UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF COLORADO
Bankruptcy Judge Joseph G. Rosania, Jr.

In re: JOSEPH SEROTA KLEIN, SSN: xxx-xx-8800, MICHELE DIANE WARREN SSN: xxx-xx-6482 Debtors.	 Case No. 17-19106-JGR Chapter 13

OPINION AND ORDER

THIS MATTER is before the Court on the Motion for Turnover of Sale Proceeds and Modification of Confirmed Chapter 13 Plan filed by the Chapter 13 Standing Trustee Adam M. Goodman on November 17, 2021 (Doc. 69) and the Debtors' Objection to Trustee's Motion to Modify, filed on December 8, 2021 (Doc. 71). On January 13, 2022, the Court held a preliminary hearing on the matter and requested the parties to file briefs on the issues.

On February 14, 2022, the parties filed a Statement of Stipulated Fact Relating to the Chapter 13 Trustee's Motion for Turnover of Sale Proceeds and Modification of Confirmed Chapter 13 Plan, and the Debtors' Objection Thereto (Doc. 83). The Chapter 13 Trustee filed his brief in support of Motion for Turnover of Sale Proceeds and Modification of Confirmed Chapter 13 Plan on February 22, 2022 (Doc. 84). The Debtors' opposition brief was filed on February 28, 2022 (Doc. 86).

On April 28, 2022, the Court heard oral argument from the parties and took the matter under advisement.

The Court has jurisdiction over this core proceeding under 28 U.S.C. §§ 1334, 157(a), and 157(b)(2)(E), and 157(b)(2)(L), and 157(b)(2)(O).

It is astonishing that, more than 42 years after the enactment of the Bankruptcy Reform Act of 1978, there are five judicial interpretations of what constitutes post-confirmation property of a Chapter 13 estate. Here, the Court is tasked with applying one of the interpretations.

BACKGROUND

Joseph Serota Klein ("Klein") and Michele Diane Warren ("Warren") (collectively "Debtors") filed a Voluntary Petition for Relief under Chapter 13 of the Bankruptcy Code on September 27, 2017 (Doc. 1). The Debtors scheduled $299,197.37 of non-priority unsecured debt, of which approximately $248,897 was nondischargeable unsecured student loan debt. Klein derives his income through providing counseling services from the operation of Joseph S. Klein MA LPC, LLC. Warren is an aesthetician and operates a sole proprietorship known as Face of the Goddess. Question 4 of the Debtors' statement of financial affairs reported gross income from the operation of the businesses in the amount of $38,690 during 2017, $44,441 during the 2016 calendar year, and $55,308 during the 2015 calendar year. In question 5, both Debtors reported the receipt of monthly Social Security benefits and Klein reported real estate income in the amount of $674 for 2016 and $620 for 2015. The Debtors scheduled a home without non-exempt equity and two fully secured vehicles. Initially, the Debtors listed non-exempt equity in firearms and miscellaneous bank account balances. The Debtors also listed non-exempt value in Joseph S. Klein MA LPC, LLC of $1,350 and the value of a 12.9% interest in Albion, LLC, a closely held entity that owned a six-office building at 1503 Yarmouth Avenue, Boulder, CO 80403 in the discounted amount of $6,000.

The Debtors initially proposed a 36-month plan (Doc. 2) with monthly payments of $887.17, for a total of $31,938.12. The plan dispersed $16,466.59 on account of the secured vehicle claims and a total of $8,188.61 to general unsecured claims, plus attorney's fees and administrative expenses. The amount payable to the unsecured creditors was $0.49 higher than the Chapter 7 reconciliation reflected would be paid in a liquidation. The Trustee filed an objection to the plan (Doc. 18), raising, among other things, the calculation of the applicable commitment period and the valuation of the Albion, LLC interest.

The Debtors' First Amended Chapter 13 Plan (Doc. 24) provided for a repayment term of 38-months, with three initial monthly payments of $591.45, followed by 35 monthly payments of $887.17 for a total of $32,825.30.The plan proposed a payment to the IRS for priority taxes in the amount of $2,053.33, total payments of $15,527.04 on account of the secured vehicle claims, and a total of $6,873.28 to general unsecured claims ($738.49 more than reflected in the Chapter 7 reconciliation), plus attorney's fees and administrative expenses. Again, the Trustee objected to the plan (Doc. 27), raising, among other things, the calculation of the applicable commitment period and the valuation of the Albion, LLC interest.

The Debtors' Second Amended Chapter 13 Plan (Doc. 31) was accompanied with an Amended Schedule A/B (Doc. 33). The Amended Schedule A/B increased the valuation of Warren's interest in Albion, LLC to $15,000.

In addition, an Amended Chapter 13 Statement of Your Current Monthly Income and Calculation of Commitment Period (Doc. 34) and Chapter 13 Calculation of Your Disposal Income (Doc. 35) were filed. The Debtors changed the applicable commitment period to five years. The change resulted from removing ordinary and necessary operating expenses from the net income of Mr. Klein's business on the statement of monthly income and corresponding calculation of commitment period. The calculation of monthly income excludes the Social Security benefits.

The calculation of disposable income was negative after deducting Mr. Klein's allowable business expenses. Because the monthly disposable income was negative ($-1,247.24), the Debtors' new plan could be confirmed as long as general unsecured creditors would receive more than they would in a hypothetical Chapter 7 reconciliation.

The new plan provided for payments over 60 months: the first five monthly payments in the amount of $887 per month followed by 55 monthly payments of $675 for a total of $41,560.00 Despite the negative disposable income calculation, the Debtors proposed to fund the new plan through the contribution of otherwise exempt monthly Social Security benefits (Klein, $1,200 and Warren, $776) (Doc. 1 at Schedules I, J). The new plan provided for the payment of attorney's fees; administrative expenses; the priority IRS tax claim in the amount of $2,053.33; the cure of a household arrearage in the amount of $129.95; payments on the secured vehicle claims in the total amount of $16,146.88; and total payments to general unsecured creditors in the amount of $14,984.84, recognizing the new, higher liquidation valuation of Albion, LLC. The amount payable to the unsecured creditors was $50.05 higher than the Chapter 7 reconciliation reflected would be paid in a liquidation. The Trustee once again objected to the new plan, contesting the valuation of the Albion, LLC interest (Doc. 38).

VALUATION OF ALBION, LLC

The Debtors initially valued Warren's 12.9% interest in Albion, LLC in the amount of $6,000. The interest was described as follows:

> Albion, LLC - single asset real state LLC, owns six-office building at 1503 Yarmouth Ave., Boulder, CO 80304, with an approximate FMV of $700,000 and subject to a $178,000 mortgage. Other members are all therapists and membership agreement restricts transfer of interest and membership. Valuation based on not readily alienable interest / lack of market interest in membership.

The Debtors' Amended Schedule A/B increased the value of the interest in Albion, LLC to $15,000.00. The description of the interest remained unchanged. Prior to the marketability discount, the value of the interest would have been approximately $67,338 (($700,000-$178,000) x 12.9%).

The Trustee's objections to confirmation consistently challenged the Debtors' reduction in the LLC's value for marketability. Eventually, the Court scheduled an evidentiary hearing on the issue. In preparation for the evidentiary hearing, the Debtors sought, and the Trustee consented, to the allowance of additional time for the Debtors to seek an expert opinion regarding the marketability discount. The Debtors obtained and provided an opinion letter from a Chapter 7 Panel Trustee regarding the liquidation value of the Albion, LLC interest in the amount of $15,000. Thereafter, the Trustee withdrew his objection, and an Order of Confirmation of Debtors' Second Amended Chapter 13 Plan was entered by the Court on June 22, 2018 (Doc. 52).

THE MOTION FOR TURNOVER OF PROCEEDS AND MODIFICATION OF THE PLAN

Approximately three years later, the Trustee sought to verify the Debtors' current household income and expenditures. The Trustee requested various financial information, including bank statements. In May 2021, the Debtors' bank statements reflected the receipt of $76,405 in proceeds from the sale of the Albion, LLC's office building attributable to the 12.9% interest in Albion, LLC. As a result, the Trustee filed his Motion for Turnover of Sale Proceeds and Modification of Confirmed Chapter 13 Plan (Doc. 69). The Trustee sought the entry of an order requiring the turnover of the proceeds and the modification of the plan to provide for the payment of the same.

The Debtors objected (Doc. 71), arguing the interest in Albion, LLC vested in the Debtors upon confirmation of the plan. The Debtors argue the interest in Albion, LLC was appropriately disclosed, the discounted valuation was accepted by the Trustee, and the interest revested with the Debtors upon confirmation. The Debtors argue the sale proceeds did not constitute property of the estate, are not required to be turned over, and the request for modification of the plan should be denied.

The Court conducted a preliminary hearing on the dispute and requested the parties to brief the matter. In connection with the briefing schedule, the parties submitted stipulated facts (Doc. 83) that, in relevant part, included:

> Mr. Klein operated his business out of commercial property located at 1503 Yarmouth Avenue, Boulder, CO 80304 ("Commercial Property"). The Commercial Property was owned by a business entity called Albion, LLC. Amended Schedule A/B (Docket no. 33) states that Debtors had a 12.9% interest in Albion, LLC and valued their interests at $15,000. Trustee objected to Debtor's valuation of the interest in Albion, LLC (Docket no. 38). Debtor obtained an opinion letter regarding the valuation of Mr. Klein's interest in the LLC from a Chapter 7 Panel Trustee and turned over the opinion letter to the Trustee on June 14, 2018. Shortly after receipt of the opinion letter, on June 20, 2018, the Trustee withdrew his objection to confirmation (Docket no. 50). The Court confirmed Debtors' plan on June 22, 2018 (Docket no. 52).

The parties additionally stipulated that the Debtors transferred $15,000 of the sale proceeds to their adult daughter, who was not listed as a creditor in the Debtors' bankruptcy case.

Resolution of the dispute requires an examination of the interplay between 11 U.S.C. § 1306 and 11 U.S.C. § 1327.

ANALYSIS

Individuals faced with the need to seek bankruptcy relief can generally choose between two fundamentally different processes. Under Chapter 7, debtors can obtain a so-called "fresh start" by receiving a discharge of most debts. In exchange, they must agree to the liquidation of any assets that are not otherwise protected by applicable exemptions. The process moves quickly, and in most cases, debtors will receive an order of discharge within approximately four months after filing the bankruptcy case.

Alternatively, Chapter 13 allows individual debtors to restructure debt through a repayment plan. Typically, plans last from three years to five years and, provided the payments exceed the value of non-exempt assets, debtors are not required to liquidate property. Under 11 U.S.C. § 541, the commencement of a bankruptcy case creates an estate generally comprised of all legal or equitable interests of the debtor in property measured on the date the case was filed (subject to certain exceptions). In a case under

Chapter 13, a debtor must file a plan that commits the payment of future earnings to a trustee in excess of the value of non-exempt property of the estate. This is commonly referred to as "the best-interest-of-creditors" test. The trustee, in turn, pays creditors according to the terms of a confirmed plan.

11 U.S.C. § 1325(a)(4) requires a plan to provide that: "the value, as of the effective date of the plan of property to be distributed under the plan on account of each allowed unsecured claim is not less than the amount that would be paid on such claim if the estate of the debtor were liquidated under Chapter 7 of this title on such date." Accordingly, if future earnings contributed to the plan exceed the value of non-exempt assets, debtors can retain property that would be liquidated in a Chapter 7 bankruptcy case.

Because future earnings are required to fund a plan, property of the estate is augmented in Chapter 13 under 11 U.S.C. § 1306 - Property of the Estate, which provides:

> (a) Property of the estate includes, in addition to the property specified in section 541 of this title—
>
> (1) all property of the kind specified in such section that the debtor acquires after the commencement of the case but before the case is closed, dismissed, or converted to a case under chapter 7, 11, or 12 of this title, whichever occurs first; and
>
> (2) earnings from services performed by the debtor after the commencement of the case but before the case is closed, dismissed, or converted to a case under chapter 7, 11, or 12 of this title, whichever occurs first.
>
> (b) Except as provided in a confirmed plan or order confirming a plan, the debtor shall remain in possession of all property of the estate.

Conversely, 11 U.S.C. § 1327 provides:

> (a) The provisions of a confirmed plan bind the debtor and each creditor, whether or not the claim of such creditor is provided for by the plan, and whether or not such creditor has objected to, has accepted, or has rejected the plan.
>
> (b) Except as otherwise provided in the plan or the order confirming the plan, the confirmation of a plan vests all of the property of the estate in the debtor.

(c) Except as otherwise provided in the plan or in the order confirming the plan, the property vesting in the debtor under subsection (b) of this section is free and clear of any claim or interest of any creditor provided for by the plan.

The question presented in this case is whether proceeds received by the Debtors from the sale of prepetition property of the estate should be contributed to their Chapter 13 plan.

This Court previously addressed the treatment of pre-petition property of a Chapter 13 estate in the case of *In re Froelich.*[1] The *Froelich* case involved a situation where the debtors, in an effort to save their home, converted a Chapter 7 case to Chapter 13 after the Chapter 7 Trustee initiated efforts to liquidate non-exempt equity in their residence.

The debtors' plan provided that the residence would revest in the debtors upon confirmation. The Chapter 13 Trustee objected, maintaining the house should remain property of the estate to preserve any non-exempt equity in the event the case was converted back to Chapter 7. The Court confirmed the debtors' plan, including the revesting provision. In examining what constitutes property of the estate after confirmation of a Chapter 13 Plan, the Court looked to various approaches previously discussed in the case of *Sender v. Golden*, 528 B.R. 803, 807 (Bankr. D. Colo. 2013): (i) estate preservation; (ii) modified estate preservation; (iii) estate transformation; and (iv) estate termination. *Golden* involved an attempt by a Chapter 7 Trustee to recover proceeds from the sale of a debtor's residence sold after confirmation of a debtor's Chapter 13 plan, but prior to conversion of the case to Chapter 7.

Golden and *Froelich* both adopted the estate termination theory, concluding that property vested with the debtors upon confirmation was no longer property of the estate, and cited to the case of *United States v. Richman (In re Talbot)*, 124 F.3d 1201 (10th Cir. 1997) (recognizing the estate termination theory is consistent with the revesting requirements of 11 U.S.C. § 1327).

The issue of revestment of property was recently analyzed by Judge Brown in the case of *In re Baker*, 620 B.R. 655 (Bankr. D. Colo. Sep. 29, 2020). In *Baker*, the debtor claimed a residence as exempt. However, after the debtor's Chapter 13 plan was confirmed, the debtor sold the house and realized $86,000 in net proceeds. The net proceeds were $11,000 greater than Colorado's Homestead Exemption. This created a

[1] The unpublished opinion can be found at *In re Froelich*, 2018 WL 4693928, *In re Froelich*, No. 17-14231-JGR, 2018 Bankr. LEXIS 2984 (Bankr. D. Colo. Sep. 27, 2018).

question as to how the non-exempt home sale proceeds should be classified and whether they were property of the estate, or property of the debtor under conflicting language in 11 U.S.C. §§ 1306 and 1327. Both the debtor and trustee sought to modify the Chapter 13 plan but differed on the treatment of the proceeds from the sale of the debtor's house.

The trustee, citing C.R.S. § 38-41-207 (2021), argued that the debtor was only entitled to retain the sale proceeds protected under the Colorado Homestead Exemption. The trustee argued that the $11,000 of non-exempt home sale proceeds was the property of the estate and could be used to pay creditors under 11 U.S.C. § 1306(a)(1) as property acquired after the commencement of the case.

The trustee also argued that not specifically allocating the non-exempt home sale proceeds to an amended plan violated 11 U.S.C. § 1325(a)(4)'s best-interest-of-creditors test and (a)(3)'s good faith requirement.

The debtor, meanwhile, argued that the non-exempt home sale proceeds belong to the debtor according to the language of 11 U.S.C. § 1327(b) that, "Except as otherwise provided in the plan or the order confirming the plan, the confirmation of a plan vests all of the property in the estate in the debtor."

The Trustee here, employing the same arguments as the trustee in *Baker*, argues for the adoption of a fifth approach, the estate replenishment approach endorsed by the First Circuit in *In re Barbosa*, 236 B.R. 540 (Bankr. D. Mass. 1999), *aff'd sub nom. Barbosa v. Solomon*, 243 B.R. 562 (D. Mass. 2000), *aff'd*, 235 F.3d 31 (1st Cir. 2000).

The estate replenishment theory provides that at confirmation, all property of the estate becomes property of the debtor; the Chapter 13 estate continues to exist and "refills with property defined in 11 U.S.C. § 1306 that is acquired after confirmation without regard to whether the property is necessary to the performance of the plan." *Baker*, 620 B.R. at 663. Implicit in the estate replenishment theory is a continued revaluation of estate property throughout the term of the plan. *Baker* rejected that argument, adopted the estate termination theory as the only interpretation that respects the plain meaning of 11 U.S.C. § 1327(b), and allowed the debtor to retain the sale proceeds as they were no longer property of the estate. *Id.* at 667.

To address the apparent contradiction of 11 U.S.C. §§ 1306(a)(1) and 1327(b), Judge Brown determined the revesting requirement under 11 U.S.C. § 1327(b) is more specific than the general language of 11 U.S.C. § 1306(a)(1). *Id.* Moreover, the estate termination theory gives meaning to both statutes. As long as a debtor performs the obligations required of the plan, the operation of 11 U.S.C. § 1306(a) serves to protect acquired assets by imposing the protection of the automatic stay to the new property while allowing the disposition of prepetition property that revests with the debtor under 11 U.S.C. § 1327(a). *Id.* at 668.

Earlier this year, in the case of *Rodriguez v. Barrera (In re Barrera)*, 22 F.4th 1217 (10th Cir. 2022), the Tenth Circuit again recognized the automatic vesting provision of 11 U.S.C. § 1327(b). *Barrera* involved the sale of a residence during the pendency of a Chapter 13 case. When the debtors' Chapter 13 plan was confirmed, the value in their home was exempt. After confirmation, the home appreciated in value and was eventually sold, generating significant non-exempt proceeds. After the sale, the debtors converted the case to Chapter 7. The Chapter 7 trustee sought to recover the proceeds as property of the estate.

Barrera concentrated on the effect of conversion of a Chapter 13 case. Under 11 U.S.C. § 348(f)(1)(A): "property of the estate in the converted case shall consist of property of the estate, as of the date of filing of the petition, that remains in the possession of or is under the control of the debtor on the date of conversion." The Tenth Circuit focused on the distinction between the home itself and the proceeds from its sale. *Barrera* held the proceeds did not exist when the petition was filed, so they could not remain in the possession of the debtors at the time of conversion. *Barrera* 22 F.4th at 1223

> The automatic vesting provision of § 1327(b) supports our conclusion that the proceeds from the sale of the Debtors' house are not included in the Chapter 7 estate. Under § 541(a)(6), only proceeds "of or from property of the estate" become property of the bankruptcy estate. In a typical Chapter 13 case, this provision is operative only before confirmation of the Chapter 13 plan because confirmation "vests all of the property of the estate in the debtor." Id. § 1327(b). Thus, proceeds generated from the debtor's property after confirmation do not become property of the estate as the underlying property no longer belongs to the estate.

Id.

The Tenth Circuit acknowledged the potential conflict between 11 U.S.C. § 1306(a) and 11 U.S.C. § 1327(b) but declined to address the question of whether the proceeds would constitute property of the Chapter 13 bankruptcy estate in the absence of conversion. *Id.* at n.3.

Several bankruptcy courts within the Tenth Circuit have adopted the estate termination approach with respect to the disposition of prepetition property, as is illustrated by the cases of *Froelich*, *Golden*, and *Baker*. Each case involved the sale of a residence and mirrored the holding of *McDonald v. Burgie (In re Burgie)*, 239 B.R. 406 (B.A.P. 9th Cir. 1999). The Ninth Circuit B.A.P. characterized the house as a prepetition capital asset and held proceeds from the sale did not represent disposable income.

> The proceeds of the sale of a debtor's real estate in a chapter 13 case never become disposable income for the purposes of chapter 13. This result applies in a chapter 13 case whether or not the property is exempt from execution. While a debtor may voluntarily use such proceeds to make payments to creditors under a chapter 13 plan, a debtor cannot be compelled to use the proceeds for this purpose.

Id. at 409.

Nevertheless, the Trustee argues that the facts of this case are distinguishable because the proceeds were not generated from the sale of a partially exempt residence, but from a business entity. Moreover, the Trustee argues that, "Debtor's acquisition of sale proceeds is intrinsically intertwined with Mr. Klein's employment and generation of income." (Doc. 84, page 11).

The Trustee looks to *Berkley v. Burchard (In re Berkley)*, 613 B.R. 547 (B.A.P. 9th Cir. 2020), to argue the sale proceeds should constitute property of the Chapter 13 bankruptcy estate. *Berkley* involved the liquidation of stock options that were acquired post-petition as part of the debtor's compensation package from employment that was also acquired post-petition. The case is distinguishable as the stock option proceeds were not generated from the sale of prepetition assets.

The Trustee also relies on *In re Solis*, 172 B.R. 530 (Bankr. S.D.N.Y. 1994). *Solis* did involve the sale of a prepetition asset, the debtor's medical practice. Less than a month after confirmation of his Chapter 13 plan, Dr. Solis contracted to sell his medical practice. The plan contemplated paying unsecured creditors a dividend of approximately 10% from income generated through the post-petition operation of the practice. The plan did not contemplate a sale, but effectively stripped the medical practice of creditors' liens. The sale of the practice, free and clear of the liens, generated $40,000 of net proceeds, which the debtor sought to retain. *Solis* did not discuss revestment of property under 11 U.S.C. § 1327. The case is also distinguishable as the Chapter 13 process was used to manipulate the value of the debtor's business at the expense of his creditors and for his personal benefit. *Id.* at 532.

Here, the sale of the LLC interest was unrelated to the Chapter 13 proceeding. The Court takes judicial notice that the COVID-19 Pandemic changed the landscape of working environments across several industries, including the debtor's therapy profession. With the rise of remote and hybrid work, the necessity of a physical location from which to conduct business has become marginalized. The record does not reflect the sale of the LLC was initiated by the Debtors. It is reasonable to conclude the decision to sell the commercial real estate resulted from the consensus of the LLC owners in light of the new economic realities and their impact on the therapy profession.

Any other conclusion would lead to the absurd result that post-confirmation increases in asset values are required to be paid into a Chapter 13 plan while decreases in asset values do not result in a corresponding reduction of the amount paid into a Chapter 13 plan.

CONCLUSION

The asset in question here is the Debtors' 12.9% interest in Albion, LLC. The value was appropriately disclosed and reconciled in the best-interest-of-creditors test. The prepetition property interest in Albion, LLC revested with the Debtors upon confirmation. The estate termination theory applied in *Baker* and by this Court allows the Debtors to retain proceeds from the post-confirmation sale of prepetition property under the facts and circumstances of this case.

The proceeds here were generated from the sale of a business entity. The proceeds do not constitute earnings under 11 U.S.C. § 1306(a)(2).

Accordingly, it is

ORDERED that the Motion for Turnover of Sale Proceeds and Modification of Confirmed Chapter 13 Plan is DENIED.

Dated this 23rd day of August, 2022.

BY THE COURT:

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Joseph G. Rosania, Jr.
United States Bankruptcy Judge