2022 Consumer Practice Extravaganza

Great Debates: Student Loans

Joshua R. I. Cohen
Cohen Consumer Law, PLC; St. Albans, Vt.

Hon D. Sims Crawford
U.S. Bankruptcy Court (S.D. Ala.); Birmingham

David P. Leibowitz
Law Offices of David P. Leibowitz LLC; Chicago

Hon Brian D. Lynch
U.S. Bankruptcy Court (W.D. Wash.); Tacoma

Michael A. Miller
The Semrad Law Firm, LLC; Naperville, Ill.

2022

ABI EXCLUSIVE

NOVEMBER 8, 2022

Claiming '100% of FMV,' Debtors Keep Postpetition Appreciation in Exempt Assets

> Ninth Circuit BAP interprets Taylor and Schwab to mean that a trustee cannot revisit the value of an exempt asset if the debtor claimed '100% of FMV' and there was no timely objection.

Ruling on a question of first impression, the Ninth Circuit Bankruptcy Appellate Panel held that a debtor who claims an exemption equal to "100% fair market value" is entitled to retain postpetition appreciation in the value of the property, even if the chapter 11 case converts to chapter 7.

The opinion is important for another reason: If adopted widely, the BAP's analysis could end the split where courts disagree about a chapter 13 debtor's right to retain postpetition appreciation in the value of a homestead. If followed, the BAP's position

postpetition appreciation in the value of a homestead. If followed, the BAP's position regarding the finality of exemption claims would mean that debtors in cases that convert to chapter 7 from chapter 13 should retain post-petition appreciation regardless of whether the home was sold before or after conversion.

Typical Facts

The husband and wife debtors filed a chapter 11 petition in 2015. They scheduled their home as being worth about $165,000 and encumbered by a $130,000 mortgage. In the schedules, they claimed an exemption under Section 522(d)(1) for "100% of fair market value."

At the time, the exemption was $45,900. No one lodged an objection to the exemption claim within the required time after the first meeting of creditors.

The bankruptcy court confirmed the debtor's chapter 11 plan in 2017. The plan called for retaining the home and continuing to pay the mortgage until maturity.

According to the BAP's November 2 opinion by Bankruptcy Judge Robert J. Faris, the plan was "muddled" but "appeared to claim [that] the entire fair market value of the home" was exempt. However, the plan recognized that the home would not be exempt until all creditors were fully paid under the plan.

The Dueling Motions

In 2018, more than one year after plan confirmation, the case converted to chapter 7. The debtors filed a motion to sell the home for $400,000 and allow them to retain all net proceeds because the home was exempt.

The debtor withdrew their motion to sell when the trustee filed an objection stating that only the trustee had the right to sell estate property. Instead, the debtors filed a motion to compel the trustee to abandon the home, because it was 100% exempt, and no one had objected.

The chapter 7 trustee countered with a motion to sell the property and contended that the debtors were only entitled to the statutory $45,900 exemption. All other net proceeds, the trustee said, should go to the estate and to creditors.

The bankruptcy court denied the debtor's motion to compel abandonment and granted the trustee's motion to sell. The trustee sold the home for $422,000, generating net

the trustee's motion to sell. The trustee sold the home for $422,000, generating net proceeds of almost $225,000. On motion by the debtors, the bankruptcy court directed the trustee to hold the net proceeds pending resolution of appeals.

The debtors appealed to the BAP, successfully.

Mootness

The trustee argued that the appeal was statutorily moot under Section 363(m). The section provides that the "reversal or modification on appeal of an authorization . . . of a sale or lease of property does not affect the validity of a sale or lease . . . to an entity that purchased or leased such property in good faith, . . . unless such authorization and such sale or lease were stayed pending appeal."

Judge Faris ruled that the appeal was not statutorily moot because the debtors were only challenging the amount of the exemption claim and the distribution of the proceeds. They were not contesting the validity of the sale, he said.

Likewise, Judge Faris said that the appeal was not equitably moot, because reversal would not result in an "uncontrollable situation" since the trustee was holding funds to pay the debtors if they were to win on appeal.

At the end of the discussion of equitable mootness, Judge Faris alluded to the idea that the distribution of sale proceeds would have necessitated dismissing the appeal. He said,

> Even if the Trustee had fully distributed the sale proceeds, he has not shown that it would be impossible or inequitable to claw back those payments from administrative and unsecured creditors. Thus, the Trustee has failed to demonstrate that equitable mootness requires the dismissal of this appeal.

The *dicta* by Judge Faris implies that the BAP would not reflexively dismiss an appeal if sale proceeds have been distributed.

The Merits

On the merits, Judge Faris first addressed the question of whether the absence of an objection to the homestead exemption claim meant that the exemption was valid, "even though it is larger than the law allows."

In sum, Judge Faris said that the answer was beyond "any debate" in view of Section 522(l), Bankruptcy Rule 1019(2)(B)(i) and *Taylor v. Freeland & Kronz*, 503 U.S. 638 (1992). The section says, "Unless a party in interest objects, the property claimed as exempt on such list is exempt."

Judge Faris said that "*Taylor* holds that § 522(*l*) means what it says: if no one files a timely objection, an exemption claim is valid even if it had no 'colorable basis' in the law."

Even though the trustee had not been appointed when the debtors claimed their homestead exemption early in the chapter 11 case, Judge Faris said that "the rules make clear that he cannot now object." Because there had been no objections to the exemption claim, he said it "is not subject to challenge."

The FMV Claim

The second question, according to Judge Faris, was whether the debtors had claimed an exemption in the full market value of the home at filing or at the time of sale.

The Supreme Court's decision in *Schwab v. Reilly*, 560 U.S. 770 (2010), "largely answered the second question," Judge Faris said. He paraphrased *Schwab* as saying "that a debtor may claim '100% of FMV' to put parties in interest on notice that he intends to claim the full value of the property as exempt." Otherwise, the Court said, parties have no obligation to object if the debtor lodges an exemption claim in a dollar amount within the limits of Section 522(d).

Judge Faris said that the debtors followed *Schwab* "to the letter" by claiming an exemption in "100% of FMV," or fair market value, and were entitled to the net proceeds even though the proceeds were in excess of the allowable exemption.

In addition to the chapter 7 trustee, the state had objected by contending that *Schwab* was mere *dicta* in counseling debtors to claim 100% of fair market value. Judge Faris said, "We do not agree that we can so easily reject language that the Supreme Court has approved for this very situation."

The Snapshot Rule

Invoking the so-called snapshot rule, the trustee argued that the exemption was limited to the value of the property at filing and would not include appreciation. Judge Faris conceded that "postpetition appreciation of estate property inures to the benefit of the bankruptcy estate."

Judge Faris described the workings of the snapshot rule as follows:

> The snapshot rule fixes the point in time that defines the exemptions that a debtor is **entitled** to take. It says nothing about what happens when a debtor claims an exemption in postpetition appreciation to which the debtor is **not entitled** and no one timely objects. [Emphasis in original.]

To have the benefit of the snapshot rule, Judge Faris said that "a trustee or party in interest must object to an exemption claim that contradicts that rule."

"As a matter of first impression," Judge Faris said that the debtor's "claim of an exemption equal to '100% of FMV' includes postpetition appreciation and becomes incontestable if there is no timely objection."

The BAP reversed the bankruptcy court's order that had limited the exemption to the statutory maximum of $45,950 and remanded for the bankruptcy court to determine how to enforce the exemption "and what other remedies, if any, are appropriate."

Observations

On a related question, the courts are split. Does a chapter 13 debtor retain the appreciation in the value of homestead, whether or not the case converts to chapter 7?

So far, only the Tenth Circuit has answered the question, but only in the context of a sale before conversion. The Tenth Circuit held that nonexempt appreciation in the value of a home sold after confirmation of a chapter 13 plan belongs to the debtor, not to creditors, if the case converts to chapter 7 after the sale. The appeals court specifically declined to opine on the result if the debtors were to remain in chapter 13 after the sale. *See Rodriguez v. Barrera (In re Barrera)*, 22 F.4th 1217 (10th Cir. Jan. 19, 2022). To read ABI's report, **click here**.

Answering an open question after *Barrera*, Bankruptcy Judge Joseph G. Rosania, Jr., of Denver ruled that a chapter 13 debtor retains appreciation in the value of nonexempt property that the debtor owned on the filing date but was sold in the course of the chapter 13 case. *In re Klein*, 17-19106, 2022 BL 310082, 2022 WL 3902822 (Bankr. D. Colo. Aug. 23, 2022). To read ABI's report, **click here**.

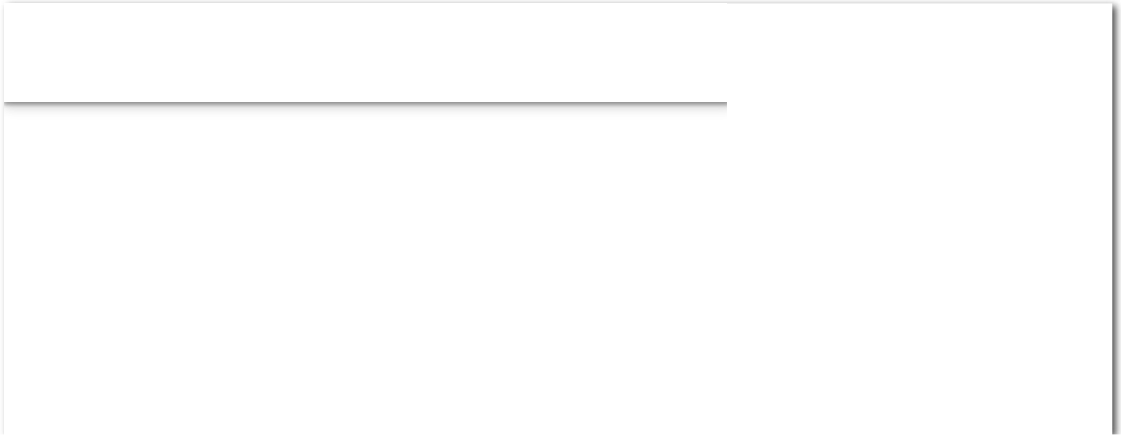
Among judges holding otherwise, Bankruptcy Judge Marc Barreca of Seattle disagreed with the result later reached in the Tenth Circuit and with a fellow bankruptcy judge in the Ninth Circuit. Judge Barreca decided that the postpetition appreciation in the value of an asset belongs to the chapter 7 estate if the case converts from chapter 13. *In re Castleman*, 631 B.R. 914 (Bankr. W.D. Wash. June 4, 2021). For ABI's report, **click here**.

The Ninth Circuit BAP's notion of the finality of an exemption would seem to mean that chapter 13 debtors retain postpetition appreciation in exempt assets regardless of whether the sale is during the chapter 13 case, before conversion to chapter 7 or after conversion.

This writer has a question about the renewal of objection periods permitted by Bankruptcy Rule 1019(2). Does the rule permit objections to exemptions that were made final by Section 522(l)? If that's so, is the rule invalid in some respect for contradicting the statute?

Opinion Link

PREVIEW



https://abi-opinions.s3.amazonaws.com/Masingale.pdf

Case Details

Case Citation	Masingale v. Muding (In re Masingale), 22-1016 (B.A.P. 9th Cir. Nov. 2, 2022).
Case Name	Masingale v. Muding (In re Masingale)
Case Type	Consumer
Court	9th Circuit
Bankruptcy Tags	Asset Sales Plan Confirmation Consumer Bankruptcy Mortgage

Consumer Corner

By Morgan Decker and Matthew Barr

Who Should Cash In When the Market Tops Out?

Morgan Decker
Rubin & Levin, PC
Indianapolis

Matthew Barr
Rubin & Levin, PC
Indianapolis

Morgan Decker and Matt Barr are associates with Rubin & Levin, PC in Indianapolis, where they both focus on creditors' rights and collections, representing trustees and other clients in bankruptcy.

This year is expected to be another year of low real estate inventory, high sale prices and historically low (but rising) mortgage rates.[1] The COVID-19 pandemic created market abnormalities that have given homeowners the opportunity to realize record sale proceeds or refinance at low rates. These opportunities have given numerous consumers the opportunity to pay off debt, save money on their monthly payments or simply enjoy the opportunity to increase their overall net wealth.

Despite positive results in the marketplace, consumer debtors who were also homeowners might have had a different experience depending on how their case progressed during the pandemic. Job losses, mandated business closures and quarantine requirements halted some individuals' sources of income. Many Americans lost their jobs and could no longer afford to maintain their chapter 13 payments. As consumer debtors converted to chapter 7, some received opposition from trustees around the nation concerning their newly acquired equity.

The Bankruptcy Code defines property of the estate generally, and specifically when a chapter 13 case is later converted to another chapter.[2] Although these definitions exist, the interpretation of the definitions and the intentions behind them have caused bankruptcy courts to split in their approaches to determining whether the post-petition appreciation belongs to the converted estate or the debtor.

Legislative Intent Behind § 348(f)

Congress enacted § 348(f) as part of the Bankruptcy Reform Act of 1994. It provides that as long as a debtor's property was property of the estate as of the petition date and remains in the debtor's possession or under their control on the date of conversion, it is property of the converted case's estate.[3] Therefore, if a debtor owned a home on the original petition date and still owns the home on the date of conversion, it is property of the estate of the converted case.

The House of Representatives' Committee on the Judiciary Report on the Bankruptcy Act of 1994 (the "House Report") includes a specific hypothetical situation that Congress aimed to prevent in enacting § 348(f).[4] The hypothetical involves a chapter 13 debtor whose equity in his home is fully exempt upon filing a chapter 13 petition. However, subsequent payments to the secured creditor during the reorganization create equity on the date of conversion.[5] Congress did not want debtors to be punished for making payments to secured creditors during a chapter 13 case. Many debtors (and bankruptcy courts) reference this hypothetical as illustrating Congress's intent in enacting § 348(f): to allow appreciation to benefit the debtor (regardless of how it was obtained).[6]

Section 348(f)'s legislative history also accepts and rejects specific case holdings in attempting to clarify whether after-acquired property comes into the estate of a case converted from one chapter to one under chapter 7.[7] The House Report explicitly adopted the reasoning in *In re Bobroff*,[8] where the Third Circuit determined that a chapter 13 debtor's tort claims accrued post-petition and pre-conversion and were not part of the chapter 7 estate.[9] The rest of this article examines this history, along with other Code provisions, to analyze the two approaches used by bankruptcy courts to determine whether post-petition appreciation of real estate is (1) property of the debtor or (2) property of the bankruptcy estate.

Approach #1: Post-Petition Appreciation of Real Estate Is Property of the Debtor

Multiple courts have held that post-confirmation appreciation of an asset is property of the debtor, even if the debtor converts to chapter 7. The courts holding such tend to justify this position in two ways: by looking at the legislative history of § 348(f) and the Bankruptcy Code generally, and by reading the language of §§ 1306 and 1327.

1 Brenda Richardson, "Experts Predict What the Housing Market Will Look Like in 2022," *Forbes* (Dec. 13, 2021), *available at* forbes.com/sites/brendarichardson/2021/12/13/experts-predict-what-the-housing-market-will-look-like-in-2022 (last visited on March 22, 2022).

2 11 U.S.C. § 541; 11 U.S.C. § 348(f)(1)(A), which provides "property of the estate in a converted case shall consist of property of the estate, as of the date of filing of the petition, that remains in the possession of or is under the control of the debtor on the date of conversion."

3 11 U.S.C. § 348(f)(1)(A).

4 *See* H.R. Rep. No. 103-835, at 57 (1994), *as reprinted in* 1994 U.S.C.C.A.N. 3340, 3366.

5 *Id.*

6 *See In re Robinson*, 472 B.R. 854 (Bankr. M.D. Fla. 2012) (finding 1994 amendments to § 348(f) encourage debtors to make payments during their chapter 13 case and equity resulting therein belongs to debtor); *In re Hodges*, 518 B.R. 445 (Bankr. E.D. Tenn. 2014) (debtors' equity in residence was result of payments made while in chapter 13 and before Bankruptcy Abuse Prevention and Consumer Protection Act cases applied, entitling debtors to post-petition equity).

7 *Id. See also In re Lybrook*, 951 F.2d 136 (7th Cir. 1991); *In re Bobroff*, 766 F.2d 797 (3d Cir. 1985).

8 *Id.*

9 *Id.*

The Tenth Circuit Court of Appeals recently analyzed these issues in *Rodriguez v. Barrera*.[10] The court began by looking at the underlying aims of chapters 13 and 7, and the general preference of chapter 13 reorganizations over chapter 7 liquidations.[11] The court then noted that § 348(f) was enacted, at least in part, to resolve the circuit split regarding whether a debtor's converted chapter 7 estate included property interests acquired after the chapter 13 filing but before conversion to another chapter, and the House Report explicitly adopted the reasoning in *In re Bobroff*.[12] With the legislative history in mind, the court held that § 348(f) dictates that pre-conversion house-sale proceeds are not property of the chapter 7 estate.[13] Thus, it follows that post-petition appreciation is an asset of the chapter 7 debtor post-conversion.

The second argument in support of this approach is that confirmation of a chapter 13 plan vests all property of the estate in the debtor, and therefore, the debtor is entitled to any post-confirmation appreciation. Section 1306 provides that property of the estate in chapter 13 cases includes all property specified in § 541 "that the debtor acquires after the commencement of the case but before the case is closed, dismissed or converted to a case under chapter 7, 11, or 12 of this title, whichever occurs first," as well as "earnings from services performed by the debtor after the commencement of the case but before the case is closed, dismissed, or converted to a case under chapter 7, 11, or 12 of this title, whichever occurs first."[14] Section 1327(b) provides "[e]xcept as otherwise provided in the plan or the order confirming the plan, the confirmation of a plan vests all of the property of the estate in the debtor."[15]

Finally, § 1327(c) provides that "[e]xcept as otherwise provided in the plan or in the order confirming the plan, the property vesting in the debtor under subsection (b) of this section is free and clear of any claim or interest of any creditor provided for by the plan."[16] In *In re Larzelere*, the bankruptcy court emphasized that it must give meaning to the vesting language of § 1327:[17]

> The court also cannot ignore that section 1327(c) says that the property that has vested back in the debtor under subsection (b) is free and clear from any claim or interest of creditors under the plan. To allow the trustee to reach the asset that has vested in the debtor renders section 1327(c) moot and would have the effect of placing the trustee in a position not contemplated by the Bankruptcy Code.[18]

Accordingly, the court held that post-petition appreciation belonged to the chapter 7 debtor post-conversion. The *Larzelere* court addressed the determinations reached by other courts, that because § 541(a)(6) makes proceeds and profits of property of the estate also property of the estate, appreciation of estate property post-petition is property of the estate, not the post-conversion debtor. Thus, "the revesting provision of the confirmed plan means that the debtor owns the property outright and that the debtor is entitled to any post-petition appreciation.... As such, it was no longer property of the estate, so the appreciation did not accrue from estate property."[19] The Tenth Circuit Court of Appeals in *In re Barrera* also dismissed the notion that the appreciation of estate property is estate property pursuant to § 541(a)(6). The court stated that "[i]f proceeds were the same interest as the anchor legal or equitable interest, the inclusion of § 541(a)(6) would be redundant alongside § 541(a)(1). Thus, § 541 recognizes that 'all legal and equitable interests' are legally distinct from "proceeds" from those interests."[20]

The *In re Barrera* court tried to assuage fears that its interpretation of § 348(f)(1)(A) could allow converting debtors to sell estate property post-conversion and pre-confirmation to shield value from creditors by pointing to § 348(f)(2). This section provides that if a debtor converts in "bad faith," property of the estate in the converted case is determined as of the date of conversion, not the original filing date.[21]

Approach #2: Post-Petition Appreciation of Real Estate Is Property of the Estate

The foregoing approach places undue emphasis on the legislative history of § 348(f) and the very specific language of a very specific hypothetical contained in the House Report. The hypothetical only speaks to equity resulting from paying down liens during a chapter 13 case, but Congress was quite specific in its hypothetical about the equity and how the hypothetical debtor acquired it. Incentivizing debtors to make payments during a chapter 13 case and allowing post-petition appreciation to benefit the converted estate are not mutually exclusive. This motivation and legislative intent can be reinforced while maintaining the integrity of § 541(a)(1) and (6).

As previously noted, property of the estate includes "[p]roceeds, product, offspring, rents, or profits of or from property of the estate, *except such as are earnings from services performed by an individual debtor after the commencement of the case*."[22] A chapter 7 debtor's assets become property of the estate on the petition date, and post-petition appreciation inures to the benefit of the estate.[23] Where a case has been converted from chapter 13 to chapter 7, how and why would that analysis change?

If a debtor owned property as of the chapter 13 petition date and still owns or controls the property on the date of conversion to a chapter 7 case, it is property of the converted estate under § 348(f)(1). This estate is no different than one where the petition was originally filed under chapter 7

10 *Rodriguez v. Barrera (In re Barrera)*, No. 20-1376, 2022 U.S. App. LEXIS 1432 (10th Cir. Jan. 19, 2022).
11 *Id.* at *3.
12 *Id.*
13 *Id.* at *5, *16.
14 11 U.S.C. § 1306.
15 11 U.S.C. § 1327(b).
16 11 U.S.C. § 1327(c).
17 *In re Larzelere*, 633 B.R. 677, 682 (Bankr. D.N.J. 2021).
18 *Id.*
19 *Id.* at 683 (quoting *In re Black*, 609 B.R. 518, 529 (B.A.P. 9th Cir. 2019)).
20 *In re Barrera*, No. 20-1376, 2022 U.S. App. LEXIS 1432, at *10.
21 *Id.* at 15.
22 11 U.S.C. § 541(a)(6) (emphasis added).
23 *See In re Hyman*, 967 F.2d 1316 (9th Cir. 1992) (applying California exemption law and bankruptcy law to determine post-filing appreciation inures for benefit of bankruptcy estate, not debtor); *In re Reed*, 940 F.2d 1317, 1323 (B.A.P. 9th Cir. 1999) (interpreting § 541(a)(6) to mean that post-petition appreciation of estate property inures to benefit of estate and not debtor, specifically where debtor did not file motion to abandon or set aside); *In re Shipman*, 344 B.R. 493, 495 (Bankr. N.D. W.Va. 2006) (noting that § 541 language does not suggest estate's interest is anything less than entire asset, including post-petition changes in its value).

continued on page 93

Consumer Corner: Who Should Cash In When the Market Tops Out?

from page 17

(unless the conversion was filed in bad faith).[24] Therefore, the property and its appreciation should be subject to the same analysis under § 541(a)(6).[25]

Neither the panel trustee nor the debtor would be able to (nor would they want to) sell an asset for less than market value, so the current market value should be utilized when analyzing assets of the converted estate.[26] Equity is inseparable from real estate and is not after-acquired property,[27] and is distinguishable from debtors' assets, as set forth in both *In re Lybrook* or *In re Bobroff*.[28] A home that a debtor possessed on the chapter 13 petition date and the date of conversion is an asset of the chapter 7 estate. It is property of the estate and may be sold at its current market value if sale proceeds (minus exemptions and paydown of any secured liens) would provide a meaningful distribution to the estate. The exhibit showcases relevant cases addressing this issue decided in the last seven years.

Conclusion

Bankruptcy courts have not been consistent in their interpretation of § 348(f) and its interaction with other Bankruptcy Code sections. The booming real estate market will not last forever, but while it is peaking through 2022 and beyond, consumer bankruptcy attorneys and trustees' counsel should be familiar with these varying approaches and counsel their clients accordingly. abi

24 11 U.S.C. §§ 348(f)(2) and 348(a) ("Conversion of a case from a case under one chapter of this title to a case under another chapter of this title ... does not effect a change in the date of the filing of the petition, the commencement of the case, or the order for relief.").

25 The debtor's farm was property of the estate since it was not after-acquired property and because the farmland was property of the estate, thus § 348(f)(1)(A) was inapplicable. *In re Evenson*, No. 05-37920, 2010 Bankr. LEXIS 3937, at *8 (Bankr. E.D. Wis. Nov. 3, 2010). Pursuant to § 541(a)(6), proceeds "of or from property of the estate" are to be included in the bankruptcy estate, and this would include the appreciation. *Id.* at *16-17.

26 *See In re Paolella*, 85 B.R. 974, 977 (Bankr. E.D. Pa. 1988) ("Because sale does not generally, if ever, occur simultaneously with formation of a bankruptcy estate, § 541(a)(6) mandates that the estate receive the value of the property at the time of the sale.").

27 *Id.*

28 *In re Lybrook*, 951 F.2d 136 (7th Cir. 1991) (debtor inherited farm after filing chapter 12 petition); *In re Bobroff*, 766 F.2d 797 (3d Cir. 1985) (debtor's tort claims did not arise until post-petition).

Exhibit

Case Name	Cite	Date Decided	Deciding Court	Holding	Subsequent History
In re Barrera	22 F.4th 1217	Jan. 19, 2022	10th Circuit Court of Appeals	Sale proceeds to the debtor	None
In re Cofer	625 B.R. 194	Jan. 8, 2021	U.S. Bankruptcy Court (D. Idaho)	Appreciation to the debtor	None
In re Castleman	631 B.R. 914	June 4, 2021	U.S. Bankruptcy Court (W.D. Wash.)	Appreciation to the estate	None
In re Goins	539 B.R. 510	Oct. 15, 2015	U.S. Bankruptcy Court (E.D. Va.)	Appreciation to the estate	None
In re Larzelere	633 B.R. 677	Aug. 24, 2021	U.S. Bankruptcy Court (D.N.J.)	Appreciation to the debtor	None
In re Black	609 B.R. 518	Nov. 21, 2019	B.A.P. 9th Cir.	Appreciation to the debtor	None

Trustee Talk

By Neil C. Gordon and Whitney R. Travis

Schwab v. Reilly Two Years Later

Appellate Opinions on Appreciation and 100 Percent of FMV

Neil C. Gordon
Arnall Golden Gregory LLP; Atlanta

Whitney R. Travis
McGuireWoods LLP Richmond, Va.

Neil Gordon is a partner in the Bankruptcy, Restructuring and Fraud Department at Arnall Golden Gregory LLP in Atlanta. He is president of the National Association of Bankruptcy Trustees and co-chair of ABI's Legislation Committee. Whitney Travis is an associate in the Restructuring and Insolvency Group at McGuireWoods LLP in Richmond, Va.

Before *Schwab v. Reilly*, debtors in many jurisdictions signaled their intent to remove an asset from a bankruptcy estate by exempting a dollar amount equal to the amount listed as the full fair-market value (FMV) of the asset.[1] In *Schwab*, however, the U.S. Supreme Court ruled that such a practice only exempted the debtor's interest in the asset to the extent of the exemption claimed.[2] Therefore, because the debtor in *Schwab* undervalued the asset, the trustee could sell the asset for the benefit of the estate.[3] In *dicta*, the Court stated that if the debtor wanted to exempt the full value of an asset, the intent would have to be unambiguous.[4] Thus, after *Schwab*, much debate has focused on the appropriate way for a debtor to signal his or her intent to exempt an entire asset from an estate. A recent Third Circuit decision, *In re Orton*, highlights the difficulty in removing an asset from a bankruptcy estate through a claim of exemption.[5]

Appreciation Remains in the Estate

In *In re Orton*, the Third Circuit made it clear that the method employed pre-*Schwab* does not operate to wholly exempt an asset from the estate even where the amount listed represents the actual FMV of the asset.[6] In *Orton*, the debtor listed his one-eighth interest in vacant land, which was subject to an oil and gas lease, as well as his one-fourth interest in the oil and gas lease, assigning an FMV of $4,250 and $1, respectively.[7] The debtor noted on his schedules that no well had been drilled on the vacant land and that no royalties were currently due under the lease.[8] The debtor then claimed wildcard exemptions for the two interests, pursuant to 11 U.S.C. § 522(d)(5), and claimed as exempt the full amount of their value—$4,250 and $1.[9] No party filed an objection to the claimed exemptions within the 30-day period prescribed by Rule 4003.[10]

The chapter 7 trustee subsequently filed a motion to close the case, but only to except the debtor's royalty interest in the oil and gas lease from abandonment, thereby preserving her ability to recover any future royalties for the benefit of the estate in the event a well was ever drilled on the property.[11] The debtor objected, arguing that he had successfully removed the lease from the estate by listing its actual FMV, which value fell within the exemption limit.[12] The bankruptcy court and district courts disagreed, ruling that the debtor had exempted only an interest in the asset and that the trustee was entitled to pursue any post-filing appreciation of the value of the oil and gas lease above the amount explicitly stated as exempt in the Schedule C.

On appeal to the Third Circuit, the debtor argued that *Schwab*'s holding should be "confined to instances of debtor malfeasance or negligence in claiming exemptions" and should be applied only in those cases where the actual value of the assets exceed either (a) the debtor's estimates of fair market value or (b) the statutory limit for exemption.[13] The Third Circuit rejected the debtor's argument, stating that "there is no indication in *Schwab* that the Court meant to carve out an exception that would benefit only debtors who are accurate (and lucky) enough to estimate and exempt an asset's exact [FMV]."[14] Rather, "*Schwab* focused on the concerns about placing trustees on notice, not concerns about inaccurate debtor valuations."[15] "[T]he Court was clear that exemptions under § 522(d)(5) are presumed to preserve a debtor's 'interest' in an asset rather than the asset itself; a debtor seeking to retain more than an 'interest' must indicate that fact unambiguously in the Schedules."[16] To do this, the Court "enumerated the specific actions that would manifest intent to exempt an entire asset."[17] Namely, the Court stated that the debtor "could make the scope of the exemption clear...by listing the exempt value as '[FMV]' or '100% of FMV.'"[18] The Third Circuit further concluded that "when a debtor retains only an interest in an asset, rather than the asset itself, the debtor is limited to the value of exemption; the estate is entitled to any appreciation in the asset's value beyond the amount exempted."[19]

1 130 S.Ct. 2652 (2010).
2 *Id.* at 2662.
3 *Id.*
4 *Id.* at 2668.
5 2012 U.S. App. LEXIS 14898 (3d Cir. July 20, 2012).
6 *Id.* at *2.
7 *Id.*
8 *Id.*
9 *Id.* at *2.
10 *Id.* at *3.
11 *Id.*
12 *Id.*
13 *Id.* at *9.
14 *Id.* at *12.
15 *Id.* at *11.
16 *Id.* at *12 (quoting *Schwab*, 130 S.Ct. at 2668 n. 21).
17 *Id.*
18 *Schwab*, 130 S.Ct. at 2668.
19 *Orton*, 2012 U.S. App. LEXIS 14898 at *16; *see also Gebhart v. Gaughan*, 621 F.3d 1206, 1210 (9th Cir. 2010) (same).

Whether Objection to 100 Percent of FMV Is Mandatory

As recognized by the Third Circuit, however, even if the *Orton* debtor had used the Supreme Court's suggested language, the result likely would have been the same.[20] In *Schwab*, "the Court warned, 'it is far from obvious that the Code would 'entitle' [a debtor] to clear title in [an asset] even if she claimed as exempt a 'full' or '100%' interest in it.'"[21] This warning has come to fruition in the majority of cases that have considered the issue, as the "courts addressing the effect of claiming as exempt '100% of FMV' of an asset (or similar words) have held that using these phrases either renders the attempted exemption facially defective or invites an evidentiary hearing to determine the [FMV] of the asset so that a dollar amount can be assigned to the exemption."[22] Those cases "reason that 'where the statutory basis for a debtor's claim of exemption provides only for an exemption of an interest in a certain property up to a specific dollar amount, the 'value of claimed exemption' must be identified as a monetary value.'"[23] However, those cases also hold that the trustee must object to preserve the estate's interest in the asset.

For example, in *In re Stoney*, the court interpreted the effect of claiming a "100% of FMV" exemption in assets under Virginia's exemption scheme.[24] Virginia, like the majority of states, has opted out of the federal exemption scheme, and the *Stoney* court found that the trustee's objection to the debtor's claim of exemption in 100 percent of FMV should be sustained where the Virginia Code contains a monetary limitation.[25] The court stated:

> Remembering the gravamen of *Schwab* concerns whether and when a trustee must object to a claimed exemption to preserve the right to subsequently liquidate an exempted asset, it is a misreading of *Schwab* to conclude [that] the Court has blessed the use of a designation such as "100% of FMV" as a valid and unobjectionable scheduling of a claimed exemption value where the relevant exemption statute, such as the Virginia Code, expressly limits the exemption to a maximum case value.[26]

The court added that to interpret *Schwab* as negating the specific requirements of the applicable body of law "would permit a judicial superseding of the state statutory requirements for exemptions and functionally negate the express authority of a state to opt out and impose its exemption limitation...on debtors who are citizens of opt-out states."[27]

The *Stoney* court, however, denied the trustee's request that it establish a bright-line rule "that a trustee is not required to object to exemptions where a debtor claims the value of the exemptions as 100% of [FMV] in order to limit the exemptions to the statutory amounts set forth in the Virginia Code."[28] The court found that *Schwab* "mandate[s] that if a debtor claims the value of an exemption [that] the trustee believes is improper or invalid, whether as to form or substance, the trustee must object to preserve the right to subsequently liquidate the asset at issue."[29] According to *Schwab*, "[r]equiring a trustee to object to exemptions 'facilitate[s] the expeditious and final disposition of assets, and thus enable[s] the debtor (and the debtor's creditors) to achieve a fresh start free of the finality and clouded-title concerns [that the *Schwab* debtor] describes.'"[30] Therefore, although the *Orton* court suggested that the outcome of its decision would have been the same had the trustee been put on proper notice of the debtor's intent through the use of "100% of FMV,"[31] other courts indicate that an objection in such a circumstance is mandatory in order to preserve the estate's interest in the asset.

No Amendment to Official Form 6C

In response to *Schwab*, the Bankruptcy Rules Advisory Committee had proposed an amendment to Official Form 6C to change the column for the value of claimed exemption by providing the debtor two options: (1) "exemption limited to $____" and (2) "full fair market value of the exempted property." The debtor would be instructed to "check one box only for each claimed exemption."[32] The Committee explained its proposed amendment, stating that "in considering the impact of *Schwab* on Schedule C, the Committee notes that the current form does not indicate the right of a debtor to exercise the option described by the Supreme Court of exempting the full [FMV] of an asset."[33] The Committee's suggestion was spawned from "concern that only knowledgeable debtors (or more likely, debtors represented by knowledgeable lawyers) would understand that 'value of claimed exemption' could be stated in something other than a specific dollar amount."[34]

However, as recognized in *Orton* and by the majority of courts that have ruled on this issue, unless the statute provides an in-kind exemption, the debtor does not have the right to exempt 100 percent of FMV of the asset, but must state in the dollar amount the extent of his or her exemption.[35] This point was unequivocally made by the First Circuit Bankruptcy Appellate Panel in *Massey v. Pappalardo*, where it flatly rejected the argument that *Schwab* "supports a debtor's retention of 'exempt property regardless of whether the relevant exemption statute includes a monetary cap or not,'" and that such a policy is "necessary to give meaning and effect to a debtor's 'fresh start.'"[36] Rather, the *Massey* court found that *Schwab* was not "outlining a procedure by which an exemption claimed under a limited-interest exemption statute could be legitimately converted into an exemption in-kind"[37] and that the Supreme Court found that such policy would actually "threaten to convert a fresh start to a free pass," stating:

20 *Orton*, 2012 U.S. App. LEXIS 14898 at *15-16, n. 1.
21 *Id.* at *13-14 (quoting *Schwab*, 130 S.Ct. at 2668).
22 *Id.* at *15 (citing *In re Luckham*, 464 B.R. 67, 77 (Bankr. D. Mass. 2012); *Massey v. Pappalardo*, 465 B.R. 720 (1st Cir. B.A.P. 2012); *In re Stoney*, 445 B.R. 543, 552 (Bankr. E.D. Va. 2011); and *In re Moore*, 442 B.R. 865, 866 (Bankr. N.D. Tex. 2010)).
23 *Id.*
24 445 B.R. at 550-54.
25 *Id.* at 546, 554.
26 *Id.* at 552.
27 *Id.*
28 *Id.* at 554.
29 *Id.* at 555.
30 *Id.*
31 *Orton*, 2012 U.S. App. LEXIS 14898, *15-16, n. 1; *see also Massey*, 465 B.R. at 726.
32 Bankruptcy Rules Advisory Committee, Report of the Advisory Committee on Bankruptcy Rules to the Standing Committee on Rules of Practice and Procedure, available at www.uscourts.gov/RulesAndPolicies/rules/archives/advisory-committee-reports/advisory-committee-rules-bankruptcy-procedure.aspx (follow "May 2011" link), at pages 15-16 (May 6, 2011).
33 *Id.*
34 *Id.*
35 *Orton*, 2012 U.S. App. LEXIS 14898; *Luckham*, 464 B.R. at 77; *Massey*, 465 B.R. 720.
36 *Massey*, 465 B.R. at 724, 729.
37 *Id.* at 727-728 (quoting *Luckham*, 464 B.R. at 74).

continued on page 96

Trustee Talk: Schwab v. Reilly *Two Years Later*

from page 53

> Congress balanced the difficult choices that exemption limits impose on debtors with the economic harm that exemptions visit on creditors, and it is not for us to alter this balance by requiring trustees to object to claimed exemptions based on form entries beyond those that govern an exemption's validity under the Code.[38]

The Committee apparently agreed and has dropped the proposed amendment.

Conclusion

Thus, while a majority of courts recognize that a claimed exemption of 100 percent of FMV is facially invalid with respect to exemptions that are limited to a specific dollar amount and sustain a trustee's objection if one is lodged, *Schwab* requires that the objection be made. Further, although such objections by the trustee could be avoided if debtors simply claim exemptions in a numerical amount within the statutory exemption limits, that practice no longer operates to exempt the entire asset iteself, even if, as in *Orton*, the debtor provides the actual, fair FMV of the asset. Thus, the Supreme Court's suggestion actually encourages gamesmanship while discouraging finality and prompt administration. On the one hand, it encourages debtors to claim exemptions in a procedurally defective manner, thereby requiring the trustee to object. On the other hand, where debtors actually claim exemptions correctly, it leaves the asset in the bankruptcy estate and places post-petition appreciation at risk of future administration by the trustee.

The solution is to look to another Bankruptcy Code section that already provides a mechanism by which the debtor can remove assets from the bankruptcy estate. Under § 554, the debtor could request that the trustee abandon the asset or could file a motion with the bankruptcy court to compel abandonment. This procedure, not attempting to remove an asset from the estate through a claim of exemption, would allow the debtor to obtain finality and prompt administration. abi

38 *Id.* at 729-30 (quoting *Schwab*, 130 S.Ct. at 2667).

Student Loan Classification in Chapter 13 Debate Consolidated Cases

The case summaries were prepared by Caleb Crahan, law clerk to Hon. Brian Lynch

1. **Payments under an Income Driven Repayment Plan can be considered "maintenance" under 11 U.S.C. § 1322(b)(5).**

    a. ***In re Pracht*, 464 B.R. 486 (Bankr. M.D. Ga. 2012)**

    In *In re Pracht*, the Bankruptcy Court for the Middle District of Georgia confirmed a plan that permitted Debtor to continue making regular payments on her student loans so that she would be eligible for the Public Service Loan Forgiveness program.[1] *Id.* at 493. Because the final payment on Debtor's student loans was due after the conclusion of the plan, the Court found 11 U.S.C. § 1322(b)(5) applicable. *Id.* at 489. Further, despite a diminished payment to other unsecured creditors as a result of contractual payments on Debtor's student loans, the Court found a lack of unfair discrimination. *Id.* at 493. Notably, the Court found a lack of unfair discrimination because the significant forgiveness of Debtor's student loans under the Public Service Loan Forgiveness program would advance the goal of a fresh start. *Id.* at 492.

2. **Payment under an Income Driven Repayment Plan is not "unfair discrimination" under 11 U.S.C. § 1322(b)(1) when other unsecured creditors receive a larger payment.**

    a. ***In re Durand-Day*, 2022 WL 14938726 (Bankr. N.D. Tex. Oct. 26, 2022)**

    In *In re Durand-Day*, the Bankruptcy Court for the Northern District of Texas confirmed two chapter 13 plans that favored general unsecured claims over student loans. *Id.* at *5. Both plans proposed one-hundred percent payment of general unsecured claims and direct payment of student loans at their contract rates. *Id.* at *1. In addition, the last scheduled payments due under the terms of both Debtors' student loan agreements were due after the commitment period of their plans. *Id.* at *2.

    The Court found the separate classification of student loans did not discriminate unfairly. *Id.* at *3. In particular, the Court found that "by separately classifying and providing the Student Loan Creditor with the very treatment specifically authorized in § 1322(b)(5), the Amended Plans' treatment of the Student Loan Creditors constitutes fair discrimination." *Id.*

[1] Under the Public Service Loan Forgiveness program, if a borrower makes 120 consecutive monthly payments at a negotiated rate without default, the balance of the remaining debt thereafter will be forgiven. *In re Pracht*, 464 B.R. at 488. In this case, approximately $50,000 of Debtor's student loans were to be forgiven if she were to remain eligible for the program. *Id.*

b. *In re Potgieter*, 436 B.R. 739 (Bankr. M.D. Fla. 2010)

In *In re Potgieter*, the Bankruptcy Court for the Middle District of Florida found a lack of unfair discrimination in a plan that contemplated one-hundred percent payment of general unsecured claims and only twelve percent payment of Debtor's student loan debt, made outside of the plan. *Id.* at 744. The Court found that the plan did not discriminate unfairly for three reasons. First, the plan provided for one-hundred percent repayment of general unsecured claims. *Id.* at 743. Second, the student loan was nondischargeable and, therefore, the student lender would receive one-hundred percent repayment. *Id.* And third, the Debtor had the right under 11 U.S.C. § 1322(b)(4) to provide for payments on any unsecured claim to be made concurrently with payments on any secured claim. *Id.*

c. *In re Carlson*, 2012 Bankr. LEXIS 4131 (Bankr. D. Vt. Sep. 6, 2012)

In *In re Carlson*, the Bankruptcy Court for the District of Vermont confirmed a plan that contemplated one-hundred percent payment to general unsecured creditors and payment of Debtor's student loans directly to Sallie Mae according to the loan's contractual terms. *Id.* at *2. The Court in that case found a lack of unfair discrimination because Debtor's payment of her student loan debt outside of the plan did not diminish the treatment of other unsecured creditors. *Id.*

Additional cases that allow separate classification, after testing shows it is not an unfair discrimination.

***In re Quinn*, 586 B.R. 1 (Bankr. E.D. Mich. 2018) (J. Daniel Opperman).** Debtor proposed continuing student loan payments through the trustee (regular monthly payment amount) while paying $0.00 to the other general unsecured claims. The Court presented a thorough discussion of 4 tests for assessing unfair discrimination under § 1322(b)(1) and adopted the "Totality of the Circumstances" test from the *Kindle* case (Bankr. D.S.C. 2017). The Court indicated that, based on the continuing payments proposed for the student loan, a 33% dividend for other general unsecured claims might be confirmable, but 0% was not.

***In re Kane*, 603 B.R. 491 (Bankr. D. Kan. 2019) (J. Dale Somers).** Debtor proposed to pay full, regular monthly payments on the student loan and about 14% to the other general unsecured claims. The Court reiterated its rejection of the *Wolff* test (9th Cir. 1982) and applied the factors under the *Bentley* test (1st Cir. BAP 2001) to determine that the debtor's proposal constituted unfair discrimination. The Court commented on the need for substantial payments to the other general unsecured creditors when a debtor seeks to specially classify a student loan. The Court sustained the trustee's objection to confirmation of the plan.

In re Bennett, 615 B.R. 384 (Bankr. N.D.N.Y. 2020) (J. Diane Davis). Debtors in 6 separate chapter 13 cases (both AMI and BMI debtors) proposed to specially classify their student loans, pay higher

amounts on the student loan claims, and pay smaller dividends to the other general unsecured claims ranging from 62% down to 1%. The trustee proposed a bright-line test that would allow special classification of student loans so long as the discrimination against other general unsecured claims did not exceed 20%. Rejecting a bright-line test, the Court adopted the *Bentley* test (1st Cir. BAP 2001) and applied the 4 *Bentley* factors to each of the chapter 13 cases. The court denied confirmation in 4 of the cases and confirmed the proposed plans in 2 of the cases. In summary, the court acknowledged the difficulty of balancing the aims of the Bankruptcy Code enacted by Congress with the interests of all affected parties. In the end, the court was unwilling to rearrange the priorities Congress had established for chapter 13 cases under the current laws.

Faculty

Joshua R.I. Cohen is a practitioner at Cohen Consumer Law, PLC in St. Albans, Vt., and is known as the Student Loan Lawyer™. He has been practicing law since 2008, defending and assisting consumers with student loan issues. He has been interviewed on Fox and Bloomberg and quoted in multiple news articles. Mr. Cohen created the Student Loan Law Workshop in 2011, an intensive seminar and comprehensive roadmap that gives other attorneys the ammunition they need to fight back and win for their clients. The workshops were designed for lawyers to learn about student loans, potential solutions, how to defend are from a variety of problems and more. More than 500 lawyers have attended the workshop. Mr. Cohen is admitted to practice in Connecticut, Vermont, and the Eastern and Western Districts of New York. He is a member of the National Association of Consumer Advocates, the National Association of Consumer Bankruptcy Attorneys, and the American, Connecticut and Vermont Bar Associations. Mr. Cohen received his B.A. in psychology from Brandeis University in 1996, his M.B.A. from the University of Phoenix in 2002 and his J.D. from Quinnipiac University School of Law in 2007.

Hon D. Sims Crawford is a U.S. Bankruptcy Judge for the Northern District of Alabama in Birmingham, appointed on Sept. 1, 2016. He previously served as a Chapter 13 Standing Trustee in the Northern District of Alabama from 2004 until his appointment as a bankruptcy judge. Judge Crawford is a member of the National Conference of Bankruptcy Judges, ABI and the Alabama State Bar, and he serves on the Bankruptcy Judges Advisory Group (BJAG) and the Human Resources Advisory Council (HRAC), both of which provide advice to the Administrative Office of the U.S. Courts and to the committees of the Judicial Conference. He received his B.A. from the University of Alabama and his J.D. from Samford University Cumberland School of Law.

David P. Leibowitz is founder and managing member of the Law Offices of David P. Leibowitz, LLC in Chicago. He is a former member of ABI's Board of Directors and co-chairs ABI's Consumer Practice Extravaganza 2021. Mr. Leibowitz has co-chaired ABI's task force on individual chapter 11 cases, and he co-chaired ABI's Consumer Bankruptcy Committee and Commercial Fraud Committee. In addition, he was co-author and editor-in-chief of the *ABI Fraud Handbook*. Mr. Leibowitz is Board Certified as both a Consumer Bankruptcy Attorney and a Business Bankruptcy Attorney by the American Board of Certification. He is recognized in *Super Lawyers*, is rated AV-Preeminent by Martindale-Hubbell, has been recognized in *The Best Lawyers in America*, and has been named one of the top 500 bankruptcy lawyers in the U.S. by *Lawdragon*. Mr. Leibowitz is a Fellow of the Wisconsin Bar Foundation and has received awards for *pro bono* excellence from the U.S. District Court for the Northern District of Illinois and from the Circuit Court for Lake County, Ill. He also has been a panel chapter 7 trustee for more than 30 years and served as a member of the board of directors of the National Association of Bankruptcy Trustees. As a chapter 7 trustee, he has administered more than 30,000 cases and is certified as a mediator by the Chicago Bar Association. Mr. Leibowitz received his B.A. in economics from Northwestern University and his J.D. *cum laude* from Loyola University of Chicago School of Law, where he was note editor of its law review.

Hon. Brian D. Lynch is a U.S. Bankruptcy Judge for the Western District of Washington in Tacoma, sworn in on June 1, 2010. He served as Chief Bankruptcy Judge from Oct. 1, 2014, to Sept. 30, 2019, and as chair of the Conference of Ninth Circuit Chief Bankruptcy Judges in 2017. Prior to his appointment, Judge Lynch served as the Standing Chapter 13 Trustee for the Portland Division of the District of Oregon, and as the Standing Chapter 12 Trustee for the District of Oregon. In 2018, he was awarded the National Association of Chapter 13 Trustees Hon. Ralph Kelley Award. Judge Lynch received his J.D. in 1975 from Georgetown University Law Center.

Michael A. Miller is a supervising attorney at the Semrad Law Firm, LLC in Chicago, where he focuses on consumer bankruptcy. He also founded and runs the firm's *pro bono* appellate practice, and has argued three times in front of the Seventh Circuit. Mr. Miller is currently an adjunct professor at The University of Illinois Chicago Law School. He is a former co-chair of the Bankruptcy Court Liaison Committee for the Northern District of Illinois, and he is currently the Seventh Circuit Leader for the National Association of Consumer Bankruptcy Attorneys. Mr. Miller received his undergraduate degree with honors from Roosevelt University and his J.D. from The John Marshall Law School, during which time he was an extern for the U.S. Trustee's Office.