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Real Property Nuances in Chapter 13: Post-Petition Property Appreciation and Avoidance Actions

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1. Tax Foreclosure Can Violate Takings Clause

In Tyler v. Hennepin Cty., 143 S. Ct. 1369 (2023) (Roberts, J.), the Petitioner owned a condominium. After she moved to a senior community, she failed to pay the real estate taxes on the condominium. Based on accrued unpaid real-estate taxes, along with some interest and penalties, the municipality foreclosed on and sold the property. The county kept the surplus from the sale (e.g., the amount above the unpaid taxes and interest and penalties). The homeowner challenged the foreclosure as a "takings," specifically challenging the municipality keeping the surplus. The district court dismissed the case and the Court of Appeals for the Eighth Circuit upheld the decision, finding that the taking was not unconstitutional because the applicable state law did not recognize a property right in the owner of the property after the property was seized by the municipality.

The owner of the property filed a petition for writ of certiorari. While the petition was pending, a similar case arose in the Sixth Circuit. In that case, the Sixth Circuit created a circuit split by holding that a real estate tax foreclosure violated the Takings Clause. *Hall v. Meisner*, 51 F.4th 185 (6th Cir. 2022). The Supreme Court granted certiorari and held oral argument on April 26, 2023.

In only approximately one month after argument, the Supreme Court issued its decision and reversed the Eighth Circuit. In its opinion, the Supreme Court noted that "[t]hirty-six States and the Federal Government require that the excess value be returned to the taxpayer" and that "[o]ur precedents have also recognized the principle that a taxpayer is entitled to the surplus in excess of the debt owed." *Tyler*, 143 S. Ct. at 1372. Ultimately, the Supreme Court held that the owner "plausibly alleged a taking under the Fifth Amendment" and reversed the lower court decision. *Id.* at 1381.

2. Can a Tax Foreclosure Be Avoided as a Fraudulent Transfer?

A. *Circuit Courts that Have Held Tax Foreclosure Sales Are Immune from Attack as Fraudulent Transfers.*

The price received at a mortgage foreclosure sale conducted in accordance with state foreclosure law conclusively establishes "reasonably equivalent value" for the subject property. *BFP v. Resol. Tr. Corp.,* 511 U.S. 531, 545 (1994). In *BFP*, the lender properly conducted a foreclosure sale under California law, selling the subject property for $433,000. After the foreclosure sale was completed, BFP filed for bankruptcy and initiated an adversary proceeding, seeking to avoid the conveyance of the property as a fraudulent transfer under section 548 of the Bankruptcy Code.

Section 548 of the Bankruptcy Code permits a trustee[1] to avoid transfers[2] made within two years prior to the bankruptcy filing for either actual or constructive fraud. 11 U.S.C. § 548(a). In order for a transfer to be avoidable due to constructive fraud, the trustee must establish that the debtor "received less than a reasonably equivalent value in exchange for such transfer or obligation," 11 U.S.C. § 548(a)(2)(B)(i), at a time when the debtor was insolvent or other enumerated circumstances, *id.* § 548(a)(2)(B)(ii).

BFP alleged that the property at the time of the foreclosure was worth $725,000, and, as such, the sale price of $433,000 was not "reasonably equivalent value" as required by section 548(a)(2)(B)(i). However, the Court noted that fair market value is distinct from forced sale value; the latter inherently being lower due to the conscriptions of a forced sale. The Court rejected that the disparity between the two values somehow impacted "reasonably equivalent value" for purposes of section 548. Instead, the Court held that when state law has been followed,[3] "mere inadequacy of the foreclosure sale price is no basis for setting the sale aside, though it may be set aside (*under state foreclosure law,* rather than fraudulent transfer law) if the price is so low as to 'shock the conscience or raise a presumption of fraud or unfairness.'" *BFP*, 511 U.S. at 542 (citations omitted). Notably, the Court in *BFP* expressly limited it's holding to "mortgage foreclosures of real estate" on the grounds that "[t]he considerations bearing upon other foreclosures and forced sales (to satisfy tax liens, for example) may be different." *Id.* at 537 n.3.

Applying *BFP*, the Fifth, Ninth, and Tenth Circuits have all held that tax foreclosure sales (i.e., a foreclosure sale conducted by a taxing authority) are not avoidable as a fraudulent transfer. *See T.F. Stone Co., Inc. v. Harper* (*In re T.F. Stone Co., Inc.*), 72 F.3d 466 (5th Cir. 1995); *Tracht Gut, LLC v. L.A. Cnty. Treasurer & Tax Collector* (*In re Tracht Gut, LLC*), 836 F.3d 1146, 1155

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[1] Or a debtor-in-possession in Chapter 11, including Subchapter V. 11 U.S.C. §§ 1107(a); 1184.

[2] "Transfer" includes "the foreclosure of a debtor's equity of redemption." 11 U.S.C. § 101(54).

[3] "Any irregularity in the conduct of the sale that would permit judicial invalidation of the sale under applicable state law deprives the sale price of its conclusive force under § 548(a)(2)(A), and the transfer may be avoided if the price received was not reasonably equivalent to the property's actual value at the time of the sale (which we think would be the price that would have been received if the foreclosure sale had proceeded according to law)." *BFP*, 511 U.S. at 545-46.

(9th Cir. 2016); *Kojima v. Grandote Int'l LLC* (*In re Grandote Country Club Co., Ltd.*), 252 F.3d 1146 (10th Cir. 2001).[4]

Most recently, the Ninth Circuit affirmed the bankruptcy court's dismissal of a debtor's complaint to avoid two tax foreclosures as fraudulent transfers and denial of leave to amend the complaint on the grounds of futility. In that case, the Ninth Circuit held that "[t]he conclusive rule regarding mortgage foreclosures established by *BFP* should also apply to tax sales in California, because the rationale and policy considerations behind the Court's holding in *BFP* are just as relevant in the California tax sale context." *In re Tracht Gut, LLC*, 836 F.3d at 1152. In so holding, the Ninth Circuit pointed to the statutory procedural protections afforded in tax auction to the highest bidder), as well as the statutory presumption that a tax deed issued after a tax foreclosure sale is conclusive evidence of strict adherence to state tax foreclosure law. Therefore, the Ninth Circuit concluded that "a tax sale conducted in accordance with California state law conclusively establishes that the price received at the tax sale was for reasonably equivalent value." *Id.* at 1155.

Prior the *Tracht Gut*, the Fifth Circuit also extended *BFP* to tax foreclosure sales, albeit in the context of a post-petition sale. *See In re T.F. Stone Co.*, 72 F.2d 466. In that case, the reorganized debtor sought to avoid a post-petition tax foreclosure sale pursuant to section 549 of the Bankruptcy Code. Although section 548 refers to "reasonably equivalent value," 11 U.S.C.§ 548(a)(2)(B)(i), section 549 requires an exchange of "present fair equivalent value," *id.* § 549(c). However, the Fifth Circuit was "unable, however, to perceive a meaningful difference between 'reasonably' and 'present fair' as applied in the context of this forced-sale case." *In re T.F. Stone Co.*, 72 F.3d at 470. Accordingly, the court held that "the logic of *BFP* trumps the differences between the relevant language of § 548(a)(2)(A) and § 549(c) and the contexts of mortgage foreclosure sales and tax sales." *Id.* at 471.

Similarly, the Tenth Circuit similarly extended *BFP* to a tax foreclosure sale challenged under the Colorado Uniform Fraudulent Transfer Act, *In re Grandote Country Club Co., Ltd.*, 252 F.3d at 1152. In so holding, the Tenth Circuit purportedly overruled *Sherman v. Rose* (*In re Sherman*), 223 B.R. 555, 558 (B.A.P. 10th Cir. 1998), wherein the Tenth Circuit B.A.P. had refused to apply *BFP* to a tax foreclosure sale challenged as a constructively fraudulent transfer under section 548. *In re Grandote Country Club Co., Ltd.*, 252 F.3d at 1152 ("We are aware that courts have not been unanimous in extending *BFP* to the tax sale context, with this circuit's Bankruptcy Appellate Panel among those refusing to apply *BFP* to a transfer made by a tax sale. Nevertheless, the decisive factor in determining whether a transfer pursuant to a tax sale constitutes 'reasonably equivalent value' is a state's procedure for tax sales . . . ." (internal citation omitted)).

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[4] A variety of lower courts have similarly adopted *BFP* to insulate tax foreclosure sales from avoidance. *See, e.g.*, *Peters v. Libert Land Holdings 16, LLC* (*In re Peters*), No. A18-8327, 2019 WL 1958660, at *4, 2019 Bankr. LEXIS 1418, at *8-9 (Bankr. D. Neb. Apr. 23, 2019); *Johnson v. Davis* (*In re Johnson*), No. 98-04849-CH, 1999 WL 35020208, at *5 (Bankr. S.D. Iowa Aug. 25, 1999); *Washington v. Cnty. of King William Treasurer* (*In re Washington*), 232 B.R. 340, 344 (Bankr. E.D. Va. 1999); *In re Samaniego*, 224 B.R. 154, 162 (Bankr. E.D. Wash. 1998); *Turner v. United States* (*In re Turner*), 225 B.R. 595, 599 (Bankr. D.S.C. 1997); *Russell-Polk v. Bradley* (*In re Russell-Polk*), 200 B.R. 218, 221 (Bankr. E.D. Mo. 1996); *Hollar v. Myers* (*In re Hollar*), 184 B.R. 243, 252 (Bankr. M.D.N.C. 1995); *Golden v. Mercer Cnty. Tax Claim Bureau* (*In re Golden*), 190 B.R. 52, 58 (Bankr. W.D. Pa. 1995); *Lord v. Neumann* (*In re Lord*), 179 B.R. 429, 436 (Bankr. E.D. Pa. 1995); *McGrath v. Simon* (*In re McGrath*), 170 B.R. 78, 83 (Bankr. D.N.J. 1994).

B. *Circuit Courts that Have Held that a Tax Foreclosure Can Be Avoided as a Fraudulent Transfer*

Each of the following circuits have held that a tax foreclosure can be avoided as a fraudulent transfer. In each case, the court examined *BFP v. Resolution Trust Corp.*, 511 U.S. 531 (1994), which held that a regularly conducted mortgage foreclosure sale cannot be avoided as a fraudulent transfer under 11 U.S.C. § 548. Each circuit either distinguished *BFP* or found that its holding was inapplicable, as discussed below.

SECOND CIRCUIT: *County of Ontario, New York v. Gunsalus*, 37 F.4th 859 (2nd Cir. 2022)[5]

The debtors owned a home, unencumbered by a mortgage, that was valued at no more than $30,000. After suffering hardships, the debtors found themselves with $1,300 in unpaid property taxes. The county filed a tax foreclosure, in which it was granted summary judgment resulting in it being awarded possession and title to the home. The county subsequently sold the property to a third party for $22,000. Under New York's strict foreclosure laws relating to tax foreclosures, the debtors received none of the surplus.

The debtors filed for bankruptcy and proposed to pay the unpaid taxes in full. The debtors then filed an adversary proceeding under 11 U.S.C. § 548(a)(1)(B)(i), seeking to avoid the tax foreclosure as a fraudulent transfer because the debtors did not receive reasonably equivalent value for the transfer. The bankruptcy court dismissed the adversary based on *BFP*, but the district court reversed and remanded to allow the bankruptcy court to decide if the debtors received reasonably equivalent value. On remand, the bankruptcy court found that the debtors did not receive reasonably equivalent value. The district court affirmed that decision.

The Second Circuit held that *BFP* did not apply to strict real estate tax foreclosures. The court explained that *BFP* applied to mortgage foreclosures that involved an "auction or sale which would permit some degree of market forces to set the value of the property even in distressed circumstances[,]" something that the strict-foreclosure law lacked. The court also noted that *BFP* contained a footnote that stated that strict foreclosures may have other considerations outside of the Court's decision. The court also found it significant that that the county kept all the proceeds of the sale, which was contrary to the goals of bankruptcy law.

THIRD CIRCUIT: *Hackler v. Arianna Holdings Co.* (*In re Hackler*), 938 F.3d 473 (3rd Cir. 2019)

The debtors fell behind on their property taxes. Under New Jersey law, a municipality may sell a tax certificate for the unpaid taxes to the bidder offering the lowest interest rate. In this case, the purchaser of the tax certificate bid $13,500 over the unpaid taxes at a zero-percent interest rate. As soon as the purchaser was able to foreclosure by law it commenced a strict foreclosure action, in which it obtained titled to the debtors' property.

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[5] *See also DuVall v. Cnty. of Ontario, New York*, No. 21-CV-6236L, 2021 WL 5199639, at *5, 2021 U.S. Dist. LEXIS 216970, at * 13 (W.D.N.Y. Nov. 9, 2021), *aff'd*, No. 21-2917-BK, 2023 WL 6323123, 2023 U.S. App. LEXIS 25804 (2d Cir. Sept. 29, 2023).

Less than 90 days after the foreclosure judgment, the debtors filed a case under chapter 13, in which they scheduled the property, which was unencumbered by a mortgage but had approximately $90,000 in other judgment liens, as being worth $335,000. The debtors subsequently filed an adversary proceeding seeking to avoid the foreclosure as a preference under 11 U.S.C. § 547 and/or a fraudulent transfer under 11 U.S.C. § 548. The bankruptcy court held that the tax foreclosure sale met all the elements of a preference and could be avoided as such. It did not examine the fraudulent transfer claim. The district court affirmed on appeal.

The Third Circuit affirmed, finding that the tax foreclosure sale met all the elements under 11 U.S.C. § 547. The purchaser argued that *BFP* controlled but the court noted that *BFP* examined fraudulent transfers, not preferences. The circuit court also distinguished the fact that a mortgage foreclosure is based on the value of property, whereas in a tax foreclosure sale the relationship to the value of the property is "nonexistent." The circuit court's reasoning suggests that the court would have reach the same conclusion had the appeal been based on section 548.

SIXTH CIRCUIT: *Lowry v. Southfield Neighborhood Revitalization Initiative* (*In re Lowry*), No. 20-1712, 2021 WL 6112972, 2021 U.S. App. LEXIS 38533 (6th Cir. Dec. 27, 2021)

After the debtor failed to pay taxes for several years, the county obtained a final judgment of foreclosure. The debtor failed to timely redeem the property by paying the taxes and the city purchased the property for $14,500, as permitted by statute. At that time, the property was assessed for $104,000 but the debtors claimed it had a market value of $152,000.

The debtor filed a chapter 13 case and an adversary proceeding, which sought to avoid the foreclosure sale as fraudulent transfer under 11 U.S.C. § 548(a)(1)(B). The bankruptcy court ruled in favor of the city on summary judgment, reasoning that (i) the *Rooker-Feldman* doctrine barred the debtor from relitigating the state court tax foreclosure, and (ii) that *BFP* prevented the debtor from prevailing on a fraudulent transfer claim. On appeal, the district court affirmed, but only based on *BFP*. The debtor subsequently appealed to the Sixth Circuit Court of Appeals.

The Sixth Circuit noted that *Rooker-Feldman* is a narrow doctrine that should not be applied broadly. As it relates to this case a court may decide that a foreclosure sale can be a fraudulent transfer without overturning the validity of the sale. It further explained *Rooker-Feldman* did not apply "because this appeal does not involve a review of the merits of the state court foreclosure judgment [because debtor's] alleged injury in this case is not the state court foreclosure judgment, but instead is the fact that he could not use § 548 to avoid the foreclosure as a fraudulent transfer." Like the decision in *Hackler*, the court explained that *BFP* did not apply to a tax foreclosure, in large part to the lack of relation between the sale price and value of the property.

SEVENTH CIRCUIT: *Smith v. SIPI LLC* (*In re Smith*), 811 F.3d 228 (2016)

The debtor failed to pay real estate taxes and became delinquent. Under Illinois law, the purchaser paid $5,000, slightly more than the unpaid taxes, for a Certificate of Purchase. The debtor failed to timely redeem the property by paying the taxes and the purchaser ultimately

obtained a tax deed. The purchaser then sold the property, which was appraised for $110,000, to a third party for $50,000.

The debtor filed a chapter 13 bankruptcy case and sued the purchaser the subsequent buyer under 11 U.S.C. § 548 alleging a fraudulent transfer. The bankruptcy court ruled that the transfer lacked "reasonably equivalent value" and was avoidable under 11 U.S.C. § 548(a)(1)(B), to the extent of the debtor's homestead exemption – $15,000. The district court reversed, holding that compliance with state law granted immunity from debtor's claim for fraudulent transfer.

The Seventh Circuit reversed the district court. The circuit court explained that *BFP* did not apply. The court explained the sale price is typically the sum of delinquent taxes and the process has no bidding procedures to raise the sale price and that a price between 3.8% and 8.8% of fair market value "is not reasonably equivalent value." The circuit court noted that the trustee was not joined in the proceeding and hinted that the trustee could have potentially recovered more than the debtor's recovery of the homestead exemption.

3. Post-Petition Appreciation of Real Property

A. *Chapter 13*

Courts are split as to whether a chapter 13 debtor retains post-petition appreciation in nonexempt property. On one hand there is the "estate termination approach." Section 1327(b) provides that "the confirmation of a plan vests all of the property of the estate in the debtor." 11 U.S.C. § 1327(b). "Except as otherwise provided in the plan or in the order confirming the plan, the property vesting in the debtor under [§ 1327(b)] is free and clear of any claim or interest of any creditor provided for by the plan. *Id.* § 1327(c). Applying these sections, some courts have determined that upon confirmation, property – including post-petition appreciation thereof – is revested in the debtor "outright, free of his creditors' claims." *Black v. Leavitt* (*In re Black*), 609 B.R. 518, 528-29 (B.A.P. 9th Cir. 2019) ("As such, it was no longer property of the estate, so the appreciation did not accrue from estate property.)

On the other hand, there is the "modified estate preservation approach." Under this approach, "property of the estate at the time of confirmation *37 vests in the debtors free of any claims from the creditors. The estate does not cease to exist however, and it continues to be funded by the [d]ebtors' regular income and post-petition assets as specified in section 1306(a)." *Barbosa v. Solomon*, 235 F.3d 31, 36-37 (1st Cir. 2000). Applying this approach, appreciation may be property of the estate warranting a modification of a plan. *See id.* at 41.

B. *Post-Conversion from Chapter 13 to Chapter 7*

The circuits are split as to whether a debtor can retain post-petition appreciation after conversion from Chapter 13 to Chapter 7.[6] *Compare Castleman v. Burman* (*In re Castleman*), 75

[6] The lower courts are equally divided. *Compare* In re Goetz, 647 B.R. 412 (Bankr. W.D. Mo. 2022); *In re Goins*, 539 B.R. 510 (Bankr. E.D. Va. 2015); *In re Peter*, 309 B.R. 792, 794–95 (Bankr. D. Or. 2004); *with* In re Cofer, 625 B.R. 194 (Bankr. D. Idaho 2021), *overruled by In re* Castleman, 75 F.4th 1052; *In re Hodges*, 518 B.R. 445, 451 (E.D. Tenn. 2014).

F.4th 1052 (9th Cir. 2023), *with Rodriguez v. Barrera* (*In re Barrera*), 22 F.4th 1217 (10th Cir. 2022).

In a split panel, the Ninth Circuit held that p-ost-petition appreciation in the debtors' primary residence inures to the benefit of the bankruptcy estate. *In re Castleman*, 75 F.4th at 1054. In that case, the debtors had originally filed for chapter 13. At the time of filing, the debtors scheduled their home with a value of $500,000, subject to a $375,077 mortgage and a $124,923 homestead exemption. After their plan was confirmed, Mr. Castleman was diagnosed with Parkinson's disease, causing the debtors to voluntarily convert to Chapter 7.

At the time of conversion, the equity in the debtors' home had increased by approximately $200,000 from the petition date.[7] The Chapter 7 trustee moved to sell the home and distribute the equity for the benefit of creditors. The debtors objected. The bankruptcy court overruled the objection and permitted the sale, which was subsequently affirmed by the district court.

The Ninth Circuit examined section 348(f) of the Bankruptcy Code, which defines property of the converted Chapter 7 estate to include "property of the estate, as of the date of filing of the petition, that remains in possession of or in under the control of the debtor on the date of conversion." 11 U.S.C. § 348(f)(1)(A). In turn, "property of the estate" is defined to include "all legal or equitable interests of the debtor in property as of the commencement of the case," *id.* § 541(a)(1), including but not limited to "[p]roceeds, product, offspring, rents, or profits of or from property of the estate," *id.* § 541(a)(6). Utilizing this broad statutory definition of "property of the estate," the Ninth Circuit determined that the value of the asset was always property of the estate and, as such, the "post-petition 'appreciation [i]nures to the bankruptcy estate, not the debtor.'" *In re Castleman*, 75 F.4th at 1056 (alteration in original) (quoting *Schwaber v. Reed* (*In re Reed*), 940 F.2d 1317, 1323 (9th Cir. 1991) (requiring debtor to turnover sale proceeds attributable to appreciation of jointly owned property during the pendency of a Chapter 7 case). "In sum, the plain language of § 348(f)(1) dictates that any property of the estate at the time of the original filing that is still in debtor's possession at the time of conversion once again becomes part of the bankruptcy estate, and our case law dictates that any change in the value of such an asset is also part of that estate." *Id.* at 1058.

In *Goetz v. Weber* (*In re Goetz*), 651 B.R. 292 (B.A.P. 8th Cir. 2023), the B.A.P. for the Eighth Circuit similarly determined that post-petition appreciation of the debtor's home was property of the chapter 7 estate. In *Goetz*, the debtor filed a voluntary petition under chapter 13. On the petition date, the debtor owned real property worth $130,000, subject to a $107,000 mortgage and a $15,000 homestead exemption. After performing under her confirmed plan for over a year, the debtor converted to chapter 7. At the time of conversion, the value of the debtor's home had increased to $205,000, which would result in sale proceeds of approximately $62,000. Concerned that the chapter 7 trustee may seek to sell her home, the debtor moved to compel abandonment. The bankruptcy court denied the motion, finding that the appreciation was property of the bankruptcy estate available for distribution to creditors.

[7] During the Chapter 13 case, the debtors had deferred their mortgage payments, such that they actually owed more on the secured debt at the time of conversion than at the time of filing.

On appeal, the Eighth Circuit B.A.P. turned to the plain language of section 348 and 541, like *Barrera*. "Nothing in Section 541 suggests that the estate's interest is anything less than the entire asset, including any changes in its value which might occur after the date of filing." *In re Goetz*, 651 B.R. at 292 (quoting *Potter v. Drewes* (*In re Potter*), 228 B.R. 422, 424 (B.A.P. 8th Cir. 1999) (relying on section 541 to conclude that post-petition pre-conversion equity increases of an interest in a trust accrue to the benefit of the bankruptcy estate)).

The court also rejected the debtor's argument that the home was no longer property of the estate. Under section 1327's vesting provision, confirmation of a plan vests all of the property of the estate in the debtor. 11 U.S.C. § 1327(b). Because the debtor had a confirmed plan in her chapter 13 case, the debtor argued that the home had revested in the debtor and was no longer property of the estate. The B.A.P. held that while the property had revested during the pendency of the debtor's chapter 13 case, "neither section 1327(b) nor the relevant provision of the confirmation order applies in the converted Chapter 7 case." *In re Goetz*, 651 B.R. at 292 (citing 11 U.S.C. § 103(j) ("Chapter 13 of this title applies only in a case under such chapter."); *Harris v. Viegelahn*, 575 U.S. 510, 520 (2015) ("When a debtor exercises his statutory right to convert, the case is placed under Chapter 7's governance, and no Chapter 13 provision holds sway.").

In contrast, the Tenth Circuit held that post-petition appreciation of real estate inures to the benefit of the debtor, albeit in slightly different circumstances. *In re Barrera*, 22 F.4th 1217. In *Barrera*, the debtors sold their home during the chapter 13 case, pocketing over $140,000 in net sales proceeds including an additional $80,000 in post-petition equity. Two weeks after the sale closed, the debtors voluntarily converted to chapter 7. At the time of conversion, the debtors retained slightly more than $100,000 of the sale proceeds. The chapter 7 trustee moved to compel the turnover of the non-exempt portion of the sale proceeds. The bankruptcy court denied the motion, which denial was affirmed by the Tenth Circuit B.A.P.

Like in *Castleman*, the Tenth Circuit turned to the express statutory language and the interplay between sections 348(f)(1)(A) and 541(a)(1), (6). However, the Tenth Circuit determined that because "all legal and equitable interests" and "proceeds" were utilized in different subsections, those concepts must be "legally distinct." *In re Barrera*, 22 F.4th at 1223. Undoubtedly, the house was property of the estate pursuant to section 541. However, "the physical house was not 'in the possession of or . . . under the control of the [D]ebtor[s] on the date of conversion'—they had sold it. And the proceeds from the sale of the physical house did not exist on the date of filing the Chapter 13 petition, so the proceeds cannot have '*remain[ed]* in the possession of or [have been] under the control of the debtor on the date of conversion[.]'" *Id.* (alteration and emphasis in original) (quoting 11 U.S.C. § 348(f)(1)(A)).[8]

[8] In dicta, the Tenth Circuit found further support in section 1327's vesting provision. See 11 U.S.C. § 1327(b) ("[C]onfirmation of a plan vests all of the property of the estate in the debtor."). Because the debtors had a confirmed plan, the debtors' house was not property of the estate at the time of sale.

C. *Chapter 7*

Courts which hold that appreciation in real estate belongs to the estate, usually base those findings on the language of section 541(a)(6), stating that property of the estate includes "[p]roceeds, product, offspring, rents, or profits of or from property of the estate." 11 U.S.C. § 541(a)(6); *see Coslow v. Reisz*, 811 Fed. App'x 980 (6th Cir. 2020); *In re Orton*, 687 F.3d 612 (3rd Cir. 2012); *Gebhart v. Gaughan* (*In re Gebhart*), 621 F.3d 1206 (9th Cir. 2010); *Schwaber v. Reed* (*In re Reed*), 940 F.2d 1317 (9th Cir. 1991); *Potter v. Drewes* (*In re Potter*), 228 B.R. 422 (B.A.P. 8th Cir. 1999).

This is subject to a debtor's claim of exemption. As more fully explained below, when an exemption is claimed, the exemption typically claims the debtor's interest in the property as exempt up to the dollar value listed. *Schwab v. Reilly*, 560 U.S. 770, 782 (2010).[9] Based on this, if property appreciates during a chapter 7 so that the non-exempt portion increases to the point where it is worth selling, a court may allow a trustee to do so.

Snapshot Rule

Exemptions are fixed at the time of filing. *White v. Stump*, 266 U.S. 310, 312 (1924). So a debtor is only entitled to use an exemption available to them at the time of filing. Although a debtor may their exemptions "at any time before the case is closed," Fed. R. Bankr. P. 1009(a), the amendments to which a debtor is entitled to amend are still determined at the time of filing.

What Can Stop a Trustee from Leaving a Case Open for a Long Period of Time to Allow for an Increase in Value/Equity?

This is the biggest concern that all debtor's attorneys should have, and it is obviously a valid one. There are two main possibilities:

Laches

A trustee must administer and close an estate "as expeditiously as is compatible with the best interests of parties in interest." 11 U.S.C. § 704(a)(1). If a trustee fails to do so, one defense that may be available to a debtor seeking to protect their home is laches. *See In re Fleming*, 424 B.R. 795 (Bankr. W.D. Mich. 2010); *In re Lents*, 644 B.R. 479 (Bankr. D.S.C. 2022). In order to succeed in a laches defense, a debtor must prove a lack of diligence by the trustee, and prejudice to the debtor. *In re Lents*, 644 B.R. at 493 ("For these equitable defenses to apply, the Debtors must demonstrate that the Trustee failed to act in accordance with her statutory duties and that the delay and lack of correspondence by the Trustee regarding the status of the case reasonably led the Debtors to believe their case was closed and that they could dispose of assets that belonged to the estate as they wished.").

[9] This does not apply when an exemption is unlimited and allows the debtor to fully exempt the property. In these cases, attorneys may want to refrain from listing an exemption amount in case the value is higher, or it increases after filing.

Abandonment

The safest way to ensure that a trustee cannot allow a chapter 7 to languish while property increases in value is to move to have it abandoned.

> **11 U.S.C. § 554 – Abandonment of property of the estate**
>
> (a) After notice and a hearing, the trustee may abandon any property of the estate that is burdensome to the estate or that is of inconsequential value and benefit to the estate.
>
> (b) On request of a party in interest and after notice and a hearing, the court may order the trustee to abandon any property of the estate that is burdensome to the estate or that is of inconsequential value and benefit to the estate.
>
> (c) Unless the court orders otherwise, any property scheduled under section 521(a)(1) of this title not otherwise administered at the time of the closing of a case is abandoned to the debtor and administered for purposes of section 350 of this title.
>
> (d) Unless the court orders otherwise, property of the estate that is not abandoned under this section and that is not administered in the case remains property of the estate.

11 U.S.C. § 554.

Abandonment removes property from the estate entirely and the general rule is that abandonment is irrevocable unless the trustee was not able to properly investigate the asset based on false or incomplete information. *Cusano v. Klein*, 264 F.3d 936, 946 (9th Cir. 2001). The Tenth Circuit has an excellent analysis of abandonment and the possible revocation thereof. *Woods v. Kenan* (*In re Woods*), 173 F.3d 770, 776-780 (10th Cir. 1999).

Expiration of Homestead Exemption?

Some states have homestead exemptions that allow a debtor to exempt proceeds from the sale of their residence, but the exemption expires after a certain number of days. For chapter 7 cases[10], there is a split among the circuits as to whether homestead proceeds that were exempt at the time of filing remain exempt if the chapter 7 is still ongoing when the proceeds expire. The Ninth Circuit held in 2012 that a chapter 7 debtor who sells their homestead during the bankruptcy and fails to reinvest the proceeds during the six-month period required to do so, loses the

[10] In chapter 13 cases, both circuits to rule on the issue agree that the exemption can expire during the term of the chapter 13 and the funds would need to be turned over to the trustee. *See Viegelahn v. Frost* (*In re Frost*), 744 F.3d 384, 389 (5th Cir. 2014); *In re Wells*, 494 F. Supp. 3d 804, 805 (D. Idaho 2020), *aff'd sub nom. McAllister v. Wells* (*In re Wells*), No. 20-35984, 2021 WL 5755086, 2021 U.S. App. LEXIS 35736 (9th Cir. Dec. 3, 2021).

exemption in the proceeds. *Wolfe v. Jacobson* (*In re Jacobson*), 676 F.3d 1193, 1199 (9th Cir. 2012). The Fifth and First Circuits, however, held that pursuant to the "snapshot rule," if the funds were exempt at the time of filing, they retain their exempt status. *Lowe v. DeBerry* (*In re DeBerry*), 884 F.3d 526, 529-30 (5th Cir. 2018); *Rockwell v. Hull* (*In re Rockwell*), 968 F.3d 12, 20-21 (1st Cir. 2020).

Amount of the Homestead Exemption

As demonstrated by *In re Castleman*, 75 F.4th 1052, where post-petition appreciation is property of the chapter 7 estate, the chapter 7 trustee may compel the sale of the property to realize the appreciation for the benefit of the estate. However, *Masingale v. Muding* (*In re Masingale*), 644 B.R. 530, 543 (B.A.P. 9th Cir. 2022), illustrates a possible way for a chapter 7 debtor to retain an appreciated asset. In that case, the debtor had originally filed for chapter 11. At the time of filing, the debtor owned real property valued at $165,000, subject to a mortgage of $130,000. Application of section 522(d)(1)'s exemption fully exempted the equity in the home. On her schedule C, the debtor claimed an exemption of "100% of FMV." More than one year after confirmation of her chapter 11 plan and after her joint-debtor husband died, the bankruptcy court converted the debtor's case to chapter 7. At the time of conversion, the home had increased in value to over $400,000. The bankruptcy court denied the debtor's motion to compel abandonment of the home and granted the chapter 7 trustee's motion to sell the home.

On appeal, the Ninth Circuit B.A.P. reversed. Pursuant to section 522(*l*) of the Bankruptcy Code, "[u]nless a party in interest objects, the property claimed as exempt on [Schedule C] is exempt." 11 U.S.C. 522(*l*). Because no party had timely objected to the exemption, the court concluded that the exemption was final and not subject to challenge.[11] Applying, *Schwab v. Reilly*, 560 U.S. 770, 775-76 (2010) ("If an interested party fails to object within the time allowed, a claimed exemption will exclude the subject property from the estate even if the exemption's value exceeds what the Code permits."), the Court determined that the objection would stand even if it claimed more than the amount permitted under section 522(d)(1).

The Ninth Circuit B.A.P. then turned to the effect of the debtor's claimed exemption of "100% of FMV." Relying again upon *Schwab*, 560 U.S. at 792-93 ("Where, as here, it is important to the debtor to exempt the full market value of the asset or the asset itself, our decision will encourage the debtor to declare the value of her claimed exemption in a manner that makes the scope of the exemption clear, for example, by listing the exempt value as "full fair market value (FMV)" or "100% of FMV."), the court held that "100% of FMV" exempted the entire asset and was not subject to any limitation. In so holding, the court rejected application of the snapshot rule and generally accepted law within the Ninth Circuit that post-petition appreciation inures to the benefit of the chapter 7 estate; instead holding that "the Masingales' claim of an exemption equal

[11] The time to object to exemptions is "thirty days after the conclusion of the § 341 meeting of creditors." Fed. R. Bankr. P. 4003(b)(1). Although usually in converted cases the objection deadline restarts from the new meeting of creditors, in cases like debtor's where "the case was converted to chapter 7 more than one year after the entry of the first order confirming a plan," the deadline is not reset. Fed. R. Bankr. P. 1019(2)(B)(i). "We do not fault the Trustee for failing to object before he took office; nevertheless, the rules make clear that he cannot object now." *In re Masingale*, 644 B.R. at 539.

to "100% of FMV" includes postpetition appreciation and becomes incontestable if there is no timely objection." *In re Masingale*, 644 B.R. at 543.

4. Partial Claims Mortgage

One tool available to a debtor behind on their home is a partial claim mortgage. Although these have been around for over 25 years, it was not until the last several years that they have become more prevalent in bankruptcies.

A partial claim is essentially a new junior mortgage from the U.S. Department of Housing and Urban Development ("HUD") that pays the mortgage lender the amount needed to resolve the arrears on that loan. It can consist of pre-bankruptcy arrears, post-bankruptcy arrears, or some combination thereof.

HUD regulations authorize the resolution of a default in payments on the Note and Mortgage through a "partial claim." *See* 24 C.F.R. § 203.355(a)(6).
In a partial claim, the amount needed to cure a default on the primary Note and Mortgage is paid by HUD to the creditor, and the debtor gives HUD a subordinate note and partial claim mortgage for the amount paid. *See* 24 C.F.R. § 203.371(a), (c).

> **§ 203.371 Partial claim.**
>
> (a) General. Notwithstanding the conveyance, sale or assignment requirements for payment of a claim elsewhere in this part, HUD will pay partial FHA insurance benefits to mortgagees after a period of forbearance, the maximum length of which HUD will prescribe, and in accordance with this section.
>
> (b) Requirements. The following conditions must be met for payment of a partial claim:
>
> (1) The mortgagor has been delinquent for at least 4 months or such other time prescribed by HUD;
>
> (2) The amount of the arrearage has not exceeded the equivalent of 12 monthly mortgage payments;
>
> (3) The mortgagor is able to resume making full monthly mortgage payments;
>
> (4) The mortgagor is not financially able to make sufficient additional payments to repay the arrearage within a time frame specified by HUD;
>
> (5) The mortgagor is not financially qualified to support monthly mortgage payments on a modified mortgage or on

a refinanced mortgage in which the total arrearage is included; and

(6) The mortgagor must have made a minimum number of monthly payments as prescribed by the Secretary on a case-by-case basis.

(c) Repayment of the subordinate lien. The mortgagor must execute a mortgage in favor of HUD with terms and conditions acceptable to HUD for the amount of the partial claim under § 203.414(a). HUD may require the mortgagee to be responsible for servicing the subordinate mortgage on behalf of HUD.

24 C.F.R. § 203.371.

§ 203.414 Amount of payment—partial claims.

(a) Claim amount. Where a claim for partial insurance benefits is filed in accordance with § 203.371, the amount of the insurance benefits shall consist of the arrearage not to exceed an amount equivalent to 12 monthly mortgage payments, and any costs prescribed by HUD related to the default.

(b) Servicing fee. The claim may also include a payment for activities, such as servicing the subordinate mortgage, which HUD may require.

24 C.F.R. § 203.414.

A. ***Chapter 7***

A partial claim mortgage is an excellent tool if you have a debtor that is behind in their home before filing but unable to fund a chapter 13. It is also an option if the debtor falls behind after filing.

B. ***Chapter 13***

On cases with less than a year of arrears, a partial claim would remove those arrears from the plan, potentially allowing for a reduced plan payment or a shorter term. For debtors who fall behind after filing, it can potentially prevent stay modification, and for cases where the stay has already been modified, it could be an option to keep the debtors in their home.

5. Mortgage Modification Mediation[12]

A. *Overview*

The bankruptcy court for each of the three districts in Florida has a Mortgage Modification Mediation ("MMM") program in place. Each of the districts allow MMM in all cases and for any real property. Details of the respective MMM programs, and links to forms and each district's Administrative Order, are available at the following links:

N.D. Fla.	www.flnb.uscourts.gov/mortgage-modification-mediation
M.D. Fla.	www.flmb.uscourts.gov/proguide/documents/Procedure/Mortgage_Modification_Mediation.pdf?id=1
S.D. Fla.	www.flsb.uscourts.gov/mortgage-modification-mediation-program-mmm

B. *Commencing MMM*

The debtor must file a motion to participate in MMM within 90 days of the petition date. If the motion is filed in that time period, the motion will be granted on an *ex parte* basis but the creditor may seek reconsideration within 14 days of the order directing MMM if it opposes the relief.

Parties must jointly select a mediator. If the parties cannot agree on a mediator, the court may select one. Each party must pay a fixed mediator fee for participation in the program. The flat fee covers two 1-hour mediation sessions with the mortgagee, the mortgagor, their respective counsels, and the mediator. The party representatives must have settlement authority.

C. *The Portal*

Each district's MMM program requires that all written documents to be reviewed for loss mitigation must be exchanged through a third-party portal. While there are several portal providers, the most common provider used is Stretto Default Solutions (dclmwp.com).

Parties must register and obtain a username and password to use the portal. Mortgagors may seek a waiver of the portal requirement if it will cause an undue hardship.

D. *The Mediation Process*

Most mediations are conducted telephonically but Zoom mediations have become more prevalent. There are multiple timeframes that the parties must adhere to, which are listed in each District's relevant Administrative Order. These include, among others:

[12] The following materials focus on the process successfully implemented in Florida. Other jurisdictions have different processes, which are not addressed herein.

- The deadline for a lender to upload its initial mortgage modification requirements to the Portal and the deadline for the debtor to return the completed package.
- The timing of the initial mediation conference and any subsequent conferences.
- The orders generally state that MMM shall be concluded within 150 days, although that deadline can be extended by agreement, court order, or stipulation.

E. *Adequate Protection Payments During MMM*

In all cases, a debtor participating in MMM should be making adequate protection payments. In Chapter 12 or 13 cases: adequate protection payments are paid in the plan to the trustee. The amount of adequate protection payments depends on whether the property is homestead property or non-homestead income-producing property.

- Hometead property: payments are calculated at the lesser of either 31% of the mortgagor's gross disposable income (from the debtor's schedules filed in the bankruptcy) minus any homeowners' association fees, or the contractual monthly payment.
- Non-homestead income-producing properties: payments are calculated at the lesser of either 75% of the debtor's monthly gross rental income or the contractual monthly payment.

In Chapter 7 and 11 cases: if adequate protections payments are not being voluntarily paid to the mortgagee, then the mortgagee should request these payments through a Motion for Adequate Protection filed with the bankruptcy court.

F. *Conclusion of MMM*

MMM is concluded upon the earliest of the filing of a mediator's report, an order approving a loan modification, or other order by the court. Upon conclusion of the mediation, the mediator shall file a final report simply stating who appeared at the mediation and if the mediation resulted in an agreement or impasse.

If the parties reach an agreement, all districts require a motion to approve any trial and/or permanent modifications. If MMM results in an impasse the debtor has to submit an amended/modified plan within a certain time. Failure to do so may result in the creditor filing a motion to dismiss for failure to comply with the Administrative Order and/or confirmed plan.

G. *MMM Statistics*

The Bankruptcy Court for the Southern District of Florida recently released statistics for MMM for the period from April 1, 2023 to August 31, 2023. During that period, debtors filed motions for MMM in 17,335 cases. In 12,393 of those cases, the mediator issued a Final Report of Mediator. The parties reached a mediation agreement in 5,537 of those cases.

Statistics are not available for Middle District or Northern District of Florida.

Faculty

Nathan E. Curtis is a senior court attorney and supervising attorney at Geraci Law L.L.C. in Chicago and has filed or reviewed more than 10,000 consumer bankruptcy cases in Illinois, Indiana and Wisconsin. His duties include handling all court matters in the Northern District of Illinois Western Division, the detailed review of complicated chapter 7 and 13 matters and being primarily responsible for the firm's bankruptcy appeals. Mr. Curtis has argued at the Seventh Circuit Court of Appeals three times and has briefed two other appeals, one as an amicus. He also filed an amicus brief in the Supreme Court case *City of Chicago v. Fulton*. Mr. Curtis is involved in the firm's in-house Continuing Legal Education program, and he has spoken at local, regional and national conferences on consumer bankruptcy matters. He received his undergraduate degree from the University of Illinois and his J.D. from the John Marshall Law School.

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Patrick Hruby is a senior associate attorney at Brock & Scott, PLLC in its Tampa, Fla., office. His practice focuses on creditor-side bankruptcy matters in all Florida and Ohio bankruptcy courts. Mr. Hruby has a broad understanding of bankruptcy from his creditor representation in all chapters, and from having served as a judicial law clerk in the U.S. Bankruptcy Court for the Northern District of Ohio and serving chapter 7 trustees for several years. He writes frequently for industry publications and is currently serving as the Editor of ABI's Consumer Committee Newsletter. Mr. Hruby received his undergraduate degree *summa cum laude* in 2006 from Cleveland State University and hs J.D. *cum laude* in 2009 from Case Western Reserve University School of Law.

Hon. Deborah L. Thorne is a U.S. Bankruptcy Judge for the Northern District of Illinois in Chicago, appointed on Oct. 22, 2015. Prior to joining the bench, she was a partner in the Chicago office of Barnes & Thornburg LLP, where she was a member of its Financial Insolvency and Restructuring Department. Her practice included the representation of creditors and other parties in insolvency proceedings, and she frequently served as a federal equity receiver in commodity fraud cases brought by the Commodity Futures Trading Commission. In addition, she co-chaired the Women's Initiative for the firm. Judge Thorne is past chair of the Chicago Bar Association Bankruptcy and Restructuring Committee and past chair of the Bankruptcy Committee for the Seventh Circuit Bar Association. She previously served as ABI's Vice President-Communications and Information Technology and is the author of ABI's *The Preference Defense Handbook: The Circuits Divided* and a co-author of its *Interrupted! Understanding Bankruptcy's Effects on Manufacturing Supply Chains*. Judge Thorne is a Fellow of the American College of Bankruptcy. She served as Education Committee chair for the

National Conference of Bankruptcy Judges from 2019-20 and as its president from 2021-22. Judge Thorne is included in *The Best Lawyers in America* in the area of bankruptcy and creditor/debtor rights law, is recognized as a Leading Lawyer in Illinois, and has been recognized by *Illinois Super Lawyers* every year since 2003. For seven years, she chaired Women Employed, a Chicago nonprofit policy organization focused on improving the lives of low-wage women through enhancing access to post-secondary education and improving job quality. Judge Thorne received her B.A. from Macalester College, her M.A.T. from Duke University and her J.D. with honors from Illinois Institute of Technology Chicago-Kent College of Law.