. 2008) (under merger rule, interlocutory orders entered prior to the judgment merge into the judgment and may be challenged on appeal).
4	The SBRA became effective on February 19, 2020. See11 U.S.C. §§ 1181, et seq. Small Business Reorganization Act of 2019 (HR 3311), Pub. L. No. 116-54, 133 Stat. 1079 (Aug. 23, 2019). The statute as originally enacted defined the debtor under § 101(51D), in the same way as a small business debtor who does not elect to proceed under subchapter V. As part of the Coronavirus, Aid, Relief, and Economic Security Act (HR 748), Pub. L. No. 116-136, 134 Stat. 281, 116th Cong. 2d Sess. (Mar. 27, 2020), the definition was changed to temporarily increase the debt limit to $7,500,000 for debtors who elected subchapter V and included a sunset of one year. The one-year sunset for this temporary amendment was extended to March 27, 2022, by the COVID-19 Bankruptcy Relief Extension Act of 2021, Pub. L. No. 117-5 (Mar. 27, 2021). In this case, § 1182(1)(A) applies for the definition of a subchapter V debtor.
5	An LLC is a "person." Gilliam v. Speier (In re KRSM Props., LLC), 318 B.R. 712, 717 (9th Cir. BAP 2004).

6	We note the case of Ho v. Dowell (In re Ho), 274 B.R. 867 (9th Cir. BAP 2002), cited by RS Air. The thrust of that case was a debtor's eligibility to proceed under chapter 13 given the debt limits set by § 109(e). The concurrence noted that a creditor has the burden to persuade the court to grant a motion to dismiss a chapter 13 case for § 109(e) ineligibility, whereas the debtor has the burden of demonstrating § 109(e) eligibility for purposes of plan confirmation. Id. at 882-83. The majority did not comment on this issue. In any case, we are not bound by Ho. The statement is dicta in a concurrence. Further, the bankruptcy court's ruling on RS Air's subchapter V eligibility was not in the context of a motion to dismiss where one might expect the movant to have the burden.

A GUIDE TO THE SMALL BUSINESS REORGANIZATION ACT OF 2019

Revised June 2022

Paul W. Bonapfel
U.S. Bankruptcy Judge, N.D. Ga.

This June 2022 compilation of *A Guide to the Small Business Reorganization Act of 2019* merges the July 2021 compilation of the *Guide* with material in the May-June 2022 Supplement and incorporates revisions in a May 2022 compilation. The earlier compilations and this one update the original version published at 93 Amer. Bankr. L. J. 571 (2019).

The May-June 2022 Supplement is in two parts. The first part supplements the July 2021 compilation with revisions and new material as of May 2022. The second part adds additional revisions and materials as of June 2022. This June 2022 compilation includes all of the revisions in both supplements.

The reader who is not familiar with the July 2021 compilation may consult only this June 2022 compilation, because it includes all the material in both of the supplements.

The reader who is familiar with the July 2021 compilation may consult only the May-June 2022 Supplement to review new material added to the July 2021 compilation. The reader who is also familiar with the May 2022 Supplement may consult only the June part of the May-June 2022 Supplement to review new material.