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# Schwab v. Reilly: An Exemption from the Duty to Object to Exemptions

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## ***SCHWAB V. REILLY: AN EXEMPTION FROM THE DUTY TO OBJECT TO EXEMPTIONS***

*Anna Do\**

### I. INTRODUCTION

Pursuant to the Bankruptcy Code (the “Code”), upon the filing of a Chapter 7 bankruptcy petition, the debtor’s assets automatically become property of the bankruptcy estate.<sup>1</sup> The assets are then liquidated in order to pay the debtor’s prepetition creditors.<sup>2</sup> In exchange, the debtor is discharged from his or her debts owed and is afforded a “fresh start.”<sup>3</sup> However, § 522 of the Code permits a debtor to exempt certain property from the bankruptcy estate.<sup>4</sup> Exemptions are critical because they allow debtors to rise out of bankruptcy with enough assets to achieve a fresh start.<sup>5</sup> So long as a party in interest does not object to the claim of exemption within thirty days of the conclusion of the meeting of creditors, such property is protected from the trustee’s and creditors’ reach.<sup>6</sup>

In 1992, in *Taylor v. Freeland & Kronz*<sup>7</sup> the U.S. Supreme Court

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\* J.D. 2011, Loyola Law School Los Angeles. I wish to thank Professor Anne Wells for her guidance on this Comment. I would also like to thank the Honorable Samuel L. Bufford and his former law clerk, Daria K. Boxer, for their support in my endeavors and for instilling in me the desire to learn about bankruptcy law.

1. 11 U.S.C. § 541 (2006).

2. *See id.* § 704(a)(1).

3. *See id.* § 727(b); *Local Loan Co. v. Hunt*, 292 U.S. 234 (1934), *superseded by statute*, 11 U.S.C. §§ 522, 541. By allowing creditors to take the debtor’s prepetition assets and discharging the debtor from his or her prepetition claims, the debtor is given “a new opportunity in life and a clear field for future effort, unhampered by the pressure and discouragement of pre-existing debt.” *Id.* at 244.

4. When property is declared exempt, it is not taken into account for purposes of counting up the debtor’s assets because it is no longer property of the estate. 11 U.S.C. §§ 522(b), 542.

5. 4 COLLIER ON BANKRUPTCY ¶ 522.01 (Alan N. Resnick & Henry J. Sommer eds., 16th ed. 2010) (“A fundamental component of an individual debtor’s fresh start in bankruptcy is the debtor’s ability to set aside certain property as exempt from the claims of creditors. Exemption of property, together with the discharge of claims, lets the debtor maintain an appropriate standard of living as he or she goes forward after the bankruptcy case.”).

6. FED. R. BANKR. P. 4003(b).

7. 503 U.S. 638 (1992).

addressed the issue of whether a trustee must object to a debtor's § 522 claim of exemption within the thirty-day window required by Rule 4003 of the Federal Rules of Bankruptcy Procedure ("Rule 4003").<sup>8</sup> The Court held that the trustee had to object within the thirty-day window in order to retain proceeds of a lawsuit that exceeded the amount allowed by the Code.<sup>9</sup> Since that decision, there has been a circuit split on the issue of what constitutes a claim of exemption to which an interested party must object.<sup>10</sup> Some courts have held that trustees have no duty to object to a claim of exemptions when the dollar value listed is within the range that the Code allows.<sup>11</sup> Other courts have held that trustees must timely object to such dollar-value exemptions if they wish to later sell the property at issue.<sup>12</sup> The courts in the former group reason that the debtor exempted only "an interest" in the property and that the exemption was, therefore, not objectionable so long as the dollar value was within the range permitted by the Code.<sup>13</sup> Courts in the latter group adopt the view that the debtor exempted the property itself by listing its full dollar value.<sup>14</sup> Applying the latter group's rationale, debtors could potentially receive a windfall if the dollar value listed undervalues the property at issue.

In *Schwab v. Reilly*,<sup>15</sup> the U.S. Supreme Court revisited the issue of whether a trustee must file objections within the thirty-day window in order to challenge a debtor's claim of exemption.<sup>16</sup> In short, the Court held that if a debtor lists a fixed-dollar value for a scheduled exemption of property that is within the statutorily allowed exemption amount, a trustee does *not* have a duty to object to the debtor's claimed exemption within the thirty-day window in

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8. *Id.* at 639.

9. *Id.* at 642.

10. Compare *In re Barroso-Herrans*, 524 F.3d 341, 344 (1st Cir. 2008) (holding that debtor exempted partial interests in lawsuits to the extent of the dollar amounts listed), with *In re Wick*, 276 F.3d 412, 416 (8th Cir. 2002) (holding that debtor only partially exempted options to the extent of \$3,925 in value, despite valuing the options as "unknown").

11. E.g., *In re Wick*, 276 F.3d at 416; *In re Williams*, 104 F.3d 688, 690 (4th Cir. 1997).

12. E.g., *In re Barroso-Herrans*, 524 F.3d at 344; *In re Green*, 31 F.3d 1098, 1100 (11th Cir. 1994); *In re Anderson*, 377 B.R. 865, 875 (B.A.P. 6th Cir. 2007).

13. E.g., *In re Wick*, 276 F.3d at 416; *In re Williams*, 104 F.3d at 690.

14. E.g., *In re Barroso-Herrans*, 524 F.3d at 344; *In re Green*, 31 F.3d at 1100; *In re Anderson*, 377 B.R. at 875.

15. 130 S. Ct. 2652 (2010).

16. *Id.* at 2657.

order to later sell that property.<sup>17</sup> The Court reasoned that a debtor's claimed exemption for the property's full dollar value protects only that dollar value—that is, an *interest* in the property—and not the property itself. The Court suggested that debtors who intend on exempting a property in-kind could list “full fair market value (FMV)” or “100% of FMV” rather than a fixed-dollar value as a claimed exemption.<sup>18</sup>

The outcome in *Schwab* was in accordance with both the language of the exemption-related statutes and their purposes. However, there is cause for concern with respect to the Court's suggestion that debtors list an asset's full fair market value as a claimed exemption if they wish to exempt the property itself.<sup>19</sup> This Comment discusses the implications of the *Schwab* decision and whether the Court strayed from the plain meaning of the statutory language by suggesting such a solution.

## II. STATEMENT OF THE CASE

The debtor in *Schwab*, Nadejda Reilly, earned a living from her one-person catering business.<sup>20</sup> When her catering business failed, she sought relief by filing a Chapter 7 bankruptcy petition.<sup>21</sup> William Schwab was appointed as the trustee of Reilly's bankruptcy estate.<sup>22</sup>

In accordance with the Code's requirements, Reilly filed schedules listing, among other things, assets she wished to exempt from the bankruptcy estate.<sup>23</sup> On her Schedule B form,<sup>24</sup> Reilly listed her catering business equipment as an asset and assigned to it a total value of \$10,718.<sup>25</sup> On her Schedule C form,<sup>26</sup> Reilly claimed the catering equipment as exempt pursuant to § 522(d)(5) and (6) of the

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17. *Id.* at 2669.

18. *Id.* at 2668.

19. *See id.*

20. *In re Reilly*, 534 F.3d 173, 174 (3d Cir. 2008), *rev'd sub nom.* Schwab v. Reilly, 130 S. Ct. 2652 (2010).

21. *Id.*

22. *Id.*

23. 11 U.S.C. § 521(a) (2006). The Bankruptcy Rules provide for standard schedule forms on which the debtor lists his or her assets. Debtors are to list their real estate assets on schedule A forms, other assets on schedule B forms, and claimed exemptions on schedule C forms.

24. FED. R. BANKR. P. Form 6, Schedule B (2005). The Schedule B form requires a debtor to state the type of property he or she wishes to claim as exempt and its value.

25. *In re Reilly*, 534 F.3d at 174.

26. 11 U.S.C. § 522(l); FED. R. BANKR. P. Form 6, Schedule C (2005).

Code.<sup>27</sup> By listing the property on the Schedule C form, Reilly was attempting to exempt the property from the pool of assets that the trustee would liquidate to pay creditors.<sup>28</sup> Under § 522(d)(6), Reilly was able to claim a “tool[s] of the trade” exemption<sup>29</sup> for the maximum allowable amount of \$1,850. Under § 522(d)(5), which allows for a miscellaneous or “wildcard” exemption of up to \$10,718,<sup>30</sup> Reilly exempted the equipment and assigned a value of \$8,868 to it.<sup>31</sup> Under the column labeled “Current Market Value of Property,” Reilly assigned a total value of \$10,718 to the catering equipment, and under the column labeled “Value of Claimed Exemption” Reilly also listed \$10,718.<sup>32</sup>

Subsequently an appraiser found that Reilly’s catering equipment might be worth as much as \$17,200, roughly \$7,200 over Reilly’s estimate.<sup>33</sup> Ordinarily, property exceeding the exemption available by statute can be seized and sold by a Chapter 7 trustee if “a party in interest” objects to the exemption within thirty days of the conclusion of a § 341 creditors’ meeting.<sup>34</sup> If no party objects, then the property “claimed as exempt . . . *is exempt*.”<sup>35</sup> The trustee in *Reilly* learned of this appraisal prior to the § 341 creditors’ meeting—well before the thirty-day window to object closed—but did not object.<sup>36</sup>

After the thirty days passed, the trustee moved to sell the business equipment in order to pay Reilly the amount of her claimed exemption, \$10,718, and to use the excess to pay Reilly’s creditors.<sup>37</sup> The trustee asserted that on her Schedule C form, Reilly had only signaled her intent to exempt a \$10,718 *interest* in her equipment and that she was not entitled to retain the excess value of the property as it would be a windfall resulting from Reilly’s own undervaluation of

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27. *In re Reilly*, 534 F.3d at 174.

28. *See* 11 U.S.C. § 522(b).

29. 11 U.S.C. § 522(d)(6).

30. 11 U.S.C. § 522(d)(5).

31. *In re Reilly*, 534 F.3d at 175 n.1.

32. *Schwab v. Reilly*, 130 S. Ct. 2652, 2660–61 (2010).

33. *Id.* at 2658.

34. 11 U.S.C. § 522(l); FED. R. BANKR. P. 4003(b). Generally parties in interest include creditors and the trustee.

35. 11 U.S.C. § 522(l) (emphasis added).

36. *Schwab*, 130 S. Ct. at 2658 n.2.

37. *Id.* at 2658.

the assets.<sup>38</sup> Reilly contended that by claiming the equipment's full value on the schedule—that is, by claiming the same amount listed as the equipment's full fair market value—she had put the trustee on notice that she was claiming an exemption for the equipment itself.<sup>39</sup> The bankruptcy court denied the trustee's motion on the ground that the property itself was exempt and, therefore, not property of the bankruptcy estate for the trustee to auction off.<sup>40</sup>

Appealing to the U.S. District Court for the Middle District of Pennsylvania and subsequently to the U.S. Court of Appeals for the Third Circuit,<sup>41</sup> the trustee averred that “neither the Code nor Rule 4003(b) requires a trustee to object to a claimed exemption where the amount the debtor declares as the ‘value of [the debtor’s] claimed exemption’ in certain property is an amount within the limits the Code prescribes.”<sup>42</sup> The trustee contended that only the claimed amount listed, \$10,718, was subject to the thirty-day window for making an objection.<sup>43</sup> Accordingly, any remaining interest in the property was not exempt and required no objection.<sup>44</sup> Both the district court and the court of appeal rejected the trustee's argument.<sup>45</sup>

The Third Circuit agreed with the bankruptcy court in finding that, by listing the full value of the property, the debtor had notified the trustee of her intent to exempt the property itself.<sup>46</sup> Relying heavily on the Supreme Court's decision in *Taylor*, the court held that the trustee's failure to make a timely objection had entitled Reilly to exempt the full value of her equipment, even if that value exceeded both the amounts that Reilly actually declared on her

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38. *In re Reilly*, 534 F.3d 173, 176 (3d Cir. 2008), *rev'd sub nom.* Schwab v. Reilly, 130 S. Ct. 2652 (2010).

39. Reilly also filed a conditional motion to dismiss stating that she would have rather ended her bankruptcy proceeding than have had her equipment auctioned off. However, the bankruptcy court denied Reilly's motion to end the bankruptcy case. *Schwab*, 130 S. Ct. at 2658.

40. *Id.* at 2659.

41. Pursuant to 28 U.S.C. § 158(a)(1), U.S. district courts have jurisdiction to hear appeals from final judgments, orders, and decrees of the bankruptcy courts. 28 U.S.C. § 158(a)(1) (2006).

42. *Schwab*, 130 S. Ct. at 2659.

43. *See id.* at 2658.

44. *See id.*

45. *Id.* at 2659.

46. *In re Reilly*, 534 F.3d 173, 174 (3d Cir. 2008), *rev'd sub nom.* Schwab v. Reilly, 130 S. Ct. 2652 (2010).

schedules and what the Code permits.<sup>47</sup> The court noted that “‘an unstated premise’ of *Taylor* was ‘that a debtor who exempts the entire reported value of an asset is claiming the ‘full amount,’ whatever it turns out to be.’”<sup>48</sup> In *Taylor*, a debtor had “meant to exempt the full amount of the property by listing ‘unknown’ as both the value of the property and the value of the exemption.”<sup>49</sup> Accordingly, by listing a dollar-value exemption in the amount equal to the listed value of the equipment, Reilly had put the trustee on notice that she intended to exempt the property in-kind.<sup>50</sup>

The Supreme Court reversed the circuit court’s decision, finding that, in claiming a dollar value as exempt, Reilly had exempted only an interest in the equipment, and not the equipment itself.<sup>51</sup>

### III. REASONING OF THE COURT

The Supreme Court ruled in a 6–3 majority opinion that the trustee was not required to object to the claimed exemption to reserve the estate’s right to retain the potential excess value of the equipment beyond the amount claimed as exempt.<sup>52</sup> The decision looks at two important bankruptcy rules: § 522 of the Code and Rule 4003. The first imposes dollar-value limits on the extent to which a debtor can exempt certain types of property.<sup>53</sup> The second requires that interested parties object to a debtor’s claimed exemptions within thirty days after the conclusion of the § 341 creditors’ meeting or lose the ability to retain any of that property for the bankruptcy estate.<sup>54</sup>

The Court accepted the trustee’s argument that it was reasonable to infer from the language of the above statutes that the debtor only intended to exempt an *interest* in the equipment worth the amount listed rather than an interest in the equipment itself.<sup>55</sup> Therefore, because Reilly stated the “value of [her] claimed exemption[s]”

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47. *Id.* at 179.

48. *Id.*

49. *Id.* at 178.

50. *Id.* at 174.

51. *Schwab v. Reilly*, 130 S. Ct. 2652, 2666–69 (2010).

52. *Id.* at 2669.

53. 11 U.S.C. § 522 (2006).

54. FED. R. BANKR. P. 4003(b)(1).

55. *Schwab*, 130 S. Ct. at 2661–63.

within the range that the Bankruptcy Code allows for “property claimed as exempt,” it was not objectionable.<sup>56</sup> In other words, the schedule exempted no greater amount than the statute permitted. Accordingly, the trustee was not required to object to the exemptions to reserve the estate’s right to retain the potential excess value beyond the amount she had claimed.<sup>57</sup> The Court viewed Reilly’s interpretation of the schedule as “complicated” and “inconsistent with the Code.”<sup>58</sup>

The Court reasoned that the issue of what constitutes a claimed exemption could be resolved by looking to the language of § 522(l).<sup>59</sup> Section 522(l) states in pertinent part: “The debtor shall file a list of property that the debtor claims as exempt under subsection (b) of this section.”<sup>60</sup> The Court pointed out that § 522(l) defines the objection’s target as “property debtor claims as exempt *under subsection (b)*.”<sup>61</sup> Subsection (b), in turn, refers to property as specified in subsection (d).<sup>62</sup> Under subsection (d), there are twelve categories of property that a debtor may claim as exempt, most of which are described as “an interest” in a property up to a specified dollar amount.<sup>63</sup> Essentially, the subject of an exemption claim is defined as “an interest” in an asset, and not the asset itself.<sup>64</sup> Therefore, the Court reasoned, the value of the claimed exemption should be judged by the dollar value the debtor assigns to the interest rather than the value assigned to the asset.<sup>65</sup>

Based on this definition of what constitutes a “claim of exemption,” the trustee had no reason to object to Reilly’s exemption claim because its stated dollar value was within the limits allowed by

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56. *Id.* at 2661–62.

57. *Id.* at 2662.

58. *Id.* at 2660 (noting that Reilly’s interpretation of the schedule required looking at the “interplay of various schedule entries” to determine whether the debtor intended to exempt an interest in the property or the property itself).

59. *Id.* at 2661.

60. 11 U.S.C. § 522(l) (2006).

61. *Schwab*, 130 S. Ct. at 2661. The Court also rejected Reilly’s claim that the latter portion of § 522(l) should be dispositive. *Id.* at 2662.

62. 11 U.S.C. § 522(b)(2).

63. *E.g.*, 11 U.S.C. § 522(d)(6) (“The debtor’s aggregate interest, not to exceed \$ 2,175 in value, in any implements, professional books, or tools, of the trade of the debtor or the trade of a dependent of the debtor.”).

64. *Schwab*, 130 S. Ct. at 2661.

65. *Id.* at 2661–62.



the Code.<sup>66</sup> The Court further justified this interpretation of the trustee's statutory obligation as being consistent with the governing Code provisions and the historical treatment of bankruptcy exemptions.<sup>67</sup>

Furthermore, the Court corrected the court of appeal in its interpretation of the *Taylor* decision, stating that *Taylor* did not rest on what the debtor "meant" to exempt and did not raise an "unstated premise" that "a debtor who exempts the entire reported value of an asset is claiming the 'full amount.'"<sup>68</sup> The Court explained that *Taylor* holds only that the trustee must object to a claimed exemption if the amount the debtor lists as the "value claimed exempt" is not within the statutory limit.<sup>69</sup> The Court further clarified that *Taylor* focused on whether, looking at the face of the schedules, the trustee had a duty to object, rather than framing it as an issue of whether the debtor intended to exempt the property's full value.<sup>70</sup>

Unlike Reilly, the debtor in *Taylor* claimed as exempt the proceeds of a lawsuit and listed its value as "unknown," a value that was clearly not within the statutory limit for exemptions.<sup>71</sup> The Court distinguished Reilly's situation with that of Taylor's because the trustee for Reilly's bankruptcy estate had no basis for objecting in the first place as the exemption was, on its face, compliant with the exemption rules, and there was no way of knowing that the asset would appreciate in value beyond the limit.<sup>72</sup> Accordingly, the trustee in *Taylor* was required to make a timely objection if he wanted the proceeds to be part of the bankruptcy estate, and the failure to timely object meant that the property in its entirety was exempt.<sup>73</sup> Reilly's claimed amount, on the other hand, was within the statutory limit, so no objection to the claimed exemption was required to preserve the estate's entitlement to the value that exceeded that amount.<sup>74</sup>

In addition, the Court discussed the role of a "market value

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66. *Id.* at 2662.

67. *Id.* (referring to the fact that previous forms required the debtor to list the value of the claimed exemption without also estimating the market value of the asset).

68. *Id.* at 2666.

69. *Id.*

70. *Id.*

71. *Id.*

72. *Id.*

73. *Id.*

74. *Id.*

estimate” on a Schedule C form.<sup>75</sup> The Court rejected the argument that its interpretation of the rules and Schedule C made a debtor’s market value estimates superfluous and suggested that those estimates are still valuable in helping the trustee identify assets that may have value beyond the amount the debtor claims as exempt.<sup>76</sup> Specifically, the trustee can “compare the value of the claimed exemption, (which typically represents the debtor’s interest in a particular asset) with the asset’s estimated market value, (which belongs to the estate subject to any valid exemption) without having to consult separate schedules.”<sup>77</sup>

Finally, the Court addressed Reilly’s concern regarding the ruling’s practical effect—namely, the delay and uncertainty to debtors caused by a trustee’s failure to timely object.<sup>78</sup> The Court stated that if it is important to the debtor to claim the asset itself exempt, the debtor may list the “exempt value as ‘full fair market value (FMV)’ or ‘100% of FMV,’” which would effectively put a trustee on notice to object.<sup>79</sup> Absent a timely or successful objection, the debtor would thus be entitled to the full fair market value of the property claimed as exempt.<sup>80</sup>

#### IV. ANALYSIS

##### *A. What Are Debtors Confronted with After Schwab v. Reilly?*

The Court’s decision in *Schwab* should ultimately lead to more efficient administration of bankruptcy estates—at least for trustees. Trustees can now look to a bright-line rule in determining whether they should file an objection. Trustees—and courts—need only rely on the values expressly listed on the schedules as evidence of an exemption’s validity and need not consider the debtor’s intent. Prior to *Reilly*, some trustees made it a practice to file prophylactic objections to claimed exemptions.<sup>81</sup> Instituting a bright-line rule

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75. *Id.* at 2663–64.

76. *Id.*

77. *Id.* at 2664.

78. *Id.* at 2667.

79. *Id.* at 2668.

80. *Id.* (“If the trustee fails to object, or if the trustee objects and the objection is overruled, the debtor will be entitled to exclude the full value of the asset.”).

81. Tamara Miles Ogier, *Schwab v. Reilly: A Win-Win Decision*, AM. BANKR. INST. J., Sept. 2010, at 38, 38. The author, a practicing bankruptcy attorney and trustee, noticed that debtors

regarding objections, as the Court did, benefits the administration of the bankruptcy estate, as it potentially eliminates such time-consuming prophylactic objections.

Debtors, on the other hand, should now be aware of the uncertainty that comes with listing a dollar-value claim as exempt, especially in situations in which the amount of the asset might have an actual value near the maximum exemptible amount.<sup>82</sup> However, unlike trustees who are repeat players in bankruptcy court, pro se debtors are not likely to know the significance of listing a dollar value as their claimed exemption.<sup>83</sup> In reality, a substantial majority of those who file for bankruptcy relief file under Chapter 7<sup>84</sup> and a substantial number of those debtors are pro se.<sup>85</sup> A fair application of § 522 and Rule 4003(b) is extremely difficult under the existing wording and schedule forms. These ambiguities, though clarified by the Court in *Schwab*, need to be addressed in a manner comprehensible to the average debtor. For example, a simple amendment to the Schedule C form providing a short explanation that listing a dollar value only exempts that specified value and nothing more would be sufficient to direct pro se debtors.<sup>86</sup>

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were frequently valuing property at \$1 and then claiming a \$1 exemption in said property—arguably attempting to claim the full amount regardless of what the value of the property turned out to be. In response, the author made it standard practice to file objections consisting of the standard language:

[N]o exemption referenced herein or taken by the Debtors in their Schedule C shall be construed to exempt all of the value or equity in any particular piece of property. The amount available to be exempted in any particular piece of property shall be as set forth herein or, if not specifically set forth herein, shall be limited to the available statutory maximum regardless of ultimate value of the property.

*Id.* at 39 n.9.

82. See *Schwab*, 130 S. Ct. at 2668.

83. See *id.* at 2677 n.15.

84. ADMIN. OFFICE OF THE U.S. COURTS, 2009 REPORT OF STATISTICS REQUIRED BY THE BANKRUPTCY ABUSE PREVENTION AND CONSUMER PROTECTION ACT OF 2005, at 5 (2009), available at <http://www.uscourts.gov/uscourts/Statistics/BankruptcyStatistics/BAPCPA/2009/2009BAPCPA.pdf> (“Approximately 71 percent of [1.4 million bankruptcy petitions], up from 66 percent in 2008, were filed under chapter 7 . . .”).

85. Susan Block-Lieb, *A Comparison of Pro Bono Representation Programs for Consumer Debtors*, 2 AM. BANKR. INST. L. REV. 37, 41 (1994).

86. The Advisory Committee on Bankruptcy Rules has already proposed amending the Schedule C form in a manner that would permit debtors to clearly state their intentions to exempt “the full fair market value of the property.” Memorandum from the Honorable Eugene R. Wedoff, Chair of the Advisory Comm. on Bankr. Rules to the Honorable Lee H. Rosenthal, Chair of the Standing Comm. on Rules of Practice and Procedure 5 (Dec. 6, 2010). The Consumer and Forms Subcommittees are considering adding a new column for exempting the full FMV of an asset under which a debtor could simply place a check mark. Interview with Barbara D. Gilmore,

*B. Effect on Claimed Exemptions That Appreciate in Value and Whether the Court Rendered the Code's Definition of "Value" Meaningless*

The Supreme Court did not specifically address whether a trustee who fails to make a timely objection to a claimed exemption is entitled to sell that property if its value later appreciates beyond the statutorily allowed exemption amount. A creditor could linger in the background and wait for an appreciation in value to accrue until it is appropriately ripe for an objection.<sup>87</sup> The danger of this particular scenario is well illustrated by the bankruptcy cases *In re Chappell*<sup>88</sup> and *In re Gebhart*.<sup>89</sup> When compared to *Schwab*, *Chappell* and *Gebhart* are particularly interesting cases because they deal with properly valued property, rather than undervalued property.<sup>90</sup>

In both cases, the claimed exemptions were dollar-value exemptions for the respective debtors' homes. When the debtors filed their bankruptcy petitions, their equitable interests in their homes (that is, the difference between the value of their homes and the mortgages with which they were encumbered) were within the permissible homestead exemption amount.<sup>91</sup> In *Chappell*, the value of the debtors' home increased and, as a result, caused the debtors' equitable interests in their home to increase to an amount beyond the allowable homestead exemption amount. The trustee did not file an

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Member of the Forms Subcomm., in Malibu, Cal. (Mar. 18, 2011). In effect, a trustee would be put on notice of the need to object within the thirty-day objection period. Assuming that the value of the property at issue remains within the allowable exemption amount up until the objection hearing and the bankruptcy court determines the allowability of the claimed exemption, the property should become exempt in its entirety—regardless of any appreciation thereafter. FED. R. BANKR. P. 4003(b)–(c).

87. For example, if a home is worth only \$40,000, a creditor might wait until its value increases to an amount exceeding the relevant exemption limit. Similar situations occurred in *In re Chappell* and *In re Gebhart*, discussed *infra*. The only hope is that when the bankruptcy case is closed and the trustee abandons the estate's properties and liens, the trustee cannot appear years later to reclaim appreciation value. Only in certain extreme circumstances, such as when the trustee is given incomplete or false information about the asset by the debtor, is abandonment revocable. FED. R. BANKR. P. 4003(b)(2); *see, e.g.*, *Stoebner v. Wick (In re Wick)*, 276 F.3d 412 (8th Cir. 2002).

88. *In re Chappell*, 373 B.R. 73 (B.A.P. 9th Cir. 2007).

89. *Gebhart v. Gaughan (In re Gebhart)*, 621 F.3d 1206 (9th Cir. 2010).

90. *In re Gebhart*, 621 F.3d at 1208–09.

91. *Id.* The debtors in *Chappell* claimed a homestead exemption pursuant to the federal exemption under § 522(d); whereas the debtors in *Gebhart* exempted under Arizona state exemption statutes, *id.*, which is permissible because Congress allowed states to opt out of the federal exemption scheme. 11 U.S.C. § 522(b)(2)–(3) (2006).

objection within thirty days of the conclusion of the creditors' meeting but still sought to obtain the value of the home that went beyond the statutorily allowed exemption amount.<sup>92</sup> Similarly in *Gebhart*, the debtor claimed a dollar-value exemption in his home. He had lived in his home for five years after filing for bankruptcy, had paid his mortgage during that time, and had believed that his bankruptcy was finished when he received his discharge.<sup>93</sup> However, after the value of his home increased to a value beyond the exemption amount allowed by the exemption statute, the trustee sought to sell the property—after leaving the case open for eighteen months without any activity.<sup>94</sup>

The Ninth Circuit addressed two consolidated appeals from *Chappell* and *Gebhart*.<sup>95</sup> Relying on the recently decided Supreme Court decision in *Schwab*, the Ninth Circuit held that the debtors had claimed only an interest in the property and were therefore only entitled to that amount.<sup>96</sup> Accordingly, the trustees were entitled to auction off the homes and use the postpetition appreciation of the homes to pay the creditors.<sup>97</sup>

These cases cast light on Reilly's argument that the Court's interpretation of the exemption statutes renders the Code's definition of "value" meaningless. "Value," as defined in the Code, is the "fair market value as of *the date of the filing of the petition*."<sup>98</sup> The Court reasoned, however, that a debtor's estimated value as of the petition date is not meaningless as it can be used to assist the trustee in identifying assets that may have value beyond the amount the debtor claims as exempt.<sup>99</sup> Nonetheless, in a case similar to *Chappell* and *Gebhart*, the critical time for valuation would be when a trustee objects to a debtor's claimed homestead exemption on the ground

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92. *In re Chappell*, 373 B.R. at 76.

93. *In re Gebhart*, 621 F.3d at 1211.

94. Though the trustee in *Gebhart* waited until after eighteen months of inactivity in the bankruptcy matter, debtors might be able to rely on the doctrine of estoppel to prevent a trustee from auctioning off their homes for postpetition appreciation. The debtor in *Gebhart* asserted this claim but did not prevail on the estoppel argument. The Ninth Circuit advised that a trustee has a duty to administer a bankruptcy expeditiously but that if he failed to do so, then the remedy lies with the U.S. Trustee's office and not with the courts. *Id.* at 1212.

95. *Id.* at 1206.

96. *Id.*

97. *Id.*

98. 11 U.S.C. § 522(a)(2) (2006) (emphasis added).

99. *Schwab v. Reilly*, 130 S. Ct. 2652, 2664 (2010).

that it exceeds the statutory limit. In that vein, it seems that with respect to exemptions, the point at which the value of property is truly meaningful is not “at the time of petition” as § 522(a)(2) might suggest.

*C. Implications and Validity of the “100% of FMV” Solution*

In situations similar to *Chappell* and *Gebhart*, Chapter 7 debtors must understand that listing a dollar value as exempt does not effectively exempt the property itself. This is especially important if keeping certain property is a necessary condition to the debtor’s fresh start.<sup>100</sup> The Supreme Court suggests that debtors who wish to exempt a property in-kind from the bankruptcy estate should list the full fair market value as their claimed exemption.<sup>101</sup> Under this theory, listing the full fair market value of a home as the claimed exemption obligates a trustee to timely object if he or she wants to stop a debtor from potentially claiming a home in-kind rather than claiming an interest in the home.<sup>102</sup> If after the thirty-day window the value of the home is still within the permissible exemption amount, then regardless of the value of the home at any point during the bankruptcy case, the homestead itself should be exempt.<sup>103</sup>

However, the validity of the full-fair-market-value solution should be a cause of concern. In suggesting that debtors list full fair market value in the column designating the value of their claimed exemption to exempt the property itself, the Court has provided a means for debtors to exempt *more* than they are statutorily allowed to.<sup>104</sup> With respect to homestead exemptions, this means that debtors could potentially obtain postpetition appreciation in real property that they otherwise would not be permitted to get.<sup>105</sup> In California, for example, the bankruptcy estate is ordinarily entitled to postpetition appreciation in the property’s value, a portion of which would otherwise be exempt.<sup>106</sup> The rationale is that the law places a cap on

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100. One of the primary purposes of allowing a debtor to file for Chapter 7 bankruptcy is to gain a fresh start. *See* *Local Loan Co. v. Hunt*, 292 U.S. 234 (1934).

101. *Schwab*, 130 S. Ct. at 2668.

102. FED. R. BANKR. P. 4003.

103. *Schwab*, 130 S. Ct. at 2668. The trustee, or objecting party, has the burden of proving that the exemptions are not properly claimed. FED. R. BANKR. P. 4003(c).

104. *Schwab*, 130 S. Ct. at 2668.

105. *See infra* notes 106–07 and accompanying text.

106. *See In re Gebhart*, 621 F.3d 1206, 1211 (9th Cir. 2010) (citing *Alsberg v. Robertson (In*

exemptions and therefore does not allow debtors to obtain exemptions in amounts above that to which they are permitted by statute.<sup>107</sup> California exemption statutes, and most other state exemption statutes, are similar to federal exemption statutes in that they generally permit debtors to exempt certain property *up to* specified amounts.<sup>108</sup>

The Court's full-fair-market-value solution appears inconsistent with the Court's own rationale for determining the definition of property claimed as exempt. The Court looked to the statute's language and reasoned that the object at which the objection is directed is property "claimed as exempt *under subsection (b)*," that is, exemptions within the statutorily allowed exemption limits.<sup>109</sup> The Court did not explain whether claiming an asset's full fair market value even fits subsection (b)'s statutory language, let alone any of the language in § 522. Indeed, the statute does not lend such an option to debtors in the first place.<sup>110</sup> As phrased, the language of the exemption-related rules reflects that the property claimed cannot be anything other than what the statute allows—the debtor's "aggregate interest in any property."<sup>111</sup> There is a disconnect, then, between the Court's principal conclusion and its full-fair-market-value solution.

Under the plain-meaning doctrine, statutory analysis should begin and end with the language of the statute when that language is plain.<sup>112</sup> Absent any "indication that doing so would frustrate Congress's clear intention or yield patent absurdity, [a court's] obligation is to apply the statute as Congress wrote it."<sup>113</sup> In the bankruptcy context, exemptions "allow an individual debtor to keep

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*re Alsberg*, 68 F.3d 312, 314–15 (9th Cir. 1995)); *Schwaber v. Reed (In re Reed)*, 940 F.2d 1317, 1323 (9th Cir. 1991); *Viet Vu v. Kendall (In re Viet Vu)*, 245 B.R. 644, 647–48 (B.A.P. 9th Cir. 2000).

107. *See Hyman v. Plotkin (In re Hyman)*, 967 F.2d 1316, 1321 (9th Cir. 1992) (noting that debtors should be given exemptions in the amount guaranteed by statute, "regardless of the vicissitudes of the real estate market or timing of the sale"); *In re Reed*, 940 F.2d at 1321 ("California does not permit a debtor to exempt his entire interest in a homestead, but specifically limits the dollar amount up to which a homestead exemption can be claimed.") (citing CAL. CIV. PROC. CODE § 704.730(a) (West 2010)).

108. *See, e.g.*, 11 U.S.C. § 522(d) (2006); ARIZ. REV. STAT. ANN. § 33-1101(A) (2011); CAL. CIV. PROC. CODE § 704.730.

109. *Schwab*, 130 S. Ct. at 2661–63.

110. *See* 11 U.S.C. § 522.

111. *Id.* § 522(d).

112. *United States v. Ron Pair Enters., Inc.*, 489 U.S. 235, 241 (1989).

113. *BFP v. Resolution Trust Corp.*, 511 U.S. 531, 570 (1994) (Souter, J., dissenting).

some property after the bankruptcy with which to preserve at least a *minimal standard* of living and to reenter the economy in a productive role rather than being cast out from it.”<sup>114</sup> Thus, the tenet underlying bankruptcy law is to give debtors a fresh start, not to provide a head start or to provide the same level of comfort to a debtor as that to which he or she was accustomed. In a sense, the full-fair-market-value solution frustrates Congress’s clear intention of providing the debtor with a fresh start that is obviously meant to be limited by § 522(b).<sup>115</sup> Under the Court’s theory regarding its full-fair-market-value solution, property can become exempt regardless of its ultimate value.<sup>116</sup> As such, exempting property in an amount that falls outside of the statutory maximum is impermissible because doing so would counter Congress’s intent.

Thus, to the extent that claiming an asset’s full fair market value as exempt is incompatible with exemption statutes, individual debtors should consider turning to Chapter 13 bankruptcy petitions if they wish to exempt their homes (or any other property important to them) in-kind.<sup>117</sup> One of the fundamental characteristics of Chapter 7 cases is the liquidation of the debtor’s assets, save for those that are exempted, in order to receive a discharge that releases the debtor from all future payments toward prepetition debts owed.<sup>118</sup> However, Chapter 13 cases differ from Chapter 7 cases in that they allow debtors who have regular sources of income to undergo financial reorganization through court-approved plans rather than liquidating their assets.<sup>119</sup> Accordingly, debtors can avoid liquidating their homes by setting up repayment plans at rates the courts determine the debtors can afford.<sup>120</sup>

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114. Richard E. Mendales, *Rethinking Exemptions in Bankruptcy*, 40 B.C. L. REV. 851, 851 (1999) (emphasis added).

115. See Frank J. Spirak, *Estates by the Entirety in Bankruptcy*, 15 U. MICH. J.L. REFORM 399, 403–04 (1982) (“The more property in the bankruptcy estate, the smaller creditors’ losses will be. Thus, one bankruptcy policy is to maximize the property in the estate to lessen creditors’ losses.”).

116. See Schwab v. Reilly, 130 S. Ct. 2652, 2668 (2010).

117. See generally 11 U.S.C. §§ 1301–1330 (2006) (discussing aspects of a Chapter 13 proceeding). Debtors can either file under Chapter 13 at the outset or, if a debtor has already filed under Chapter 7 (such as the debtors in *In re Chappell* and *In re Gebhart*), convert his Chapter 7 case to a Chapter 13 case. 11 U.S.C. §§ 301(a), 706(a), 706(c), 707(b) (2006).

118. Spirak, *supra* note 115, at 403–04.

119. 11 U.S.C. § 1322(a).

120. *Id.* § 1325(a)(6).



## V. CONCLUSION

In short, the Court instituted a clear rule regarding the interpretation of exemption schedules. The decision is likely to result in the clear administration of bankruptcy estates because of the bright-line rule regarding the application of the exemption rules (making the subjective intent of the debtor irrelevant to interpreting exemption schedules). The Court's decision was a fair and reasonable interpretation of the exemption-related statutes in light of the exemption rules' purpose and function. Debtors are prejudiced only by the amount that they are not statutorily permitted to retain in the first place. The biggest concern with the Court's decision, however, is that while it is grounded in the principle that a debtor is allowed to have a fresh start *within the limits imposed by § 522 with respect to exemptions*, its 100-percent-of-FMV solution is not grounded in that principle.