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LEGAL ARGUMENT

This supplemental brief addresses the impact of the recent Supreme Court decision in *Schwab v. Reilly* —U.S. —, — S.Ct. — , 2010 WL 2400094 U.S.,2010 upon disposition of this case. In short, the result in *Schwab* is driven by a distinguishing critical factual difference, but the underlying reasoning and methodology hold that the debtor's entire interest residence was withdrawn from estate and that the court below must be reversed..

The Proper date for valuing property for exemption purposes is the date of filing.

There is no question that the proper date for making valuations for exemption purposes is the date of filing. The petition date is the date for valuation. If the petition date is not selected, the entire process is left to the vagaries of time and there can be no finality. *See, Culver, LLC v. Chiu (In re Chiu)*, 266 B.R. 743, 751 (9th Cir. BAP2001), aff'd, 304 F.3d 905 (9th Cir. 2002),

Judge Posner in *In re Polis*, 217 F.3d 899,902 (7th Cir. 2000) explained the valuation issues well:

The possibility that the debtor will obtain a windfall as a consequence of the exemptions recognized by the Bankruptcy Code arises from the fact that the date of valuation of an asset for purposes of determining whether it can be exempted is the date on which the petition for bankruptcy is filed; it is not a later date on which the asset may be worth a lot more. Often property appreciates in a wholly unexpected fashion. A lottery ticket that turns out against all odds to be a winner is merely the clearest example. A debtor who exempted a painting thought to be worthless in a market sense, having a purely sentimental value, might discover the day after his discharge from bankruptcy that it had suddenly increased in value because other paintings by the artist had just been bought by the Metropolitan Museum of Art; the creditors could not reach it, provided that until then its fair market value had in fact been slight. Common stock that had traded at \$100 a share on the date the petition for bankruptcy was filed might a month later be worth \$1,000, and again the creditors would be out of luck if the debtor had exempted her shares by claiming the personal property exemption for them.

The facts of this case and *Schwab* are critically different.

The determinative factual distinction between the Schwab and the case at bar is in the comparison of the actual value of the property to the maximum allowable exemption on the date of filing. In *Schwab*, the value of the property claimed exempt at the time of filing exceeded the available

exemption allowance. The debtor estimated the property to be worth \$10,718 and claimed that amount exempt.. The trustee had the property appraised by the auctioneer to be at no less than \$17,000, and sought to realize the excess of some \$6,282 which represented the excess of the actual value over the claimed exemption.

In the case at bar the value of the property at the time of filing was stipulated to be equal to or less than the sum of the underlying liens plus the claimed exemption.

The property had a value of \$350,000 and the liens owing, and homestead exemption claimed also totaled \$350,000, leaving no value interest above the exemption. (ER 26 Lines 16 – 19) Under the analytical methodology employed in *Schwab*, this fact pattern results in withdrawal of the debtor's entire interest from the estate on the date specified by 522(l).

Exempt property passes out of the estate 30 days after § 341 Hearing of creditors under 522(l).

Schwab begins with support for the debtor/appellant's position that exempt property is excluded or withdrawn from the estate. The first paragraph of the opinion states:

When a debtor files a Chapter 7 bankruptcy petition, all of the debtor's assets become property of the bankruptcy estate, see 11 U.S.C. § 541, subject to the debtor's right to reclaim certain property as “exempt,” § 522(1). The Bankruptcy Code specifies the types of property debtors may exempt, § 522(b), as well as the maximum value of the exemptions a debtor may claim in certain assets, § 522(d). Property a debtor claims as exempt will be excluded from the bankruptcy estate “[u]nless a party in interest” objects. § 522(l).

And again at p. 11:

As we emphasized in *Rousey*, [544 U.S. 320, 125 S.Ct. 1561 (2005)]. “[t]o help the debtor obtain a fresh start, the Bankruptcy Code permits him to **withdraw from the estate** certain **interests in** property, such as his car or home, up to certain values.” 544 U.S., at 325 [emphasis in original]

This approach is in accordance with long established 9th Circuit Law.

In re Smith 235 F.3d 472, 478 (9th Cir. 2000) this court said:

It is widely accepted that property deemed exempt from a debtor's bankruptcy estate reverts in the debtor. *See* 11 U.S.C. § 522(l); *see also In re Brown*, 178 B.R. 722, 726-27 (Bankr.E.D. Tenn.1995) (citing cases to that effect), *Owen v. Owen*, 500 U.S. 305, 308, 111 S.Ct. 1833, 114 L.Ed.2d 350 (1991) (when property becomes exempt, it is “withdrawn from the estate (and hence from the creditors) for the benefit of the

debtor); *In re Bell*, 225 F.3d at 215-216 (collecting cases).

Exemption determinations are made upon the basis of the actual value of the property on the petition date.

In *Schwab*, the Supreme Court for the first time addressed the manner of claiming exemptions in property and determined that neither the Debtor's valuation nor the Debtors exemption claim determined the estate's interest in an asset. Rather, the trustee's interest is determined by the excess of the actual value of the debtor's interest over the amount of the claimed exemption. The Debtors valuation of the asset was irrelevant. The debtor claimed that because the trustee did not object to the exemption within 30 days after the first meeting of creditors, the entire property passed out of the estate pursuant to 11 U.S.C. 522 (l) regardless of whether the property actually had value in excess of the claimed exemption.

The Court rejected this argument, holding that an interest having a value equal to the properly claimed exemption passed out of the estate and the interest represented by the remaining value remained in the estate for administration by the trustee. That is a proper result if there is actually excess value, but what happens if there is no value in excess of the debtor's

legitimate exemption claim? Answering that question requires analysis of the reasoning behind *Schwab*.

In *Schwab*, the court differentiated between value of property the value claimed exempt. The Court determined that there was no requirement that the trustee object to value even though there was a requirement that the trustee object to the exemption if the debtors claimed something to which they were not entitled. The manner in which the exemptions were claimed did not preclude an objection to determine the value of the property and hence whether any value inured to the estate. *Schwab* Footnote 15:

Because the Code provisions we rely upon to resolve this case do not obligate trustees to object under [Rule 4003\(b\)](#) to a debtor's estimate of the market value of an asset in which the debtor claims an exempt interest, our analysis does not depend on whether the schedule of “property claimed as exempt” (currently Schedule C) calls for such an estimate or not.

The ruling teaches that the part of the debtors aggregate interest actually claimed exempt passes out of the estate, and the remainder of the Debtor's aggregate interest remains for the trustee to administer. That is the appropriate result when the value of the aggregate interest in the asset in question exceeds the allowable exemption. This prevents the Debtor from

sandbagging the trustee on value in the hope that the trustee will not discover the valuation issue in time.

The case at bar presents a very different situation in which the entire actual value fell within the claimed exemption. (ER 26) The Court defined the " 'property' a debtor may 'claim as exempt'" as an interest the extent of which is determined by value. p. 13 By "interest" the Court must have intended "aggregate interest" because that is the language of 11 U.S.C. 522(d).¹ In the case at bar,

The debtor's aggregate interest was equal to or less than the amount of the claimed and allowable exemption. (ER 26 Lines 16 – 19). *Schwab* requires that the interest be measured by the value. The result is that there was no value and therefore no interest for the estate after the aggregate or entire interest was withdrawn from the estate under 522(l). Thus, there was nothing left in the estate for the trustee to administer. *Schwab*, at 11; *Taylor*

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Use of the term aggregate was not relevant in *Schwab* because at the time of the filing, the actual value of the debtor's interest in the property claimed exempt exceeded both the amount actually claimed exempt and the maximum allowable value of the interest claimed exempt, but the term is important to resolution of issues when the exemption claim equals the value of the entire actual aggregate interest. The aggregate interest passes out of the estate never to be administered, if it does not exceed the allowed value, but, that portion of the debtor's aggregate interest at filing in excess of the allowed exemption does not leave the estate.

v. Freeland & Kronz, 503 U.S. 638, 642-643, 112 S.Ct. 1644, 118 L.Ed.2d 280 (1992)

Unlike *Schwab*, here the value of the entire aggregate interest was within the statutory allowance and the Debtors entire (aggregate) interest passed out of the estate, leaving nothing for the trustee. It may be true that subsequent value accrued through two years of subsequent appreciation, but the possibility of such appreciation is most appropriately treated as factored into the value of the debtors original aggregate interest because one of the elements of value is the possibility of future appreciation or depreciation. Just as it is impossible to put the toothpaste back into the tube, it impossible for the trustee to put the appreciated interest previously withdrawn from estate back into it some two years later.

This is what the trial judge concluded: (ER 27 Lines 16 – 20)

Because as of the date the bankruptcy was filed, the value of the subject property was equal to or less than the sum of the underlying secured obligations and exemptions claimed under 11 U.S.C. § 522(d)(1), the subject property is withdrawn from administration pursuant to 11 U.S.C. § 522(1) at the expiration of the time to object to claims and there is no remaining interest in the property for the Trustee to administer.

This approach creates a sustainable principle consistent with other established bankruptcy law as follows:

Where the actual value of an asset at the time of filing exceeds the claimed exemption, the interest represented by that excess value remains for the trustee to administer without objection to the exemption, but where the actual value of the asset at filing is less than or equal to a claimed and allowed exemption, then the entire asset passes out of the estate under 522(l) and is withdrawn from administration by the trustee.

Such a rule is not only consistent with the statutory language and the methodology of *Schwab*, but is consistent with other well established principals of bankruptcy law. For example, a debtor may avoid an involuntary lien impairing an exemption. The case law holds that the valuation is made at the date of filing. *Chiu, supra, Polis, supra* Further the rule is exactly parallel to the rule proposed here. If at the time of filing the Debtor has no interest in excess of the first lien plus exemption, he may avoid a junior non consensual lien. 11 U.S.C. § 522(f)(1) *Chiu, supra*. Similarly, in a Chapter 13 debtor may avoid a junior voluntary lien if, at filing, the debtor's interest has no value in excess of liens senior to that being avoided. *In re Zimmer* 313 F.3d 1220 (9th Cir 2002). These rules are all

consistent with the appellant/debtor's approach to this case, i.e. The debtors interest is valued and fixed as of filing. The appellee's position is not supported and is contrary to the rule in every other case.

Under the appellee's reasoning, the exemption is determined and the valuation of interests is made at some indeterminate time post filing date. Values can change, either up or down.² How can this be reconciled with lien avoidances effected on the basis of values at filing? As another example, the debtor may apportion an exemption such as that provided in 522 (d)(1) and (5) among several assets. How can that be accomplished if the trustee can choose among shifting values arising from post filing appreciation or depreciation? The issues are complicated enough without the added problem of inconsistent methodologies and timetables for evaluating exemption allowances in different contexts. If the value of the real property declined and the value of personal property increased, could the debtor reallocate the exemptions to reflect the changes in value? Finality is important and allowing the value to be recomputed at different times is a recipe for disaster. The debtor's fresh start requires a decision in the beginning. Why

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The uninsured car that is an accident, the real estate that goes up or down in value, the stock portfolio in a bank stock that is closed by the FDIC are only examples.

would any rational debtor maintain the property and make payments (with post petition income) for years if the trustee could, some 2 years later decide that the interest should come back and be liquidated.

The Bankruptcy Appellate Panel's reliance on value is misplaced.

Schwab also requires reversal of the court below because of the BAP's misplaced emphasis upon the exempt value without recognizing that that value must be applied to determine the scope of an interest at a particular time, the date of filing. The BAP would allow determination of the trustee's interest based upon a perceived value as of some two years after the case is filed. *Schwab* contradicts this approach by recognizing that at a particular time (the filing date) the value of the property defines the respective interests of the debtor and the trustee. What is exempt exits the estate. Whatever happens (increase or decrease in value) to the property after is "withdrawn" *See, Owen, supra*, is not property of the estate and not subject to administration. What is property of the estate, remains property of the estate.

CONCLUSION

In this case the debtors aggregate interest in property was claimed exempt. The findings of the trial court specifically determined that there was

no value in the property in excess of the claimed exemption. Because the trial court found that at the time of filing there was no value in excess of exemptions and encumbrances, the entire aggregate interest passed out of the estate under 522(1). The trial court's conclusion that there was no interest in the property left in the estate for the trustee to administer was correct.

Respectfully submitted this July 23, 2010

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