Nos. 16-39, 16-40 (consolidated)

IN THE
UNITED STATES BANKRUPTCY APPELLATE PANEL
FOR THE TENTH CIRCUIT

In re: JOHN T. BIRD, *Debtor*; and
In re: BRENT D. CHRISTENSEN and JO-ANN H. CHRISTENSEN, *Debtors*;

GARY E. JUBBER and FABIAN VANCOTT,
Appellants,
– v. –

JOHN T. BIRD,
Debtor/Appellee (Case No. 16-39); and
BRENT D. CHRISTENSEN and JO-ANN H. CHRISTENSEN,
Debtors/Appellees (Case No. 16-40).

On Appeal from the United States Bankruptcy Court
For the District of Utah, Nos. 15-29783, and 15-29773

BRIEF OF AMICI CURIAE NATIONAL CONSUMER BAKRUPTCY RIGHTS CENTER AND THE NATIONAL ASSOCIATION OF CONSUMER BANKRUPTCY ATTORNEYS IN SUPPORT OF APPELLEES AND SEEKING AFFIRMANCE OF THE BANKRUPTCY COURT'S DECISION

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April 6, 2017

STATEMENT OF INTERESTED PARTIES

Pursuant to Fed. R. Bankr. P. 8012 and L.R. 8003-2(b), *amici curiae*, the National Consumer Bankruptcy Rights Center and the National Association of Consumer Bankruptcy Attorneys, state that they are both nongovernmental corporate entities that have no parent corporations and do not issue stock.

Further, amici are not aware of any interested parties beyond those already disclosed by the parties to the case.

CERTIFICATION OF AUTHORSHIP

Pursuant to Fed. R. Bankr. P. 8017(c)(4), the undersigned counsel of record certifies that this brief was not authored by a party's counsel, nor did party or party's counsel contribute money intended to fund this brief and no person other than amici contributed money to fund this brief.

CONSENT

The parties have consented to filing of this brief.

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STATEMENT OF INTEREST OF AMICI CURIAE

NCBRC is a nonprofit organization dedicated to preserving the bankruptcy rights of consumer debtors and protecting the bankruptcy system's integrity. The Bankruptcy Code grants financially distressed debtors certain rights that are critical to the bankruptcy system's operation. Yet consumer debtors with limited financial resources and minimal exposure to that system often are ill-equipped to protect their rights in the appellate process. NCBRC files *amicus curiae* briefs in systemically-important cases to ensure that courts have a full understanding of the applicable bankruptcy law, the case, and its implications for consumer debtors.

NACBA is also a nonprofit organization whose members are attorneys across the country. NACBA advocates nationally on issues that cannot adequately be addressed by individual member attorneys. It is the only national association of attorneys organized for the specific purpose of protecting the rights of consumer bankruptcy debtors.

NCBRC, NACBA and its membership have a vital interest in the outcome of this case. NACBA member attorneys represent individuals, many of whom file under Chapter 7 and have little or no equity in property that is normally considered a necessity of daily life, like a personal residence or vehicle. Any issue concerning the nature and extent of a trustee's power to sell such property, thereby depriving the debtor of any property exemptions and/or foreclosure defenses, is of great

significance to many debtors, who seek a "fresh start" with the expectation that this fully encumbered property will be available for their use during and after the bankruptcy process.

SUMMARY OF ARGUMENT

Trustee's proposed "carve-out" transactions drive a stake in the heart of a debtor's fresh start. They accomplish this result by evicting debtors from their homes, paying them nothing for their homestead exemptions, and potentially keeping them saddled with tax debt that will haunt them post-discharge.

Equally concerning is that, in exchange for the havoc these transactions would wreak on debtors' lives, the Chapter 7 estate would receive little, if anything, in return. Instead, the primary beneficiary of these transactions is the trustee himself. Under the compensation limits of Section 326, Trustee could have received nearly $50,000 upon the successful consummation of the transactions in the debtors' Chapter 7 case. Now that his efforts were unsuccessful, and the debtors are in Chapter 13 cases, he seeks $110,358.60 in compensation. In either situation—sale in the Chapter 7 case or payment through the Chapter 13 plan—this money comes directly out of the pockets of the unsecured creditors, and most likely erases any benefit they would have ever received from these transactions.

The bankruptcy court was rightly disturbed with these transactions, as they are a form of abuse that is not permitted by the Bankruptcy Code. Indeed, these transactions exemplify why the abandonment procedure was initially developed – first in the common law, and then later in the 1978 Bankruptcy Code itself.

Without any meaningful distribution to the estate's unsecured creditors, abandonment remains the proper procedure. Neither Sections 363(f) nor 724(b) provide a statutory justification otherwise. Further, the defining characteristic of these transactions – carving out funds for a specified purpose – inherently disrupts the Code's distribution scheme, and would therefore not pass muster under the Supreme Court's recent decision in *Czyzewski v. Jevic Holding Corp*.

Should this Court permit these transactions anyway, then at a minimum, debtors should be allowed to assert their exemptions against the property, or resulting proceeds. As clarified by *Law v. Siegel*, such exemptions cannot be denied unless there is a specific statutory basis for that denial. There is no such statutory basis to deny honest debtors of their crucial homestead exemptions.

ARGUMENT

Trustee seeks a handsome payout – well beyond six figures – for his failed pursuit of these carve-out transactions that were improper in the first instance. This Court should follow the bankruptcy court's lead, and reject this lucrative, and abusive, practice that enriches trustees at the expensive of innocent debtors.

The illusory benefit to the bankruptcy estate is not just grounds to deny compensation, it is grounds to disapprove the proposed transactions altogether. Without any meaningful benefit to the estate, such transactions are barred by the

Bankruptcy Code. Even in the highly unlikely event that these transactions could be approved, debtors are allowed to assert their exemptions against the proceeds.

I. Trustee Compensation Is Improper Because The Estate Did Not Benefit From The Transactions – Nor Were The Transactions Designed To Produce Such Benefit.

As a threshold matter, it is important to note that Trustee seeks to be paid a total of $110,358.60 out of the debtors' Chapter 13 estates, even though those estates have not received any benefit from his purported services.

Before engaging in any in-depth analysis, the lack of benefit to the estate by itself has led many Courts – including this one – to deny compensation to a former Chapter 7 trustee in a converted Chapter 13 case. *See, e.g.*, *Rupp v. Ewing (In re Ewing)*, No. UT-07-074, 2008 Bankr. LEXIS 685, at *28-29 (B.A.P. 10th Cir. Mar. 24, 2008); *see also In re Mingledorff*, No. 12-41543-EJC, 2015 Bankr. LEXIS 2076, at *19-20 (Bankr. S.D. Ga. June 23, 2015). In fact, this Court's *Ewing* decision specifically distinguished the case of *In re Barkell*, No. 05-38602, 2006 Bankr. LEXIS 4442 (Bankr. D. Utah Aug. 11, 2006), relied upon by Trustee here, *see* Appellant's Br. at 40, on these very grounds. *See Ewing*, *supra* at *28-29. Accordingly, the simple fact that the estate has not received any benefit whatsoever from these transactions should be reason enough to affirm the bankruptcy court's decision.

Moreover – and the remainder of this brief will focus on this issue – compensation should also be denied because the proposed transactions were not ever designed to benefit the estate. Under the Code, "the court *shall not* allow compensation for… services that were not– (I) reasonably likely to benefit the debtor's estate; or (II) necessary to the administration of the estate." 11 U.S.C. § 330(a)(4)(A) (emphasis added). Courts routinely use these mandatory guidelines to reject compensation for carve-out agreements that are not likely to benefit the estate. *See In re Lan Associates XI, LP.*, 192 F.3d 109, 120 (3rd Cir. 1999) ("a trustee who expends time and effort administering fully encumbered assets should not receive compensation except to the extent that his actions provide an actual benefit to the estate."); *In re All Island Truck Leasing Corp.*, 546 B.R. 522, 535 (Bankr. E.D.N.Y. 2016) (denying compensation to trustee where trustee's commission and fees consumed entire amount remaining for distribution). Here, the bankruptcy estate stood to gain little, if anything, while the proposed sales would have resulted in a tremendous payday to Trustee.

Whether one examines the actual benefit these transactions have had on their bankruptcy estates (none), or the likely benefit they would have had if consummated (also none), Trustee's compensation request is clearly improper.

II. Trustee's Proposed Carve-Out Agreements Are Not Permitted By The Code.

Trustee's request for compensation arises from the false premise that his proposed sales were permissible. However, as recognized below, the proposed "carve-out" transactions were not permitted by the Bankruptcy Code.[1] A Chapter 7 Trustee has essentially two options to dispose of estate property: abandonment under Section 554, or sale under Section 363. *See In re Jaussi*, 488 B.R. 456, 458-59 (Bankr. D. Colo. 2013). When a debtor's property is fully encumbered by liens and exemptions, abandonment is clearly the appropriate route.

A. Assets Fully Encumbered By Liens And Exemptions Should Be Abandoned By The Bankruptcy Estate, Not Sold By The Trustee.

"As a general rule, the bankruptcy court should not order property sold 'free and clear of' liens unless the court is satisfied that the sale proceeds will *fully* compensate secured lienholders *and* produce some equity for the benefit of the bankrupt's estate." *In re Riverside Inv. P'ship*, 674 F.2d 634, 640 (7th Cir. 1982) (emphasis added) (citing *Hoehn v. McIntosh*, 110 F.2d 199, 202 (6th Cir. 1940)); *see also* 7 Collier on Bankruptcy ¶ 704.02[1] at 704-8 (16th ed.) ("when a property is encumbered to the extent that its sale, after payment of costs (including *ad*

[1] "Although the term is widely used but rarely defined, a 'carve-out agreement' is generally understood to be 'an agreement by a party secured by all or some of the assets of the estate to allow some portion of its lien proceeds to be paid to others, i.e., to carve out of its lien position.'" *In re Robotic Vision Sys., Inc.*, 367 B.R. 232, 240 n.23 (B.A.P. 1st Cir. 2007).

valorem taxes), administrative expenses and encumbrances, will produce little or no money for the estate, it is improper for the trustee to take possession of or sell it"). In determining whether there is sufficient equity to benefit the estate, courts consistently look to "the value remaining for unsecured creditors above any secured claims and the debtor's exemptions." *DeGiacomo v. Traverse (In re Traverse)*, 753 F.3d 19, 29 (1st Cir. 2014). Without sufficient equity to benefit unsecured creditors, the bankruptcy "court should order the release and surrender possession and control of the property to the lienor to foreclose or otherwise proceed in a court of competent jurisdiction." *Hoehn*, 110 F.2d at 202; *see also In re Landreneau*, 74 B.R. 12, 13 (Bankr. W.D. La. 1987).

This long-standing common law practice became embedded in the Code in the abandonment provisions of Section 554. *See Midlantic Nat'l Bank v. N.J. Dep't of Envtl. Prot.*, 474 U.S. 494, 508 (1986) (Rehnquist, J., dissenting) (describing common law practice); *see* Pub. L. No. 95-598, 92 Stat. 2549, 2603 (1978) (enacting 11 U.S.C. § 554). It has now become "almost universally recognized that where the estate has no equity in a property, abandonment is virtually always appropriate because no unsecured creditor could benefit from the administration." *In re Feinstein Family Pshp.*, 247 B.R. 502, 507 (Bankr. M.D. Fla. 2000); *see also In re Barfield*, No. 11-72074, 2015 Bankr. LEXIS 270, at *22 (Bankr. C.D. Ill. Jan. 29, 2015); *Jaussi*, 488 B.R. at 458-59; *In re Covington*, 368

B.R. 38, 41 (Bankr. E.D. Cal. 2006) ("when an asset is fully encumbered by a lien, it is considered improper for a chapter 7 trustee to liquidate the asset."); *In re Ayers*, 137 B.R. 397, 400 (Bankr. D. Mont. 1992); *In re Williamson*, 94 B.R. 958, 962-63 (Bankr. S.D. Ohio 1988); *In re Lambert Implement Co.*, 44 B.R. 860, 862 (Bankr. W.D. Ky. 1984).

The abandonment, rather than sale, of fully encumbered property by the estate serves several purposes. First and foremost, such abandonment "serve[s] the overriding purpose of bankruptcy liquidation: the expeditious reduction of the debtor's property to money, for equitable distribution to creditors," because liquidating worthless assets would necessarily "slow[] the administration of the estate and drain[] its assets." *Midlantic*, 474 U.S. at 508 (Rehnquist, J., dissenting). In fact, the Chapter 7 "trustee's duty to expeditiously close the estate [is] his 'main' duty." *In re Riverside-Linden Inv. Co.*, 925 F.2d 320, 322 (9th Cir. 1991); *In re Dorn*, 167 B.R. 860, 865 (Bankr. S.D. Ohio 1994) ("there are two goals in the administration of chapter 7 cases, i.e., to administer nonexempt assets as expeditiously as possible for the benefit of creditors, and to provide a fresh start to debtors."); *In re Paolella*, 79 B.R. 607, 609 (Bankr. E.D. Pa. 1987).

Keeping this duty in mind, the abandonment of fully encumbered assets more closely aligns with the role of the Chapter 7 trustee, whose "purpose is to liquidate the estate for the benefit of the unsecured creditors," *In re K.C. Machine*

& Tool Co., 816 F.2d 238, 245-46 (6th Cir. 1987), "and not for the benefit of secured creditors," *Rambo v. Chase Manhattan Mortg. Corp. (In re Rambo)*, 297 B.R. 418, 433 (Bankr. E.D. Pa. 2003). It is important that these loyalties be delineated because in many ways, the interests of the secured creditor are "totally antagonistic to the interests of the general unsecured creditors." *Feinstein*, 247 B.R. at 507; *see also* 7 Collier on Bankruptcy ¶ 704.02[1] at 704-8 (16th ed.) (noting potential for conflicts of interest in such transactions). Further, secured creditors, whose liens survive the bankruptcy process, need neither the protection nor assistance of the trustee in liquidating their claims, as they may continue to avail themselves of foreclosure or repossession proceedings. *See Dewsnup v. Timm*, 502 U.S. 410, 417-418 (1992). Nor do trustees need to administer secured claims, and many jurisdictions already prohibit compensation to the trustee for liquidating fully encumbered assets. *See, e.g.*, *Lan Associates*, 192 F.3d at 120.

Allowing trustees to sell fully encumbered assets invites self-dealing by less scrupulous trustees. This palpable concern was the driving force behind Section 554's abandonment procedures:

> Congress was aware of the claim that formerly some trustees took burdensome or valueless property into the estate and sold it in order to increase their commissions. Some of the early cases condemned this particular practice in no uncertain terms, and decried the practice of selling burdensome or valueless property simply to obtain a fund for their own administrative expenses.

K.C. Machine, 816 F.2d at 246; *see also In re KVN Corp.*, 514 B.R. 1, 7 (B.A.P. 9th Cir. 2014) (describing "past abuses"); *In re Sunbum5 Enters., LLC*, No. 6:10-cv-1268-Orl-28, 2011 U.S. Dist. LEXIS 113295, at *31 (M.D. Fla. Sep. 30, 2011). Indeed, "[t]he existence of nominal asset cases, in which the bankruptcy system is operated primarily for the benefit of those operating it, has been one of the most frequently expressed criticisms" of the prior bankruptcy system. H. Rep. No. 95-595, at 94 (1977). Courts have thus admonished against continued "attempt[s] by the trustee to churn property worthless to the estate just to increase fees." *K.C. Machine*, 816 F.2d at 246.

The instant cases present the lucrative compensation scheme that concerned Congress in 1977. For attempting to sell the two homes, Trustee now seeks compensation totaling $110,358.60. (*See* Order, 26 n. 81.) Yet, after accounting for homestead exemptions, *see* Section III *infra*, the estate's unsecured creditors stood to gain nothing from these transactions.

Even without taking the debtors' exemptions into account – as Trustee incorrectly urges the Court to do – the carved out $10,000 remains an illusory benefit to the general unsecured creditors. Under the original terms of the stipulation, those funds would be "distributed in accordance with the priorities of the Bankruptcy Code," (B00136; C00845,) which means that Trustee would be paid first, *see* 11 U.S.C. §§ 503(b)(2) (trustee compensation as administrative

expense), 507(a)(2) (priority payments for administrative expenses). The distribution for Trustee's compensation could be as high as $19,350 for the Bird property and $24,500 for the Christensen property.[2] The sales would also inevitably incur other administrative expenses payable under Section 503(b). Thus, even without further payments to the IRS,[3] Trustee's compensation alone had the potential to wipe out any meaningful distribution to the general unsecured creditors. Regardless of the exemption question, it is obvious that Trustee is the primary beneficiary of these transactions.

Selling debtors' homes, which should be protected from liquidation under established bankruptcy practices, and evicting them, in order to benefit the trustee (rather than the estate) is a form of abuse. Unfortunately, today, the opportunities for this abuse are especially pronounced in regions of the country where consumers continue to struggle from the effects of the housing crisis. If this Court were to endorse the sale of encumbered properties by Chapter 7 trustees, despite deeply rooted bankruptcy practice, then the door to this lucrative, and abusive, practice would be flung open.

---

[2] *See* 11 U.S.C. § 326(a) (limits on trustee compensation); Opinion at 6-7 (proposed sale prices).

[3] It is unclear whether the IRS would have received further payment. According to the parties' stipulations, the IRS would have retained its claim as a general unsecured creditor. But the IRS may have waived that claim later. *See, e.g.*, B00331-32; C01018-19.

Given the above principles, it is wholly improper for a "Chapter 7 trustee [to] act as a liquidating agent for secured creditors who should liquidate their own collateral." *Feinstein*, 247 B.R. at 507.

B. Section 363(f) Does Not Authorize The Proposed Transactions.

As the court below noted, Trustee's proposed 363(f) sale was also unsupported by the plain text of that provision. Section 363(f) empowers a trustee to sell property only in enumerated circumstances, including (as argued here) if there is a bona fide dispute as to a party's interest, or if the interested party could be compelled to accept a money satisfaction of the interest. 11 U.S.C. § 363(f)(4)-(5).

Trustee's primary basis for justifying the proposed 363(f) sales is that the debtors' exemptions were in "bona fide dispute" per Section 363(f)(4). Appellant's Br. at 33-35. What makes this rationale so remarkable is that Trustee himself lodged the dispute, not on any disputed factual grounds underlying the exemptions, but on grounds that the properties merely lacked equity and the exemptions were thus "ephemeral." Opinion at 4. As the bankruptcy court noted, Trustee's "intentions soon became apparent." *Id*.

Section 363(f)(4) does not give a Chapter 7 trustee unlimited authority to create disputes over exemptions in order to have a basis for a 363 sale. "The purpose of § 363(f)(4) is to permit property of the estate to be sold free and clear of

interests that are disputed by the representative of the estate so that liquidation of the estate's assets need not be delayed while such disputes are being litigated." *Moldo v. Clark (In re Clark)*, 266 B.R. 163, 171 (B.A.P. 9th Cir. 2001). Analyzing this basic purpose, the *Moldo* Court rejected an identical argument raised by Trustee. The court reasoned that, under Section 363(f)(4),

> [t]ypically, the proceeds of sale are held subject to the disputed interest and then distributed as dictated by the resolution of the dispute; such procedure preserves all parties' rights by simply transferring interests from property to dollars that represent its value. In this case, Debtor presumably believed the lots were his exempt property and did not want them sold at all. His right to continue to own the lots would not have been preserved had they been sold, with his interest in them transferred to proceeds.
>
> The Trustee cites no authority for the proposition that section 363(f) permits sale of property free and clear of exemption claims.

Id. at 171-72. Nor has Trustee cited such authority in this case. Instead, Trustee relies on authority that did not contemplate a debtor's exemptions. *See* Appellant's Br. at 35 (citing *In re Mundy Ranch, Inc*., 484 B.R. 416, 423-24 (Bankr. D.N.M. 2012); *In re Collins*, 180 B.R. 447, 452 (Bankr. E.D. Va. 1995). As in *Moldo*, this Court should reject Trustee's argument that he may move forward with a 363 sale simply by objecting to a debtor's exemptions.

Trustee's assertion that the sale was permissible under Section 363(f)(5) is also a non-starter. The Court of Appeals of Utah has already decided that the

state's exemption scheme requires, upon execution, that a debtor be paid the full value of his or her homestead exemption in cash. *Jackson v. Halls*, 314 P.3d 1065, 1067-68 (Utah Ct. App. 2013). Given the proposed sales prices, and the value of the existing liens, it is clear that these debtors could not have been paid their homestead exemptions in accordance with *Jackson*'s clear mandate – at least not unless one of the secured creditors was shortchanged. Recognizing the weakness in his position, Trustee later pivots, and instead argues that the proceeds actually "were more than enough to adequately protect, and pay the full amount of the exemption if so required." Appellant's Br. at 42. Trustee provides no explanation as to where these exemption payouts would come from, and indeed, given the sales prices, the bald assertion defies basic math.

C. Section 724(b) Does Not Have A Power Of Sale Clause.

Trustee's attempt to use Section 724(b) to justify his proposed transactions fails for the fundamental reason that the provision does not confer such authority on him. *See* Appellant's Br. at 27-29.

Just as its title "Treatment of Certain Liens" implies, the plain language of Section 724 simply delineates the particular manner in which certain types of liens are treated in bankruptcy. For example, Section 724(b) in particular describes nothing more than the six priorities when distributing proceeds from property encumbered by the covered liens. Under this particular priority scheme, tax lien

claims change positions "so that instead of being paid ahead of secured creditors and all administrative claimants, they are paid after secured creditors with senior liens and after § 507(a)(1)–(6) administrative claimants, but only to the extent of the amount of the tax liens." *In re A.G. Van Metre*, 155 B.R. 118, 121-22 (E.D. Va. 1993); *see also Pearlstein v. U.S. Small Bus. Admin.*, 719 F.2d 1169, 1175 (D.C. Cir. 1983). But nothing in the 724(b) priority scheme even mentions—let alone establishes—the trustee's power to sell the asset.

The power to sell estate property, as discussed above, is instead governed by Section 363, which expressly empowers a trustee to "use, sell, or lease" property of the estate, while defining the circumstances under which that power may be exercised. *See* 11 U.S.C. § 363(a)-(p). Section 363 "is the *only* basis for the Trustee to sell property of the estate . . ." *Feinstein*, 247 B.R. at 508 (emphasis added); *see also Matter of Vill. Properties, Ltd.*, 723 F.2d 441, 444 (5th Cir. 1984) ("Section 363 defines the rights and powers of the trustee regarding the use, sale or lease of estate property and the rights of third parties with interests in the subject property."). Because Section 724(b) does not create such power, it understandably also contains no limitations on the exercise of any such hypothetical power. Thus, construing Section 724(b) to create an independent power of sale would allow the trustee to circumvent Section 363's carefully crafted limitations.

Simply put, sections 363 and 724(b) do not serve as independent bases of power to liquidate property. As their plain text and their placement within the structure of the Code show, section 363 grants the liquidation power and section 724(b) simply determines the manner in which the sale proceeds are distributed. *See In re Grand Slam U.S.A., Inc.*, 178 B.R. 460 (Bankr. E.D. Mich. 1995) ("Once the property is sold in accordance to Section 363(f), § 724(b) comes into play to determine the 'distribution' of the proceeds from such sale."); *In re Roberts*, 249 B.R. 152, 156 (Bankr. W.D. Mich. 2000); *In re Oglesby*, 196 B.R. 938, 943 (Bankr. E.D. Va. 1996).

D. Carving Out A Token Payment To The Bankruptcy Estate Does Not Ameliorate This Otherwise Improper Transaction, And Even Runs Afoul of *Jevic*.

Carving out a token payment to the bankruptcy estate does not save transactions such as the one in this case. The transactions are fundamentally at odds with the workings of the Code, and because "carve-outs" invariably change the priority of distributions, they are barred by the Supreme Court's recent *Jevic* decision. *See Czyzewski v. Jevic Holding Corp*., -- U.S. --, No. 15-649, 2017 U.S. LEXIS 2024 (Mar. 22, 2017).

"The approval of such token 'carve outs'… is a practice neither contemplated by nor provided for in the Bankruptcy Code." *In re Tobin*, 202 B.R.

339, 340 (Bankr. D.R.I. 1996). There is good reason that such carve-out agreements are absent from the Code. Their obvious function and purpose is to avoid the above limitations normally placed on the sale of fully encumbered property. The *Feinstein* Court succinctly described the workings of such transaction:

> It is not rare that trustees of Chapter 7 estates are approached by secured creditors who seek the trustee's help to liquidate fully encumbered collateral. They realize that before the trustee is willing to go along with the proposition the secured creditor must put a little sweetener in the deal by agreeing to pay sufficient sums to compensate the trustee and to pay other costs of administration. The more sophisticated trustee may demand that the secured creditor throw in a pittance to pay a meaningless dividend to unsecured creditors, making the arrangement more palatable to the Court.

Feinstein, 247 B.R. at 507. And it is clear that the parties to such agreements stand to benefit from the arrangement:

> The proposition is very attractive from the secured creditor's point of view and economically sound because it may stave off a possible attempt by the Trustee to seek to surcharge the collateral and, most importantly, save the potentially expensive cost of a foreclosure suit. The offered deal is also attractive to the trustee because it assures that he or she will earn a commission in an otherwise no asset case and may seek a commission based on the gross sales price and not on the net distributed to parties of interest.

Id.; *see also In re Fialkowski*, No. 12-12231K, 2012 Bankr. LEXIS 5608 at *7 n. 4 (Bankr. W.D. N.Y. Dec. 3, 2012) ("It is often beneficial for a lienholder to let a

bankruptcy trustee sell its collateral, instead of incurring the expense of state-law foreclosure and sale.”).

Further, because parties to the “carve-out” transaction are the ones who dictate its distributions, they invariably alter the Code’s priority scheme. Needless to say, this scheme is a complex and carefully balanced system accounting for secured claims, priority claims, unsecured nonpriority claims, and even the disposition of certain property attached by tax liens. 11 U.S.C. §§ 506, 507, 726, 724 (respectively). As the Supreme Court has recently noted, “[i]n Chapter 7 liquidations, priority is an absolute command–lower priority creditors cannot receive anything until higher priority creditors have been paid in full.” *Jevic*, 2017 U.S. LEXIS 2024, *22. And even in the more flexible Chapter 11 world, parties are not allowed to agree to priority schemes, over the objections of other creditors, that contradict the Code. *Id.*, at *23-31.

Transactions such as these nevertheless overwrite this scheme by assigning distributions at the whim of the trustee and parties to the sale. For example, even though these particular carve-outs aim to make “distribut[ions] in accordance with the priorities of the Bankruptcy Code,” Record Appendix B00136; C00845, such distributions cannot truly happen because the IRS has only stipulated “to subordinate its own unsecured claims to the $10,000 carve-out.” Record Appendix B00331-32; C01018-19. Thus, as the court observed, “[i]n cases where the IRS

would not be paid in full from such sales, tax debts would remain," notwithstanding the Code's priorities. *See* Opinion at 2. Clearly, these deals, which pay general unsecured creditors before priority tax debts, and before the debtors' exemption claim, run afoul of the principles reaffirmed by *Jevic*.

The bankruptcy court below is not alone. These concerns have led a number of other courts to reject such transactions. *See, e.g.*, *Tobin*, 202 B.R. at 340 ("We are aware of no valid reason why the practice should be encouraged or allowed to continue."); *Feinstein*, 247 B.R. at 509.

Even authorities that have allowed the concept of a carve-out agreement have done so with great skepticism. For example, the Ninth Circuit B.A.P. has allowed carve-out agreements in limited circumstances, but has applied a "presumption of impropriety" against them. *KVN*, 514 B.R. at 7; *see also All Island*, 546 B.R. at 533 ("Such carve-outs are presumptively improper…"). Rebutting the presumption requires *inter alia*, a showing not only that there will be some distribution to the unsecured creditors, but that such distribution will be "meaningful." *Id*. at 8. The official Handbook for Chapter 7 Trustees similarly allows carve-out agreements only if they "will result in a meaningful distribution to creditors." Handbook for Chapter 7 Trustees, published by the Executive Office for United States Trustee, at 4-14 (2012). However, "[i]f the sale will not result in

a *meaningful* distribution to creditors, the trustee must abandon the asset." *Id* (emphasis added).

The instant "carve-out" transactions violate these common law principles, as well as the mandate of the U.S. Trustee's Office itself. As described above, the $10,000 carved out for the estate would be entirely consumed by the debtor's exemption, Trustee's compensation, or both. The final distribution to the unsecured creditors would be de nominal, or even non-existent.

Debtors, much like other interested parties who do not consent to the carve-out, also stand to lose important rights and remedies in these transactions. Should a creditor pursue liquidation on its own outside of bankruptcy, then the debtor could, for instance, raise defenses against home foreclosure, or pursue loss mitigation remedies that would prevent foreclosure altogether. Or, these debtors could even have redemption rights under Utah law. *See* Utah Code Ann. § 78B-5-504(6). These important rights for homeowners are lost forever in the face of these backroom, "carve-out" deals.

There is simply no reason to deprive homeowners and other consumers of these rights in these "carve-out" deals. By the very nature of the transactions, they provide minimal, if any, benefit to the bankruptcy estate, and serve only to increase compensation to the trustee, allowing the secured creditors to short-circuit state foreclosure laws and protections.

III. Even Assuming The Carve-Out Transactions Are Generally Permissibly, Debtors Are Entitled To Assert Exemptions Against The Property Or Its Proceeds.

Even if carve-out agreements are generally permissible as a device to create an artificial benefit to the estate, it is inappropriate to use the device to sell fully encumbered property in which an individual debtor can claim an exemption.

A. There Is No Statutory Basis To Deny Exemptions On The Sole Basis that Equity Was Created Postpetition.

"[E]xemptions in bankruptcy cases are part and parcel of the fundamental bankruptcy concept of a 'fresh start.'" *Schwab v. Reilly*, 560 U.S. 770, 791 (2010). "Exemptions let the debtor maintain an appropriate standard of living as he or she goes forward after the bankruptcy case," and aid a debtor's 'fresh start' by enabling the debtor to emerge from bankruptcy with adequate and necessary possessions." *In re Farr*, 278 B.R. 171, 175 (B.A.P. 9th Cir. 2002) (quoting H. R. Rep. No. 95–595, at 126 (1977), reprinted in 1978 U.S.C.C.A.N. 5963, 6087); *see also In re Demeter*, 478 B.R. 281, 292 (Bankr. E.D. Mich. 2012) ("the exemption scheme under § 522(d) is crucial to, and an integral part of a debtor's 'fresh start.'"). Thus, "[t]he trustee need not and should not collect or take possession of property that the debtor has claimed as exempt." 7 Collier on Bankruptcy ¶ 704.02[1] at 704-8 (16th ed.).

These exemptions are so crucial to a debtor's fresh start that they can only be denied based on the specific, limited circumstances enumerated in the Code.

Siegel, 134 S. Ct. at 1194-95 (bankruptcy court erred by surcharging a debtor's exemption to account for debtor's own fraud). Otherwise, "exempt property is not liable for the payment of any prepetition debt or any administrative expense." *Id.* at 1192 (internal quotations omitted); *see also Clabaugh v. Grant (In re Grant)*, 658 F. App'x 411, 415 (10th Cir. 2016) (unpublished) (citing *Ellman v. Baker (In re Baker)*, 791 F.3d 677, 681 (6th Cir. 2015)). The *Siegel* opinion highlighted the importance of those exemptions by even refusing to surcharge an exemption on equitable grounds to account for the debtor's own fraud. *Siegel*, 134 S. Ct. at 1194-95.

Trustee incorrectly argues that, because the debtors lacked equity in the properties, the value of their homestead exemptions was zero, and they were thus not entitled to any proceeds from the carve-out. Appellant's Br. at 20-24. Of course, this assertion is factually incorrect, as it is undisputed that the proposed sales would have left a small amount of equity in the properties. *See* Opinion at 6-7.

But the argument also suffers the same disregard of *Siegel*'s mandate to protect a debtor's exemption unless there is a specific statutory basis in the Code not to do so. Trustee has not cited any provision—and amicus counsel is not aware of any such provision—that allows a court to deny an exemption merely on the basis that the value was created postpetition. Even before *Siegel*, many courts

were already protecting a debtor's valid exemption against carved out funds. *See*, *e.g.*, *In re Wilson*, 494 B.R. 502 (Bankr. C.D. Cal. 2013); *see also In re Mannone*, 512 B.R. 148, 153-54 (Bankr. E.D.N.Y. 2014) ("Debtor's right to claim the homestead exemption, along with the dollar amount to be claimed, was fixed as of the Petition Date. However, the extent to which the Debtor is entitled to be paid on account of his claimed homestead exemption is governed by the actual sale price."). In both *Mannone* and *Wilson*, the debtor was entitled to claim as exempt money that was realized from the sale of property that was underwater at commencement of the case.

B. No Statutory Provision Allows Exemptions To Be Denied On The Sole Basis That Equity Was Created Postpetition.

Trustee next attempts to comply with *Siegel* by citing Section 522(c)(2) for statutory authority to deny the debtors' exemptions. These attempts are also unavailing.

First, Section 522(c)(2) is wholly inapplicable in this context. Under the provision, exempt property can remain liable for "a debt secured by a lien that is… a tax lien, notice of which is properly filed." 11 U.S.C. § 522(c)(2)(B). Although tax liens may exist in the background of these cases, nobody has suggested that the debtors' exemptions should supersede those tax liens. Instead, the bankruptcy court properly rejected Trustee's transactions, which could only benefit the estate if the *general unsecured creditors* were paid from the debtor's exemption – a result

clearly at odds with Section 522(c) and *Siegel*.[4] Trustee's attempt to use Section 522(c)(2)(B) to divert attention from the real source of the exemption charge is a textbook red herring.

To the extent Trustee believes that Section 522(c)(2)(B) gives him independent authority to sell exempt homestead property in order to satisfy tax obligations, he is also mistaken. While perhaps a novel argument in the context of tax debts, this argument has been repeatedly tested, and has just as often failed, in the parallel context of domestic support obligations under Section 522(c)(1). *See e.g.*, *In re Quezada*, 368 B.R. 44, 48 (Bankr. S.D. Fla. 2007). Indeed, there is "apparently [a] unanimous conclusion of the bankruptcy courts that have addressed the issue that a Chapter 7 trustee cannot pursue exempt assets on behalf of a DSO creditor." *In re Hibbard*, No. 08-36322, 2010 Bankr. LEXIS 2467, at *6 (U.S. Bankr. S.D. Ohio Aug. 18, 2010) (cases cited). Just as Section 522(c)(1) does not convey such authority to trustees, neither does 522(c)(2).

Later in its brief, Trustee looks to some authority on Section 522(c)(2). However, these cases contradict the above lessons from *Siegel*, and this Court should decline to follow them. For example, Appellant heavily relies on a line of authority from the Sixth Circuit, including *Brown v. Ellmann (In re Brown)*, No.

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[4] Presumably, Trustee would have requested his own compensation and administrative expenses to be paid out of the debtors' claimed exemptions as well. This result is also barred by Section 522(k) and *Siegel*.

15-11017, 2016 U.S. Dist. LEXIS 70469 (E.D. Mich. May 31, 2016), and *Baldridge v. Ellman*, 533 Fed. App'x 598 (6th Cir. 2014) (unpublished) ("*Baldridge II*"). *See* Appellant's Br. at 21, 31. The *Baldridge* case was based on the erroneous idea that Section 522(c)(2) prevents debtors from asserting exemptions on fully encumbered property. *See Baldridge v. Ellmann (In re Baldridge)*, No. 12-14612, 2013 U.S. Dist. LEXIS 58512, at *3-4 (E.D. Mich. Apr. 24, 2013) ("*Baldridge I*") (citing Section 522(c)(2), and explaining that "[c]onsequently, if the amount of the secured debt exceeds the fair market value of the property such that there is no equity, the exemption is lost").[5]

Parsing Section 522(c)(2) reveals that it does not actually read that way. The provision only states that "property exempted under this section" is still liable for a "debt secured by a lien..." 11 U.S.C. § 522(c)(2). However, the general rule remains that, for other debts, such as administrative expenses and other general unsecured debts, a debtor's exemption is not liable. *See* 11 U.S.C. § 522(c), (k). Again, Section 522 does not say that exemptions can be denied on the basis that a particular value was not realized until after the petition. Nor is there support anywhere else in the Code for such a notion. The *Brown* Court unfortunately

[5] Because the district court opinion in *Baldridge* contains more analysis, this brief will focus on the discussion in *Baldridge I*.

adopted *Baldridge* wholesale, without considering these underlying problems. *See Brown*, 2016 U.S. Dist. LEXIS 70469, at *7.

C. Trustee Misreads And Misapplies *Schwab* As To Utah's Homestead Exemption.

Finally, attempting to avail himself of the Supreme Court's *Schwab* decision, Appellant unpersuasively insists that Utah homestead exemptions attach to a debtor's interest in property, instead of the property itself, and that the exemptions can therefore be disregarded here. This argument fails for a number of reasons.

The *Schwab* Court clarified the difference between exemptions based on property itself, and exemptions based on a debtor's interest in that property. *Schwab*, 560 U.S. at 782. This distinction becomes important when it is discovered that the value of certain property exceeds the asserted exemption. In the case of dollar-limited exemptions based on a debtor's interest, "an interested party need not object to an exemption claimed in this manner in order to preserve the estate's ability to recover value in the asset *beyond the dollar value the debtor expressly declared exempt*." *Id*., at 774 (emphasis added).

First, regardless of how one interprets the Utah exemptions, the *Schwab* distinction is immaterial here because the debtors could not possibly recover value "beyond the dollar value the debtor[s] expressly declared exempt." Bird initially asserted a homestead exemption of $30,000, and the Christensens asserted a

homestead exemption of $51,000. Opinion at 4. Under the proposed sales, none of the debtors could receive anything close to the full value of their exemptions. *See id*. at 6-7. And *Schwab* does not remotely suggest that there are circumstances in which debtors should be denied the full dollar value of their exemptions.

Further, the range of a debtor's interests that can be exempted is broad, and goes far beyond the mere dollar-value of equity. *See In re Berrong*, 53 B.R. 640, 643 (Bankr. D. Colo. 1985) ("while equity is an interest, it is not necessarily the only interest of the debtor"). Thus, a debtor can exempt any interest in property, even a possessory interest, *see In re Maddox*, 27 B.R. 592, 596 (N.D. Ga. 1983) (this phrase is "a broad term encompassing many rights of a party, tangible, intangible, legal and equitable"), and even if there is no equity in the asset, *In re Chesanow*, 25 B.R. 228, 229 (Bankr. D. Conn. 1982) ("The word 'interest' is not the substantive equivalent of the word 'equity'"). This rule is especially true under Utah's revered homestead exemption. *See In re Cornia*, No. 13-22364, 2013 Bankr. LEXIS 1746, at *7-8 (Bankr. D. Utah Apr. 26, 2013) ("Under Utah law, an equitable interest in property is sufficient to assert a homestead exemption."). Thus, the role of Utah's homestead exemption exceeds the straight equity analysis from *Schwab*, and would protect a debtor's full range of interests in the property – including possession.

Finally, even if the *Schwab* distinction were somehow relevant to these transactions, Trustee nonetheless miscategorizes the Utah homestead exemption. The test to determine under which category an exemption falls is not whether an exemption statute contains dollar limits, as most do, but whether the language defining the exemption refers to the property itself, or the debtor's interest in that property. *Compare Mwangi v. Wells Fargo Bank, N.A.*, 764 F.3d 1168, 1175 n.2 (9th Cir. 2014) (asset itself exempted by statute applying to "75 percent of the disposable earnings of a judgment debtor"), *with Gebhart v. Gaughan*, 621 F.3d 1206, 1210 (9th Cir. 2010) (citing 11 U.S.C. § 522(d)(1) ("debtor's aggregate interest"); Ariz. Rev. Stat. § 33-1101 ("The person's interest")). Similar to the exemption in *Mwangi*, the Utah statute provides that the "homestead exemption *consist[s] of property* in this state…" with certain limits. *See* Utah Code Ann. § 78B-5-5-3(2) (emphasis added). On its face, the homestead exemption goes to the asset itself.

In the end, should this Court find carve-out agreements acceptable, it should at a minimum, reinforce the text of the Bankruptcy Code and the *Siegel* decision by adopting the reasoning of *Mannone* and *Wilson*, and allowing debtors to protect exemptions in such transactions.

CONCLUSION

For the reasons stated above, *amici curiae* ask this court to affirm the decisions of the bankruptcy court.

Respectfully submitted,

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CERTIFICATE OF COMPLIANCE

1. This brief complies with the type-volume limitation of Fed. R. Bankr. P. 8017(d) because this brief contains 6,708 words, excluding parts exempted by Fed. R. Bankr. P. 8015(a)(7)(B)(iii).

2. This filing complies with L.R. 8015-1(b) and the type style requirements of Fed. R. Bank. P. 8015(a)(6) because this brief has been prepared in a proportionally spaced typeface using Microsoft Word in Times New Roman 12-point type.

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CERTIFICATE OF SERVICE

I hereby certify that I electronically filed the foregoing with the Clerk of the Court for the United States Bankruptcy Appellate Panel for the Tenth Circuit by using the Appellate CM/ECF system on April 6, 2017. I certify that all participants in the case are registered CM/ECF users and that service will be accomplished by the Appellate CM/ECF system.

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