Law v. Siegel and the Ever-Changing Face of Exemptions

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OBJECTIONS TO EXEMPTIONS: TIMING

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Federal Rule of Bankruptcy Procedure 4003(b)(1) provides a time limit for filing an objection to a debtor's claim of exemptions. The subsection provides as follows:

> Except as provided in paragraphs (2) and (3), a party in interest may file an objection to the list of property claimed as exempt within 30 days after the meeting of creditors held under §341(a) is concluded or within 30 days after any amendment to the list or supplemental schedules is filed, whichever is later. The court may, for cause, extend the time for filing objections if, before the time to object expires, a party in interest files a request for an extension.

Fed.R.Bankr.P. 4003(b)(1). A date of conclusion of the § 341 meeting is crucial should a question be raised over the timeliness of an objection to exemption. Although any party in interest may object to a debtor's claim of exemptions, objections are usually filed by the panel trustee appointed to oversee the bankruptcy case. Issues regarding the date of conclusion of § 341 meetings frequently arise because trustees often continue these meetings for a variety of reasons. Debtors may delay in providing complete document production, trustees may request additional documentation or simply need more time to investigate a debtor's bankruptcy case.

In order to preserve the right to object to exemptions, trustees must continue § 341 meetings to a specific date. It will likely not be sufficient if a trustee continues a meeting generally, or to a future date. *See In re Newman*, 428 B.R. 257 (1st Cir. BAP 2010) (superseded in other matters by rule). Litigation over the conclusion date of § 341 meetings has resulted in three lines of approach among courts. These different approaches have been referred to as the "bright-line" approach, the "case-by-case" approach and the "debtor's burden" approach.

Under the "bright-line" approach, a meeting continued without a follow-up date will be deemed concluded on the date of the initial meeting for the purpose of determining the beginning of the thirty-day objection period. *See In re Smith,* 235 F.3d 472, 476 (9th Cir.2000); *In re Friedlander,* 284 B.R. 525, 527 (Bankr.D.Mass.2002); *In re Levitt,* 137 B.R. 881, 883 (Bankr.D.Mass. 1992); *see also In re Cushing,* 401 B.R. 528 (1st Cir. BAP 2009); *In re McGowan,* 226 B.R. 13 (8th Cir. BAP 1998) (discussing the implementation of the "bright-line" approach by local rule). Courts favoring this approach note the certainty to trustees regarding the administration of assets and the fact that it allows debtors to move forward with a fresh start by allowing exemptions to become final within a definite time period. *In re Dutkiewicz*, 408 B.R. 103, 107 (6th Cir. BAP 2009) (citations omitted). The Ninth Circuit explained the benefits of the "bright-line" approach as follows: "To authorize trustees to adjourn meetings indefinitely, even when it is unlikely that any subsequent meeting will in fact be called, would nullify the thirty-day requirement of [Bankruptcy] Rule 4003(b), rendering the holding in *Taylor v. Freeland & Kronz,* 503 U.S. 638, 112 S.Ct. 1644, 118 L.Ed.2d 280 (1992)[1] hollow, and undermining the concerns expressed by the Supreme Court about promptness and finality." *Smith,* 235 F.3d at 476.

The second approach is generally referred to as the "case-by-case" approach. Under this test, the facts and circumstances of a particular case are examined to determine the conclusion

[1] Under § 522(l) and Bankruptcy Rule 4003(b)(1), property appearing on a debtor's list of exemptions will be excluded from the estate unless a party in interest objects within thirty days of the conclusion of the meeting of creditors convened under § 341(a). *See Taylor v. Freeland & Kronz,* 503 U.S. 638, 643, 112 S.Ct. 1644, 118 L.Ed.2d 280 (1992).

date of the § 341 meeting. *See Petit v. Fessenden,* 182 B.R. 59, 63 (D.Me.1995), *aff'd on other grounds,* 80 F.3d 29 (1st Cir.1996). In adopting this approach, the Fifth Circuit observed that courts "have considered at least four factors in determining the reasonableness of a trustee's delay in adjourning a meeting of creditors: (1) the length of the delay; (2) the complexity of the estate; (3) the cooperativeness of the debtor; and (4) the existence of any ambiguity regarding whether the trustee continued or concluded the meeting." *In re Peres,* 530 F.3d 375, 378 (5th Cir. 2008).

The final approach has become known as the "debtor's burden" approach. It developed in response to trustees announcing general continuances without a specific date set so they would not run afoul of the thirty-day objection deadline. *See In re Flynn,* 200 B.R. 481, 483 (Bankr. D.Mass.1996). Adherents to this approach reason that a § 341 meeting will not terminate until declared so by the trustee or ordered by the court. Courts applying this test reject the case-by-case approach because the objecting party would never know if the objection was barred as untimely until the court investigated the circumstances of the case. The approach places the onus on the debtor since the debtor has the greatest interest in having his or her case concluded. It should be noted that the handful of circuit courts to address the issue of timely objections to exemptions have rejected the "debtor's burden" approach. These courts have opined this approach places an inordinate burden upon the debtor in contradiction of the provisions of the Bankruptcy Code and Rules, and permits trustees to continue § 341 meetings indefinitely. *Smith,* 235 F.3d at 477 n. 447; *Peres,* 530 F.3d at 378; *Newman*, 428 B.R. at 263-64.

Not all courts to address the issue of timely objections to exemptions have adopted one of the three approaches outlined above. Illustrative of this point is the case *In re Newman*, 428 B.R. 257 (1st Cir. BAP 2010). The debtors in *Newman* filed a Chapter 7 bankruptcy and claimed a homestead exemption in property owned by the debtor-husband and his two siblings. The debtor's mother had a life estate in the property and had declared it as her homestead under state law. The property was valued at $318,500 and it was owned free and clear of any liens. In addition to that property, the debtors had a separate homestead in which they resided and claimed an exemption. The initial § 341 meeting was held and the trustee questioned the debtors about the doubtful homestead exemption in the first property. The trustee demanded further documentation, which the debtors timely provided. The trustee subsequently sent the debtors a settlement offer after reviewing the additional documentation. The debtors promptly refused the settlement.

At a second meeting held seven months later, the trustee again questioned the debtors about the exemption in the life estate property. The debtors filed a motion for determination that the meeting had been concluded. Thereafter, the trustee filed her first and only objection to the homestead exemption claimed in life estate property. The issue presented was whether the trustee had timely filed her objection under Bankruptcy Rule 4003(b)(1). The bankruptcy court ruled in favor of the trustee and found the § 341 meeting had not been concluded. The debtors subsequently filed an appeal.

On appeal, the Bankruptcy Appellate Panel for the First Circuit reversed the holding of the bankruptcy court. The BAP rejected the "debtor's burden" approach to the issue. The court also declined to accept or reject the "bright-line" and "case-by-case" approaches. In the court's opinion, these two tests could be applied jointly and would yield the same results. The BAP determined the § 341 meeting was concluded at the end of the initial meeting. It was mindful of the fact the trustee had demanded additional documentation be provided within ten days of that meeting. However, the BAP found that such a demand without something more is not notice of an adjournment to a specific date and time. Therefore, the trustee's objection was late under Bankruptcy Rule 4003(b)(1) and she was precluded from challenging the exemption at issue.

The BAP stressed it is the trustee's responsibility to conclude or adjourn the § 341 meeting. It explicitly stated the outcome in the case could have been avoided if the trustee had taken heed of the policy of the U.S. Trustee as set forth in its "Handbook for Chapter 7 Trustees." The policy states as follows:

> The trustee should not routinely continue § 341(a) meetings when the debtor appears. If a trustee must continue the meeting, however, the trustee must, if at all possible, announce the continued date to all parties present at the initial meeting, and advise the United States Trustee and, if necessary, the clerk of the bankruptcy court, of the continued date.

Accordingly, the BAP found the bankruptcy court's reliance on the "debtor's burden" approach to be an error of law. The ruling of the bankruptcy court was therefore reversed in favor of the debtors.

Under Rule 4003(b)(1), it is imperative for trustees to have a set date for the conclusion of § 341 meetings. The Rule requires objections to exemptions to be filed within thirty days of the conclusion of such meeting. In order to prevent running afoul of the thirty-day objection deadline, trustees should take heed when continuing § 341 meetings. Indefinitely continuing the meeting, or continuing it to a "future date," will generally not suffice to preserve the objection period.

The Legacy of *Law v. Siegel*

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Exemption laws are designed to protect a debtor from his creditors and to provide him with the basic necessities of life so that even if his creditors levy on all of his nonexempt property, the debtor will not be left destitute and a public charge. However, bankruptcy relief is only designed for the honest debtor. What can a bankruptcy court and bankruptcy trustee do when the artful debtor has been less than candid or secreted assets? Can a court create a rule to punish the wryly debtor and deter others from following his example by denying him his right to discharge?

The Court of Appeals for the 9th Circuit thought it could do so by surcharging the debtor's exemption to pay administrative expenses. But, in January 2014, a unanimous U.S. Supreme Court decided *Law v. Siegel* 134 S. Ct. 1188 (2014). The Court held that Courts cannot create exceptions to the explicit dictates of Congress. Congress enacted 11 U.S.C. §522(k) to prevent a debtor's exemption from being surcharged to pay costs of administration. No matter how outrageous the debtor's conduct was, Congress, not the courts was the final arbiter. However, the opinion did not stop there. The Court also held that Congress clearly adopted exceptions to the debtor's claim for exemption and the courts were not free to manufacture new ones. This dicta overruled a long line of cases which held that if the debtor acted in bad faith and with prejudice to the creditors and the trustee, she could not amend her exemptions. Under *Law*, if the debtor hid her assets and the trustee found out, she could amend her schedule C and assert an exemption regardless of bad faith or prejudice. Ironically, under the statutory exemptions, if the debtor gave a cooler full of cash to a neighbor for burial in the neighbor's back yard and the trustee avoided the transfer, she could not assert a claim for exemption. However, if she buried the cooler full of cash in her own back yard, she could assert an exemption.

Several court have ignored this dicta arguing that it was not part of the Supreme Court's holding. Other courts suggest that Federal Rule of Bankruptcy 403(b)(2) gives the bankruptcy court authority to deny the debtor's request for an amendment. Neither of these approaches has found much favor with either the appellate courts or the commentators.

However, a new line of case has arisen in California. What if the claim for exemption is not valid under state law? Then, the bankruptcy court does not need to create a federal judicial exception to the sly debtor's attempt to assert an exemption on secreted assets.

The first case is *Lua v. Miller (In re Lua)*, 551 B.R. 448 (C.D. Cal. 2015), a copy of which is attached as Exhibit A. In *Lua*, the debtor filed a voluntary Chapter 7 petition. The debtor initially claimed to own 30% of her homestead and asserted the full $75,000 exemption under California law. The debtor subsequently amended her schedules to disclaim any interest in the property and any exemption. In the meantime, the trustee discovered that she did have an interest in the home and entered into an agreement with her non-filing husband to sell the home. The debtor attempted to frustrate the sale. Ultimately, the debtor amended her schedules once against to assert that she owned 50% of the home and was entitled to a $100,000 exemption. Had the debtor succeeded, after the costs of sale there would have been nothing left over for creditors.

The trustee objected to the amended exemption on the grounds of judicial estoppel, equitable estoppel and laches. The Bankruptcy Court sustained the trustee's objection. *See In re Lua*, 529 B.R. 766, 779 (Bankr. C.D. Cal 2015). The debtor appealed to the U.S. District Court. The Court noted that the bankruptcy court may deny an exemption if the property were not exempt under state law. *See Law*, 134 S. Ct. at 1196-97 (2014). The District Court found that the debtor under California law would be equitably estopped from asserting exemption.

The Court found that a trustee who seeks equitable estoppel must satisfy a five part test. First, the trustee must establish that the debtor has misrepresented or concealed a material fact. In the case at bar the debtor lied on her schedules and changed her position constantly. Second, the trustee must show that he had no knowledge of the facts although ignorance or mistake will not prevent an estoppel when a debtor makes an affirmative statement of facts rather than remains silent. Third, the trustee must also demonstrate that he was ignorant, actually and permissibly of the truth. Fourth, the court must find that the debtor intended the trustee to act on her representation. Finally, the trustee must demonstrate that he changed his position in reliance on something said or done by the debtor resulting in detriment or prejudice to the party asserting equitable. The District Court found that equitable estoppel rests firmly upon a foundation of conscience and fair dealing. In the case at bar, the debtor did not deal fairly with the trustee. She remained silent for three years despite knowing that the trustee was pursuing the property in attempt to compensate creditors, then amended her schedules at the last minute to nullify the trustee's significant efforts and reap a windfall for herself and the marital community.

The *Lua* case is no on appeal to the Court of Appeals for the 9th Circuit.

The doctrine of equitable estoppel is alive and well in Illinois. *See Geddes v. Mill Creek Country Club, Inc.* 196 Ill. 2d 302 (2001). In *Geddes*, the Illinois Supreme Court held that the proponent of equitable estoppel must satisfy a six part test. To establish equitable estoppel in Illinois, the party claiming estoppel must demonstrate that: (1) the other person misrepresented or concealed material facts; (2) the other person knew at the time he or she made the representations that they were untrue; (3) the party claiming estoppel did not know that the representations were untrue when they were made and when they were acted upon; (4) the other person intended or reasonably expected that the party claiming estoppel would act upon the representations; (5) the party claiming estoppel reasonably relied upon the representations in good faith to his or her detriment; and (6) the party claiming estoppel would be prejudiced by his or her reliance on the representations if the other person were permitted to deny the truth thereof. Thus, under Illinois law, the trustee can contest the debtor's claim for exemption where she lied or hid the asset if the trustee can satisfy this six part test.

However, the trustee may also have two other arguments for blocking an exemption – judicial estoppel and laches. On March 25, 2016, the United States Bankruptcy Court for the Southern District of California in *Nels Louis and Rachael Ann Berg* Bankruptcy No. 09-17553 bared the debtors' claim for an exemption on their home and an insurance settlement. A copy of the *Berg* decision is attached as Exhibit B.

In October 2007 wildfires swept through San Diego County, California. The fire damaged the debtors' property--and instead of evacuating, Nels remained at the property to fight the fire. In the aftermath of the wildfires, San Diego Gas & Electric ("SDG&E") was sued for allegedly causing some of the fires, and among the plaintiffs were the debtors. In 2009 the debtors filed their original petition for relief under Chapter 7. The debtors did not disclose the lawsuit against SDG&E in their schedules. At the § 341 meeting, the debtors claimed that the burned out home was owned by Mr. Berg's mother. The debtors also stated that the lawsuit against SDG&E had a value of $530,000 and asserted a $150,000 personal injury exemption under California law. Nels never visited a doctor and had no documents to a support a personal injury. In 2012 after Nels' mother died, Mr. Berg sued his siblings claiming that he owned the burned out home and claimed that the burned out home was his homestead and that he and his wife were entitled to a $160,000 homestead exemption. The debtors did receive a discharge on February 13, 2012.

Ultimately, the trustee settled the debtors' litigation against SDG&E and the debtors acquiesced in the settlement. The settlement agreement did not apportion any funds for personal injury reimbursement.

The trustee objected to the debtors' claim for exemption on three grounds – judicial estoppel, equitable estoppel and laches.

The Bankruptcy Court first noted that *Law v. Siegel* prevents the bankruptcy court from adopting an federal basis for denying the debtors claim for exemption for a ground not specifically identified in 11 U.S.C. § 522. However, the Bankruptcy Court also found that *Law v. Siegel* does not prevent a bankruptcy court from denying an exemption if the debtor would not have been entitled to an exemption under state law.

First, the Bankruptcy Court considered judicial estoppel. Under California law, judicial estoppel applies when: (1) the same party has taken two positions; (2) the positions were taken in judicial or quasi-judicial administrative proceedings; (3) the party was successful in asserting the first position; (4) the two positions were totally inconsistent; and (5) the first position was not taken as a result of ignorance, fraud, or mistake. In the case at bar, the debtors received a discharge based on the ownership of assets originally alleged on their schedules. The debtors cannot change their claim for assets post discharge and hope to continue to enjoy the benefits of that discharge. The court cannot help be feel offended that the debtors received a discharge

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based upon trick. In addition, when the debtors sought the benefit of the trustee's settlement with SDG&E based on personal property damage and now assert that it was really a personal injury settlement, judicial estoppel comes into play. Because the Bankruptcy Court ruled against the debtors on both the basis of equitable estoppel and laches, it did not rule on whether judicial estoppel applies.

The Illinois Supreme Court recognizes the doctrine of judicial estoppel in bankruptcy cases. *Seymour v. Collins* 39 N.E. 3d 961 (Ill. 2015). While the Illinois Supreme Court follows the five factors reached by the California courts, it adds an important judicial gloss. The Court requires the trial court to consider the significance of the debtor's action in the first proceeding, and whether there was an intent to deceive or mislead, as opposed to the prior position having been the result of inadvertence or mistake.

Second, the Bankruptcy Court repeated the factors for invoking equitable estoppel listed in *Lua*.

Third, the doctrine of laches bars a cause of action when the plaintiff unreasonably delays in asserting or diligently pursuing the cause and the plaintiff has acquiesced in the act about which the plaintiff complains, or the delay has prejudiced defendant.

The Illinois Supreme Court also recognizes the doctrine of laches in *Van Milligan v. Bd. of Fire & Police Comm'rs.*, 158 Ill 2d 85; 630 N.E. 2d 830 (1994). The Illinois Supreme Court held that laches will apply when a party: (1) has failed to assert timely a right; and (2) has caused prejudice to the adverse party.

Thus, an Illinois creditor or trustee may have a basis to object to the artful debtor's belated claim of an exemption after he has been caught lying or secreting an asset. The Illinois courts create a substantial burden, but not an impossible one. However, because Illinois' exemptions are so much more parsimonious than those of California or of Illinois' neighboring states, there may not be enough money involved to justify much litigation.

Exemption Planning after Law v. Siegel: Can "Hogs" Still Get Slaughtered?

The hallmark of the "clean" chapter 7 bankruptcy case is that the debtor's assets are all either fully secured or exempt, leaving the trustee nothing to administer so that the case moves swiftly from petition date to discharge date without incident. The focal point of this presentation is those debtors who do not arrive at their bankruptcy attorney's doorstep with their affairs so neatly arranged.

"Exemption planning" or "pre-bankruptcy planning" is the act of converting non-exempt assets into exempt assets on the eve of a bankruptcy filing. In general, such transfers are "a lightning rod for intense scrutiny." See Keith M. Lundin & William H. Brown, *Chapter 13 Bankruptcy* 4th ed. § 181.1 at ¶ 1.

Exemption statutes, whether state or federal, are ostensibly designed to provide debtors with the "basic" necessities of life so that they will not become a "public charge." See H.R. Rep. No. 95-595, at 126 (1977), as reprinted in 1978 U.S.C.C.A.N 5963, 6087; In re Woodside, 538 B.R. 518 (Bankr. C.D. Ill. 2015). As the Seventh Circuit recently observed, "There is nothing unlawful about structuring one's assets to take advantage of the bankruptcy laws as Congress . . . [has] seen fit to write them." Wittman v. Koenig, __ F.3d __, 2016 WL 3997251 (7th Cir. July 26, 2016). A debtor's *restructuring* of assets immediately prior to a bankruptcy petition will, however, often be scrutinized by both creditors and courts for some indication of fraudulent behavior.

Typically, aggressive pre-bankruptcy planning was met with two objections: either an objection to the exemption claim itself, or an objection to the debtor's discharge under 11 U.S.C. §727(a)(2) (for engaging in the "transfer" of an asset to "hinder, delay, or defraud" creditors). Conversion of non-exempt property into exempt property can qualify as a transfer within the meaning of the code. See Matter of Smiley, 864 F.2d 562, 565-66 (7th Cir. 1989); 11 U.S.C. § 101(54)(D) (a transfer is "each mode, direct or indirect, absolute or conditional, voluntary or involuntary, of disposing of or parting with (i) property; or (ii) an interest in property"). Other potential remedies include dismissal of the case, sanctions, revocation of discharge, denial of confirmation, and more.

Still, no debtor owes creditors "more than the law demands." Koenig, 2016 WL 3997251 at *6. This tension is at the heart of the debate over exemption planning – at what point does a financially strapped debtor's liquidation of non-exempt assets to purchase exempt property cross the (potentially invisible) line from permissible to fraudulent? See Mathai v. Warren (In re Warren), 512 F.3d 1241, 1249 (10th Cir. 2008) ("one of the more difficult issues in bankruptcy law is deciding when, if ever, intent to defraud creditors can be shown by the debtor's conversion of nonexempt assets to exempt assets").

The Smell Test's Results May Vary

In Smiley, the Seventh Circuit characterized the problem as follows: "Conversions of assets from nonexempt to exempt forms are not *necessarily* fraudulent to creditors." 566 F.2d at 566 (emphasis added); Norwest Bank Nebraska, N.A. v. Tveten, 848 F.2d 871, 874 (8th

Cir.1988) ("[A]bsent extrinsic evidence of fraud, mere conversion of non-exempt property to exempt property is not fraudulent as to creditors even if the motivation behind the conversion is to place those assets beyond the reach of creditors"). Prior to the Supreme Court's decision in Law v. Siegel, courts often applied the same basic standard to both denial of an exemption or the debtor's discharge. See Tveten, 848 F.2d at 874 (the standard "is the same"); In re Bogue, 240 B.R. 742, 750 (Bankr. E.D. Wis. 1999) (the "same reasoning" applies to denial of discharge as on the issuance of exemption disallowance); In re Przybylski, 340 B.R. 624 (Bankr. E.D. Wis. 2006) ("The test is the same").

Since direct evidence of fraudulent intent is rarely, if ever, easily accessible, courts look to the so-called "badges of fraud" to determine whether a debtor acted with the request intent. Addison v. Seaver (In re Addison), 540 F.3d 805, 811 (8th Cir.2008); see also Village of San Jose v. McWilliams, 284 F.3d 785, 790 (7th Cir. 2002) (intent to defraud must be actual and cannot be constructive, but because it is "unlikely" the debtor will admit fraud, intent may be established by circumstantial evidence).

In Smiley, the Seventh Circuit identified "extrinsic signs of fraud" as including:

> (1) that the debtor obtained credit in order to purchase exempt property; (2) that the conversion occurred after the entry of a large judgment against the debtor; (3) that the debtor had engaged in a pattern of sharp dealing prior to bankruptcy; ... and [(4)] that the conversion rendered the debtor insolvent.

864 F.2d 562. In that case, the court affirmed the denial of the debtor's discharge not because the debtor had converted non-exempt property into exempt property, but because he misrepresented to creditors the value of the three assets and their availability to satisfy creditor's claims in order to delay the filing of an involuntary proceeding. Id. at 569. In addition, courts have considered other factors, such as:

1. Amount of exemption.
2. Proximity of time of conversion to time of filing for bankruptcy.
3. Source of funds used to acquire exempt property.
4. Misleading contacts with creditors by debtors while in the process of converting the assets from non-exempt to exempt status.
5. Purpose of the conversion of assets.
6. Conveyances for less than fair consideration.

See Bogue, 240 B.R. at 750-51; Przybylski, 340 B.R. at 630-31; In re Blackburn, 2007 WL 5582054 (Bankr. M.D. Tenn. May 2, 2007); see also In re Crater, 286 B.R. 756 (Bankr. D. Ariz. 2002) (discussing UFTA badges of fraud in context of dischargeabilty under Section 727(a)(2)).

The routine uncertainty about the precise standard for this determination can be illustrated by the cases of Norwest Bank Nebraska, N.A. v. Tveten, 848 F.2d 871 (8th Cir. 1988) and In re Hanson, 848 F.2d 866 (8th Cir. 1988). Tveten involved a debtor who, on the eve of bankruptcy, converted approximately $700,000 of non-exempt assets into exempt assets; Hanson involved farmers who converted about $31,000 in assets. The 8th Circuit concluded that because the state exemption at issue in Tveten was unlimited, it had "the potential for unlimited abuse." Agreeing that the debtor "did not want a mere *fresh* start, he wanted a *head* start," the court affirmed the denial of the debtor's discharge. 848 F.2d at 876 (citing In re Zouhar, 10 B.R. 154 (Bankr. D. N.M. 1981); see also In re Johnson, 880 F.2d 78 (8th Cir. 1989) (remanding determination that conversion of certain assets into exempt property could be fraudulent based upon the size of the exemptions sought, with the exception of the debtor's homestead claim). In Hanson, meanwhile, the court affirmed a finding of *no* fraudulent intent and observed that the debtors only sought to take advantage of "limited" exemptions. 848 F.2d at 869. As observed by the concurrence in Hanson, the distinction was problematic because "a debtor will be allowed to convert property into exempt form, or not, depending on findings of fact made in the court of first instance, the Bankruptcy Court, and these findings will turn on whether the Bankruptcy Court regards the amount of money involved as too much." Id. at 870-71 (J. Arnold, concurring).

The notion of a continuum on which the size of the exemption is relevant to the determination of has been characterized in various ways, perhaps most notably as: "There is a principle of too much: phrased colloquially, when a pig becomes a hog it is slaughtered." Zouhar, 10 B.R. at 157. This can be contrasted with the original bankruptcy court opinion in Johnson, which posited that a "smell test" is too subjective because "Everyone's nose, after all, is different." In re Johnson, 80 B.R. 953, 961-62 n.9 (Bankr. D. Minn. 1987); see also Smiley, 864 F.2d at 566-67 (agreeing with courts which disregarded either the actual amount claimed as exempt or evidence of the debtor's motivation; the fact that the debtor stood to gain a large amount of money was "irrelevant"); Crater, 286 .R. at 765 (rejecting notion that conversion of assets should result in denial of a discharge just because it occurred shortly before filing).

Law v. Siegel

The Supreme Court unanimously decided that the bankruptcy court overstepped its authority when it "surcharged" the debtor's homestead exemption to pay administrative expenses (i.e., the trustee's legal fees) incurred in litigation over fraudulent liens created to preserve non-exempt equity. Law v. Siegel, 134 S.Ct. 1188, 188 L.Ed. 2d 146 (2014). On one level, the case stands for the proposition that a bankruptcy court cannot use the general equitable powers available under 11 U.S.C. § 105 to overcome specific dictates of the code (namely, the provision in § 522(k) that exempt property "is not liable for payment of any administrative expense").

In assessing the trustee's arguments, however, the Court also had occasion to touch on pre-bankruptcy planning issues as well:

> Siegel points out that a handful of courts have claimed authority to disallow an exemption (or to bar a debtor from amending his schedules to claim an exemption, which is much the same thing) based on the debtor's fraudulent concealment of the asset alleged to be exempt. See, e.g., In re Yonikus, 996 F.2d 866, 872–873 (C.A.7 1993); In re Doan, 672 F.2d 831, 833 (C.A.11 1982) (per curiam); Stewart v. Ganey, 116 F.2d 1010, 1011 (C.A.5 1940). He suggests that those decisions reflect a general, equitable power in bankruptcy courts to deny exemptions based on a debtor's bad-faith conduct. *For the reasons we have given, the Bankruptcy Code admits no such power.* It is of course true that when a debtor

> claims a state-created exemption, the exemption's scope is determined by state law, which may provide that certain types of debtor misconduct warrant denial of the exemption. E.g., In re Sholdan, 217 F.3d 1006, 1008 (C.A.8 2000); see 4 Collier on Bankruptcy ¶ 522.08[1]–[2], at 522–45 to 522–47. Some of the early decisions on which Siegel relies, and which the Fifth Circuit cited in Stewart, are instances in which federal courts applied state law to disallow state-created exemptions. See In re Denson, 195 F. 857, 858 (N.D.Ala.1912); Cowan v. Burchfield, 180 F. 614, 619 (N.D.Ala.1910); In re Ansley Bros., 153 F. 983, 984 (E.D.N.C.1907). But federal law provides no authority for bankruptcy courts to deny an exemption on a ground not specified in the Code.

134 S.Ct. at 1196-97 (emphasis added).

Subsequent decisions have adopted these statements (whether dicta or not) to conclude that bankruptcy courts do not have the ability to *disallow* exemptions based on bad faith or other misconduct. See, e.g., In re Baker, 791 F.3d 677 (6th Cir. 2015). Courts have also concluded that this is true of pre-bankruptcy exemption planning. See In re Castellano, 550 B.R. 214 (Bankr. E.D. N.Y. 2016) (there was no "viable basis" for disallowance under the Code or applicable non-bankruptcy exemption law, and the exemption could not be denied on debtor's alleged bad faith conduct in using non-exempt funds to enhance value of IRAs); In re Hurt, 542 B.R. 798 (Bankr. E.D. Tenn. 2015) (an objection to exemption based on bad faith cannot be sustained absent specific statutory authorization).

Cases within the Seventh Circuit also reflect this change, which generally serves to eliminate the notion that the test for denial of an exemption and denial of discharge are essentially the same, at least in the context of federal exemptions. See In re Coyle, 2016 WL 828459 (Bankr. C.D. Ill. March 2, 2016) ("Bankruptcy courts no longer have the authority to consider the merits of objections to exemptions based on bad faith or non-statutory equitable grounds"); In re Bogan, 534 B.R. 346, 349 (Bankr. W.D. Wis. 2015) ("Essentially, dicta or not, the Supreme Court provides a clear directive concerning the limits of federal power"); In re Franklin, 506 B.R. 765, 771 (Bankr. C.D. Ill. 2014) ("The Court disavowed the long-standing non-statutory basis for disallowing an exemption where a debtor fraudulently conceals an exempt asset, determining that courts do not have a general equitable power to deny exemptions based on a debtor's bad faith conduct"); see also In re Simpson, 2015 WL 5604240 (W.D. Wis. September 23, 2015) ("a court must have a valid statutory basis to deny an exemption").

Efforts to distinguish or limit the effect of Law v. Siegel have generally been ineffective. For example, in Coyle the creditors tried to distinguish Law because they filed timely objections to the claim and were not trying to surcharge exempt property later in the case. The court responded that "nothing in Law suggests that the timing of the filing of the objection is controlling or even relevant." 2016 WL 828459 at * 6. And in Bogan the court rejected concerns of an "influx" of bad faith exemption claims, noting "there are other codified avenues to address this issue such as dismissal under 11 U.S.C. § 707(b)(3)." 534 B.R. at 349.

A statutory provision in state exemption statutes which supports denial of the exemption can still be enforced. Law, 134 S.Ct. at 1196-97; Simpson, 2015 WL 5604240 at *3. Many state exemption schemes do have provisions which still might justify the denial of an exemption because of fraudulent conduct on the debtor's part in obtaining or exercising the exemption. For example, the Illinois personal property exemption includes the following caveat: "If a debtor owns property exempt under this Section and he or she purchased that property with the intent of converting nonexempt property into exempt property or in fraud of his or her creditors, that property shall not be exempt from judgment, attachment, or distress for rent. Property acquired within 6 months of the filing of the petition for bankruptcy shall be presumed to have been acquired in contemplation of bankruptcy." 735 ILCS § 5/12-1001. Similarly, Wisconsin's exemption statute provides that "Any or all of the exemptions granted by this section may be denied if, in the discretion of the court having jurisdiction, the debtor procured, concealed, or transferred assets with the intention of defrauding creditors." Wis. Stat. § 815.18(10); see also Bronk v. Cirili, 2012 WL 12012746 (W.D. Wis. September 28, 2012) (reversed on other grounds, 775 F.3d 871 (7th Cir. 2015)) (denial of exemption under Wis. Stat. § 815.18(10) is properly analyzed under the same test as a denial of discharge).

While changing the standard for denial of an exemption, Law v. Siegel did not change the prospect of other sanctions, such as the denial of discharge, for perceived fraudulent conduct. 134 S.Ct. at 1198 ("There is ample authority to deny the dishonest debtor a discharge"); see also In re Urbonas, 539 B.R. 533 (Bankr. N.D. Ill. 2015) (considering conversion of non-exempt property in context of denying debtor's discharge). In Bogan, the court also highlighted another possible remedy: dismissal of the case. In In re Schwartz, 799 F.3d 760 (7th Cir. 2015), the Seventh Circuit found that sufficient "cause" for dismissal existed when a debtor filed bankruptcy in an attempt to discharge debts that they could have dealt with by making "appropriate lifestyle adjustments." The court noted that the statutory list of circumstances which may constitute "cause" for dismissal is nonexclusive, and need not consist of procedural defects in the petition itself; dismissal for cause embraces conduct that, "while not a violation of required procedures, avoids repayment of debt without an adequate reason." Id. at 763.

More specifically, the court stated:

> No one is asking [the debtors] to live in a tent, dress in rags, drive a 1950 Chevy, or emulate Mme. Loisel in guy de Maupassant's short story "The Necklace" ("La Parure") who loses a borrowed necklace that she believes to be very valuable and ruins herself and her husband financially in order to remunerate the owner, only to discover in the end that the necklace was a fake, made of glass and worth almost nothing. What the [debtors] failed to do was pay as much of their indebtedness as they could without hardship. Their action was deliberate and selfish, and provides good cause for denying the discharge . . . we agree that an unjustified refusal to pay one's debts is a valid ground under 11 U.S.C. § 707(a) to deny discharge of a bankrupt's debts.

Id. at 763-64.

These statements *could* be viewed as further justifying dismissal for "cause" in the context of pre-bankruptcy planning (i.e., was the debtor's conversion of non-exempt assets into exempt assets an *unjustified* refusal to pay one's debts?). However, in affirming a broad interpretation of Wisconsin's unlimited exemption for annuities, another panel of the Seventh Circuit recently noted that in the context of bankruptcy planning, "no debtor owes her creditor more than the law demands," and there is "nothing unlawful about structuring one's assets to take advantage of the bankruptcy laws." Wittman v. Koenig, __ F.3d __, 2016 WL 3997251 at *6 (7th Cir. July 26, 2016). Even though Law v. Siegel abrogated existing law regarding the bankruptcy court's ability to deny an exemption without express statutory authorization, the issue of when – and how – to punish a debtor for seemingly excessive bankruptcy planning remains open.