No. 11-60

IN THE
UNITED STATES BANKRUPTCY APPELLATE PANEL
FOR THE FIRST CIRCUIT COURT OF APPEALS

In re DAMON MASSEY,
Debtor.

DAMON MASSEY.
Appellant

— v. —

DENISE M. PAPPALARDO,
Appellee

ON APPEAL FROM THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF MASSACHUSETTS – NO. 11-41059

BRIEF OF *AMICUS CURIAE* NATIONAL ASSOCIATION OF CONSUMER BANKRUPTCY ATTORNEYS IN SUPPORT OF MASSEY AND SEEKING REVERSAL OF THE BANKRUPTCY COURT'S DECISION

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TABLE OF CONTENTS

TABLE OF AUTHORITIES

Cases

Statutes

Codes

Other Sources

STATEMENT OF INTEREST OF AMICUS

Incorporated in 1992, the National Association of Consumer Bankruptcy Attorneys (NACBA) is a non–profit organization consisting of more than 4,800 consumer bankruptcy attorneys nationwide. NACBA's corporate purposes include education of the bankruptcy bar and the community at large on the uses and misuses of the consumer bankruptcy process. Additionally, 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. NACBA has filed amicus curiae briefs in various courts seeking to protect the rights of consumer bankruptcy debtors. *See, e.g., Schwab v. Reilly*, 560 U.S. —, 130 S.Ct. 2652 (2010); *Kawaauhau v. Geiger*, 523 U.S. 57 (1998); *Marrama v. Citizens Bank of Massachusetts, et al*, 127 S.Ct. 1105 (2007).

The NACBA membership has a vital interest in the outcome of this case. By allowing the debtor to retain essential property, exemptions serve the overriding bankruptcy purpose of providing the debtor with a fresh start. The Bankruptcy Code permits a debtor to exempt his or her entire interest in certain property so long as the interest does not exceed a specified value at the time of the petition. Once exempted that property interest is withdrawn from the property of the estate. The bankruptcy court's decision would subject

exempt property that has been withdrawn to later administration by the trustee, in contravention of the Bankruptcy Code, the Federal Rules of Bankruptcy Procedure and the Supreme Court's decision in Schwab v. Reilly, 560 U.S. __, 130 S.Ct. 2652 (2010).

Argument

As a general rule, all property in which the debtor has a legal or equitable interest becomes property of the bankruptcy estate at the commencement of a case. *See* 11 U.S.C. § 541(a)(1). "The Code, however, allows the debtor to prevent the distribution of certain property by claiming it as exempt." *Taylor v. Freeland & Kronz*, 503 U.S. 638, 642, 112 S.Ct. 1644, 1647, 118 L.Ed 2d. 280 (1992). The debtor's exempted interest in property is no longer part of the bankruptcy estate. 11 U.S.C. § 522(l); *Owen v. Owen*, 500 U.S. 305, 11 S.Ct. 1833 (1991)(cite)("An exemption is an interest withdrawn from the estate"); *In re Bell*, 225 F.3d 203, 215 (2d Cir. 2000)("It is well-settled law that the effect of this self-executing exemption is to remove property from the estate and to vest it in the debtor"); *see also In re Cunningham*, 513 F.3d 318, 324 (1st Cir. 2008); *Abramowitz v. Palmer*, 999 F.2d 1274, 1276-77 (8th Cir. 1993). Exemptions are determined as of the time of the filing of the debtor's petition. *See Cunningham*, 513 F.3d at 324; *In re Polis*, 217 F.3d 899, 902 (7th Cir. 2000). More specifically, the Code dictates that value of a debtor's interest in property for exemption purposes means the fair market value as of the date of the filing of petition.

11 U.S.C. § 522(a)(2). The definition of value would be meaningless if exemptions are not determined as of the date of the petition.

Historically, the purpose of exemption law has been to allow debtors to keep those items of property deemed essential to daily life. In the bankruptcy context, exemptions serve the overriding purpose of helping the debtor to obtain a fresh start by maintaining essential property necessary to build a new life. *See* H.R. Rep. No. 95-595, at 117 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6078 (purpose of this scheme is to provide "adequate exemptions and other protections to ensure that bankruptcy will provide a fresh start."); *Rousey v. Jacoway*, 544 U.S. 320, 322, 325 (2005). Accordingly, section 522 of the Bankruptcy Code permits debtors to exempt certain property from the bankruptcy estate pursuant to the federal exemptions, listed in 11 U.S.C. § 522(d), or the applicable state exemptions.

I. Both the Bankruptcy Code and the Supreme Court's decision in *Schwab v. Reilly*, allow debtors to exempt their entire interest in property so long as the value of that interest does not exceed a specified amount at the time of the petition.

As in all cases of statutory construction, the starting point must be the language of the statute. *See Lamie v. U.S. Trustee*, 540 U.S. 526, 534, 124 S.Ct. 1023, 1030 (2004); *United States v. Ron Pair Enters., Inc.,* 489 U.S. 235, 241-42,

109 S.Ct. 1026, 1030-31 (1989). The plain meaning of the statute should be "conclusive, except in the rare cases [in which] the literal application of a statute will produce a result demonstrably at odds with the intention of the drafters." *Ron Pair*, 480 U.S. at 242 (*quoting Griffin v. Oceanic Contractors, Inc.,* 458 U.S. 564, 571, 102 S.Ct. 3245, 3250 (1982)).

In this case, Debtors elected to use the federal exemptions pursuant to section 522(b)(2). Section 522(d)(1) provides in relevant part that the debtor may exempt "[t]he ***debtor's*** aggregate ***interest***, not to exceed $21,625 in value, in real property or personal property that the debtor or a dependent of the debtor uses as a residence…" (emphasis added). Section 522(d)(2) states that the debtor may exempt "[t]he ***debtor's interest***, not to exceed $3,450 in value, in one motor vehicle." (emphasis added). Section 522(d)(5) permits the debtor to exempt "[t]he ***debtor's*** aggregate ***interest*** in any property, not to exceed in value $1,150 plus up to $10,825 of any unused amount of the exemption provided under paragraph (1) of this subsection" (emphasis added).

The key language in these subsections is "debtor's interest." The term "interest" is not defined in the Bankruptcy Code. However, consistent with our fundamental understanding of property rights this Court has interpreted the word "interest" as "some legal or equitable interest that can be quantified by a monetary figure." *See In re Khan*, 375 B.R. 5 (B.A.P. 1st Cir. 2007) (interpreting the term interest in section 522(p)(1)). "Interests" in property

vary, and so property rights are likened to a "bundle of sticks" in which each stick represents a right or stream of benefit. It is possible to own all of the rights (or interest) in a certain property or only have a portion of them. For example, with respect to real property one end of the spectrum is fee simple title and at the other end of the spectrum lie a variety of less-than-complete estates such as a life estate. The holder of any one of these rights has an "interest" in the property.

An interest in property is fundamentally different from the value of that interest. State law generally defines the existence of an interest in property. By contrast, a host of external factors define the value of an interest in property. *See, e.g.,* Audie Blevins and Katherine Jensen, *Gambling as a Community Development Quick Fix*, 556 Annals Am. Acad. Pol. & Soc. Sci. 109, 117 (1998)(describing escalation in land prices due to speculation about profits from building casinos after the legalization of gambling); Fred E. Foldvary, *Market-hampering Land Speculation: Fiscal and Monetary Origins and Remedies*, 57 Am. J. Econ. & Soc. 615, 622 (1998) (noting that "[s]peculators who anticipate where the next subway will be built or influence where government will lay out the infrastructure servicing a new development can reap the subsequent rents."); James Q. Wilson & Geroge L. Kelling, *Broken Windows*, Atlantic Monthly, Mar. 1982, at 29 (describing the negative neighborhood effect

resulting from the persistence of minor disorders, such as broken windows).

The debtor's interest in property is not defined by value.

The Code does not preclude debtors from exempting their entire *interest* in property so long as the value of that interest does not exceed a specified amount at the time of the petition. *See, e.g.,* 11 U.S.C. 522(d)(1), 522(d)(2), and 522(l). In *Schwab v. Reilly*, 130 S. Ct. 2652 (2010), the Supreme Court directed debtors to indicate their intention to exempt interests in their entirety (as opposed to a portion of their interest) by stating the value of the exemption as "full fair market value" or "100% of FMV." Once exempted using this language, the debtor's entire interest in the property is withdrawn from the estate. *See Owen v. Owen*, 500 U.S. 305, 11 S.Ct. 1833 (1991)("An exemption is an interest withdrawn from the estate").

II. The bankruptcy court erred in sustaining the Chapter 13 Trustee's objection to the Debtors' exemption of their property interests valued at "100% of FMV."

In this case, each Debtor has a 1/3 ***interest*** in a single-family home located in Billerica, MA (the "Billerica Property").[1] The value of the Debtors' interest in the home is listed as $92,000.00.[2] The property is encumbered by approximately $136,500.00 in liens. In accordance with *Schwab*, the Debtors,

[1] Another family member holds the remaining 1/3 interest in the property. This 1/3 interest in the property did not become property of the estate upon commencement of the case.

[2] It appears that the $92,000.00 represents the value of the home and land in total rather than the Debtors' interest alone as indicated on Schedule A.

intending to exempt their entire interest (1/3 each, not the asset) in the real property listed the value of their exemption as "100% of FMV." Similarly, the debtors sought to exempt their interest in their motor vehicle and valued the exemption at "100% of FMV." Here, there is no dispute as to what property the debtors were claiming as exempt: their 1/3 interest each in the Billerica Property and their entire interest in the motor vehicle.

The Chapter 13 Trustee objected to the claims of exemption because she believed that 1) the fair market value of the debtors' interests may exceed the statutory maximum, and 2) the 100% of FMV designation would impermissibly exempt post-petition appreciation.

A. Where the Chapter 13 Trustee believes that the value of the debtors' interest in property exceeds the maximum exemption amount, the issue is properly resolved by an evidentiary hearing.

Section 522(l) requires the debtor to file a list of property that the debtor claims as exempt under subsection (b). *See also* Fed. R. Bankr. P. 4003(a). Unless a party in interest objects, the property claimed as exempt on the list is exempt. 11 U.S.C. § 522(l). The information provided by the debtor must be sufficient to put interested parties, including the trustee, on notice as to what property the debtor in claiming as exempt. *See Schwab,* 130 S. Ct. at 2661. Bankruptcy Rule 4003 sets forth the procedure for objecting to a claim of exemption. The objecting party has the burden of proving that exemptions are not properly claimed. Fed. R. Bankr. P. 4003(c).

Here, the Chapter 13 Trustee did not allege insufficient notice as to what property Debtors are claiming as exempt. It is clear that the Debtors sought to exempt their entire 1/3 interest each in the Billerica Property and their full ownership interest in their motor vehicle. The value of the Debtors' interest in the Billerica Property and motor vehicle are listed as $92,000 and $1,455, respectively. If the Chapter 13 Trustee truly believed that the value of Debtors' entire fractional interest in the Billerica Property and their entire ownership interest in their fifteen-year old car exceeded the statutory exemption limits at the time of the petition, then she had the burden of proving at a hearing that the value exceeded the amounts specified. *See* Fed. R. Bankr. P. 4003(c). The Bankruptcy Court did not appear to sustain the Chapter 13 Trustee's objection based upon value. Indeed, any valuation issues should have been resolved properly only by an evidentiary hearing on the matter.

B. Post-petition appreciation of a fully exempt asset is not property of the estate subject to administration by the Chapter 13 Trustee.

Valuation of the debtor's interest in property is determined as of the date of the petition. 11 U.S.C. § 522(a)(2); *see Cunningham*, 513 F.3d at 324; *Polis*, 217 F.3d at 902. As a result, any appreciation in exempt property inures to the benefit of the debtor, not creditors. *See id.* By contrast, post-petition appreciation of non-exempt assets is property of the estate, subject to debtor's potential exemption rights. 11 U.S.C. § 541(a)(6); *see Barbosa v. v. Soloman*, 235

F.3d 31 (1st Cir. 2000)(dealing with appreciation of non-exempt property). A bright-line rule in which appreciation of exempt assets inures to the debtor and appreciation of non-exempt assets inures to the estate allows the parties to proceed from the objection deadline date knowing which property is property of the estate and which property belongs to the debtor. *See In re Peterman*, 358 B.R. 801, 804 (Bankr. D. Colo. 2006) (citations omitted). From that day forward, the debtor "can treat exempted property as his or her own and is not forced to wait until some unknown future date when the trustee or another party in interest might haul the debtor into court seeking that property." *Id.*

As Judge Posner noted in *Polis*,

> If the assets sought to be exempted by the debtor were not valued at a date early in the bankruptcy proceeding, neither the debtor nor the creditors would know who had the right to them. So long as the property did not appreciate beyond the limit of the exemption, the property would be the debtor's; if it did appreciate beyond that point, the appreciation would belong to the creditors.

217 F.3d at 903. Such a system would hardly promote the finality contemplated by Rule 4003 and mandated by *Schwab*, where the Court continued to extol the importance of "the expeditious and final disposition of assets." *Schwab,* 130 S. Ct. at 2668. The Supreme Court has explicitly condoned using the terms "100% of FMV" or "full fair market value" where the debtor's entire interest at the time of the petition is valued at less than the applicable exemption limit. Further, there would be little point in the Supreme

Court's suggestion of valuing exemptions at "100% of FMV" if such a claim of exemption were not permitted under the Bankruptcy Code.

The bankruptcy court's decision below leads to a situation in which debtors never have the certainty of knowing whether or not they may keep exempted property until the case had ended. This is so because under the bankruptcy court's decision, if the property appreciated during the life of the case, the trustee could sell the property at any time to recover any post-petition appreciation for the benefit of the estate. Such a result was specifically rejected in *Schwab*. *Id.* (refuting debtor's claim and dissent's critique that the disposition of the property would be uncertain under the methodology outlined in the majority's opinion).

III. *Barbosa v. Soloman* is inapposite because the debtors did not exempt the investment property that was the subject of the controversy.

In *Barbosa v. Soloman*, 235 F.3d 31 (1st Cir. 2000), the First Circuit Court of Appeals addressed whether the proceeds from the sale of ***non-exempt*** investment property were property of the estate. *See In re* Barbosa, 236 B.R. 540, 542 n.1 (Bankr. D. Mass. 1999)("Debtors did not claim an exemption in this property"). In that case, the debtors' investment property was sold after confirmation at a price significantly higher than the value listed in their

schedule of assets. The chapter 13 trustee moved to modify debtors' confirmed plan to compel debtors to increase the distribution to unsecured creditors. The legal issue in the case involved the relationship between the vesting provisions of section 1327(a) and section 1306, which deals with property acquired post-petition. The case did not address the post-petition appreciation of exempt property. *Barbosa* does not stand for the proposition that a chapter 13 trustee could force the sale of debtors' exempt property in order to capture additional value that may have accrued over the life of the case. *Cf. In re Trumbas,* 245 BR 764 (Bkrtcy.D.Mass. 2000) (denying creditor's motion to modify plan post-confirmation to capture increase in value of property where sale or refinancing of the property was no longer contemplated by the debtor).

More to the point, the First Circuit Court of Appeals considered the issue of post-petition appreciation of exempt property in *In re Cunningham*, where it held that proceeds from the sale of exempt property retained exempt status and were not available to satisfy a judgment creditor's prepetition debt. There the court noted that section 522(c) states that "property exempted under this section is not liable during or after the case for any debt of the debtor that arose…before the commencement of the case." 11 U.S.C. § 522(c); *Cunningham*, 513 F.3d at 323-24. Though the sale of the property in *Cunningham* occurred after the termination of the debtor's bankruptcy case, the plain language of

section 522(c) applies equally ***during*** the case. The value of property to be exempt is measured at the time of the petition. To leave the disposition of exempt property open to be administered at virtually any time would rob debtors of any sort of meaningful finality as contemplated by Rule 4003 and *Schwab*. *Schwab,* 130 S. Ct. at 2668.

IV. *Gebhart* and *Kieta* are also inapposite.

In *In re Gebhart*, 621 F.3d 1206, 1208 (9th Cir. 2010), the debtors filed a petition for relief under chapter 7. The debtor claimed a homestead exemption in the amount of $89,703, which represented the difference between the market value of the home and the mortgages which encumbered it. The trustee failed to object to the homestead claim within the period allowed by Rule 4003. *Id.* This factual scenario is identical to that in *Schwab*, where the Supreme Court held that listing an exemption as a certain dollar amount limited the debtor in the future to that dollar amount. *See Gebhart*, 621 F.3d at 1210 n.4 (noting that the *Gebhart* facts did not present the situation where the full value of the property at the time of filing is equal to or less than the specified monetary amount). In accordance with *Schwab*, the Ninth Circuit held that the debtor's exemption was limited to the dollar amount claimed, not the entire property, and that the trustee maintained the ability to administer the property at a later date if the debtor's equity exceeded the specific dollar amount exempted.

Gebhart differs from this case in which the debtor did not list an exemption for a certain dollar amount, but rather listed the value of the exemption as "100% of FMV" as the Supreme Court instructed when the debtor intends to exempt his or her entire interest in the property.

In her objection, the Chapter 13 Trustee cited *In re Keita*, 315 B.R. 192 (Bankr. D. Mass. 2004) for the proposition that post-petition appreciation belongs to the estate. *Kieta* is not relevant to the issue before this Court because there the confirmation order, rightly or wrongly, stated that post-petition appreciation of estate property would remain property of the estate. *Id.* at 196. The court did not have to address any statutory issues as it simply applied the language in the confirmation order. The court held that the language of the confirmation order precluded the debtor from retaining the benefits of post-petition appreciation in her real property.

Conclusion

By permitting the debtor to retain those property interests essential to going forward, exemptions are fundamental to a bankruptcy debtor's fresh start. The trustee had sufficient notice of the property debtors claimed as exempt. To the extent the trustee challenged the value of that property as of the petition date, she had the burden of proving its value at an evidentiary hearing. Further, because the value of the debtors' interests in the Billerica

property and the motor vehicle were less than the permitted amount at the time of the petition, those interests would be withdrawn from the property of the estate. The trustee is not entitled to post-petition appreciation on such assets. The bankruptcy court's decision to the contrary is inconsistent with the Code, the Federal Rules of Bankruptcy Procedures and the Supreme Court's recent opinion in *Schwab*. All of which promote the "the expeditious and final disposition of assets" over plodding uncertainty.

For these reasons, the decision of the Bankruptcy Court should be reversed.

Respectfully submitted,

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By its attorney.

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CERTIFICATE OF SERVICE

I hereby certify that I served this Amicus Curiae Brief of the National Association of Consumer Bankruptcy Attorneys on counsel for all parties, electronically through the ECF System, on this 18th day of October 2011.

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