

Postpetition Property Issues in Consumer Cases

This outline is intended to provide an overview of recent developments in the law regarding postpetition issues that may arise in consumer cases. Specifically, short sales involving the chapter 7 trustee, abandonment of assets and appreciation of property in chapter 13 cases.

A. Short sales of residences and other property.

ISSUE:

Recent trend is for a chapter 7 trustee to work with a lender to liquidate property that would otherwise not have equity for the bankruptcy estate. Through use of a “carve out,” a trustee is able to generate a dividend and in some instances has been able to avoid the debtor’s exemption altogether under the theory that the secured creditor is voluntarily giving up part of its security.

1. Trustee may still sell a fully encumbered asset

- General rule, trustee should abandon an asset of inconsequential value to estate. *In re KVN Corp., Inc.*, 514 B.R. 1, 5-6 (9th Cir. BAP 2014)(citing U.S. DOJ Exec. Office for U.S. Trs., Handbook for Chapter 7 Trustees at 4-16 (2012)). The Trustee Handbook does recognize that carve-out arrangements are permissible in certain circumstances. Handbook for Chapter 7 Trustees at 4-7. Where the trustee is able to negotiate a carve-out agreement and short sale of encumbered property that agreement creates a rebuttable presumption of impropriety because of the risk that the trustee is merely acting as a liquidating agent for the secured creditor. *KVN Corp.*, 514 B.R. at 7.
- Property is not protected simply because it is encumbered. A sale may be allowable in certain instances but generally requires a showing of “meaningful distribution to the creditors.” *In re Christansen*, No. 15-29783, 2016 Bankr. LEXIS 4312 at *14-15 (Bankr. D. Utah Dec. 14, 2016); *In re All Island Truck Leasing Corp.*, 546 B.R. 522, 532 (Bankr. E.D.N.Y. 2016). Although not a term defined by the Code, a “meaningful

distribution” is ordinarily one that generates more for unsecured creditors than what is consumed by trustee’s fees. *In re Scoggins*, 517 B.R. 206, 208 (Bankr. E.D. Cal. 2014).

- Even where the sale itself is approved that does not grant the trustee and other professionals *carte blanche* to bill against the proceeds. *See, e.g., In re Greathouse*, No. 15-40666-BDL, ECF No. 36 (Bankr. W.D. Wash. May 20, 2015)(denying certain proposed fees in application to employ such as ‘buffer fees’ and ‘short sale facilitation fee’).

2. Can the Debtor Exempt the Short Sale Proceeds?

- Key concern, especially with residential real property, is whether the Debtor may exempt the funds generated by the carve out?
- The court in *Christensen* determined that a debtor may exempt the “value” created by a secured creditor voluntarily capping the security interest in the subject property. 2016 Bankr. LEXIS 4312 at *26-31. In an oft-cited case, the Ninth Circuit concluded that the value of an exemption is fixed on the date of the petition. *In re Hyman*, 967 F.2d 1316, 1321 (9th Cir. BAP 1992). What *Hyman* did not say is that a debtor is not entitled to claim any value in a subsequent sale made pursuant to ss. 363. Nevertheless, it remains unclear in the Ninth Circuit whether a debtor may exempt short sale proceeds. Compare *In re Bunn-Rodemann*, 491 B.R. 132, 136 (Bankr. E.D. Cal. 2013)(no right to exempt ‘incentive payment’ from secured creditor) and *Baldridge v. Ellmann (In re Baldridge)*, 553 F. App’x 598, 598 (6th Cir. 2014) with *In re Wilson*, 494 B.R. 502, 506 (Bankr. C.D. Cal. 2013); *In re Barfield*, No. 11-72074, 2015 Bankr. LEXIS 270, at *22 (U.S. Bankr. C.D. Ill. Jan. 29, 2015).

B. Abandonment

ISSUE: An oft-cited tool for the debtor to deal with recalcitrant trustees or improper delay is the power of the court to order a trustee abandon assets. 11 U.S.C. § 554(b) but is this a realistic tool to protect assets that the Trustee desires to sell after the date of the petition?

1. Abandonment is not routine and represents an exception rather than the rule. *Vu v. Kendall (In re Vu)*, 245 B.R. 644, 647 (9th Cir. BAP 2000). Where property is of inconsequential value to the estate, the Manual for

Chapter 7 Trustees ordinarily requires the trustee to abandon the asset. U.S. DOJ Exec. Office for U.S. Trs., Handbook for Chapter 7 Trustees at 4-16 (2012). Counsel for a debtor should be prepared to file an abandonment motion where it appears that the trustee is merely “churning” the estate or is otherwise failing to act. *Christensen*, 2016 bankr LEXIS 4312 at *10-11; *In re K.C. Mach. & Tool Co.*, 816 F.2d 238, 246 (6th Cir. 1987).

2. In the case of a short sale, some courts conclude that where no equity exists in the subject property it is not property of the estate. *See, e.g., In re Baldrige*, 553 F. App'x at 598. If this is true, there is no means to force abandonment of what the estate does not have. However, if an asset is not estate property then why is the trustee selling it?

3. In the Ninth Circuit, where an exemption is in the value of property and not the property itself, a debtor is not able to take the entire asset out of the estate with an exemption. *Alsberg v. Robertson (In re Alsberg)*, 68 F.3d 312, 314-15 (9th Cir. 1995). Where a debtor remains silent in the face of a rising market the risk exists that equity above the exemption will allow a trustee to sell the asset. *Klein v. Chappell (In re Chappell)*, 373 B.R. 73, 81 (B.A.P. 9th Cir. 2007) *aff'd Gebhart v. Gaughan (In re Gebhart)*, 621 F.3d 1206, 1210 (9th Cir. 2010) (trustee entitled to sell residence to capture postpetition appreciation where debtors ‘took no action to extricate their property from the estate’ for two years).

C. Postpetition Appreciation

ISSUE: Given the continual rise in the real estate market what does a consumer attorney need to watch out for postpetition?

1. Consider claiming the full exemption in the initial schedules. Depending on how long it takes the chapter 7 trustee to administer the estate, a debtor could be faced with a substantial loss of apparent equity in a rising real estate market.

- In a chapter 7 the postpetition appreciation is often covered by the debtor’s exemption which takes § 541 property out of the bankruptcy estate. However, the exemption right arises on the petition date and represents the ability to exempt value, not a specific asset. *In re Hyman*, 967 F.2d 1316, 1321 (9th Cir. BAP 1992). Therefore, appreciation over and above the exemption amount belongs to the bankruptcy estate. *Schwaber v. Reed (In re Reed)*, 940 F.2d 1317, 1323 (9th Cir. 1991); *Gebhardt v. Gaughan (In re Gebhardt)*, 621 F.3d 1206, 1211 (9th Cir. 2010).

Key to the *Gebhardt* holding was that the asset remained in the bankruptcy estate with the debtor's exemption only applicable to a certain amount of value in the asset and not the asset itself. *Gebhardt*, 621 F.3d at 1210.

2. In a case with significant implications for our district, the Court recently declined to allow a debtor to amend her exemptions in order to claim the Washington State homestead where she had originally claimed an exemption of \$3,560 under the federal exemption scheme. *In re Wilson*, No. 13-20904-CMA (Bankr. W.D. Wash. Oct. 25, 2016), *appeal docketed*, No. 2:16-cv-01684-RAJ (W.D. Wash. Nov. 10 2016). Citing *Gebhardt*, The trustee argued that Ninth Circuit precedent required the Court to fix the value of the debtor's exemption at filing with any postpetition appreciation benefitting the bankruptcy estate without the ability for the debtor to amend the exemptions.

- If confronted with the facts of *Wilson* the Ninth Circuit may limit the reach of its holding in *Gebhardt* to the relatively unremarkable proposition that an exemption in the value of an asset is not the same as exempting the asset itself. This should not prevent a debtor from amending an exemption claim to recognize the full amount allowed by statute. "While postpetition appreciation in value of property inures to the benefit of the estate, the estate's interest in the appreciation must be limited by the ability of the debtors to obtain the maximum value of their federal exemptions." *Chappell*, 373 B.R. at 81-82, at n. 7 *aff'd Gebhart v. Gaughan* (*In re Gebhart*), 621 F.3d 1206, 1210 (9th Cir. 2010); *Mwangi v. Wells Fargo Bank, N.A.* (*In re Mwangi*), 764 F.3d 1168, 1176 n.4 (9th Cir. 2014) (*Gebhardt* is an exception to the general rule that exempt property reverts in the debtor).

3. Consider the implications of section 1326 when advising clients about post-confirmation changes in a chapter 13 case.

- Another concern is to what extent postpetition appreciation belongs to the estate in a chapter 13. Unlike in a chapter 7, the Code provisions in chapter 13 expressly provide for the revestment of property upon confirmation of a plan. 11 U.S.C. §§ 1322(b)(9) & 1327(b). The question of postpetition appreciation will likely depend not only on whether the asset is pre- or postpetition, but whether the asset existed preconfirmation and was therefore dealt with by the confirmed plan. *In re Shay*, 553 B.R. 412, 420 (Bankr. W.D. Wash. 2016). Equity developed through plan payments to a secured creditor in a plan likely

belongs exclusively to the debtor while new assets that come into the estate postconfirmation through 11 U.S.C. § 1306 may instead become subject to the modification provisions in the Code.