Business Law Section

Insolvency Law Committee

January 28, 2019

Dear constituency list members of the Insolvency Law Committee, the following is a recent case update.

SUMMARY

The U.S. Court of Appeals for the Ninth Circuit held that the value of a debtor's homestead exemption is fixed at the date of the filing of the bankruptcy petition, regardless if the debtor was claiming federal or state law exemptions. *Wilson v. Rigby (In re Wilson)*, 909 F.3d 306 (9th Cir. 2018). The Ninth Circuit affirmed rulings by the United States District Court and Bankruptcy Court for the District of Washington, both holding that the debtor's exemption was limited to the amount she is entitled to under Washington state law as of the petition date. To read the full decision, click here.

FACTS

The facts are relatively straightforward. At the time the debtor filed her bankruptcy on December 18, 2013, the value of her condominium was $250,000, subject to a $246,440 mortgage, leaving her net equity of $3,560 as of the petition date. During the course of the bankruptcy the value of the debtor's property substantially appreciated to $412,500. The debtor filed an amended Schedule C claiming "100% of the fair market value, up to any applicable statutory limit." The amended schedule listed Washington's state homestead exemption as the basis for her amended exemption, as opposed to the wildcard federal exemption that she scheduled in her initial Schedule C.

Both the Chapter 7 trustee and the debtor's bank filed an objection to the exemption.

The issue was whether the debtor was entitled to an increase in her homestead exemption based on the post-petition increase in the value of her residence.

Under Washington law, the debtor's homestead exemption allows the exemption to be scheduled in the amount of the debtor's equity in the property. Therefore, the debtor claimed she was entitled to increase her homestead exemption from $3,560 as listed in her original wildcard Schedule C federal exemption, to the equity in her property, valued at $412,500 at the time she filed her amended Schedule C.

REASONING

Washington's homestead exemption is tied to the amount of equity in the debtor's property. The debtor initially claimed an exemption of $3,560 using the federal Schedule C wildcard exemption, but subsequently amended her Schedule C to claim exemptions under the Washington state statute to capture the significant post-petition increase in equity reflected in the property's appreciation in value from $246,440 to $412,500. The debtor argued, in essence, that the increase in equity justified the change of exemptions.

Using the longstanding "snapshot rule," the Ninth Circuit disagreed, holding that exemptions are fixed as of the time of the bankruptcy filing. Using the facts before it, the Ninth Circuit analogized to the opposite factual scenario (i.e., a decrease in property value), noting that the debtor's reasoning in this case (i.e., that she should be entitled to the post-petition increase in equity) would also require that a debtor claiming an exemption in a falling market is subject to post-filing depreciation.

According to the majority of the panel, "nothing in the bankruptcy law compels (or even suggests) such a drastic interference with the operation of the state homestead exemption statute." The debtor offered several responsive arguments. The Ninth Circuit rejected all of them. First, the debtor cited numerous decisions, each differing in material respects from the Washington statute (which applies a sliding scale). Moreover, in each of these decisions, the value of the homestead exemption was still determined as of the date of the bankruptcy petition.

The debtor (and various amici curiae) also relied on *Klein v. Chappell*, 373 B.R. 73 (B.A.P. 9th Cir. 2007), aff'd sub nom, *In re Gebhart*, 621 F. 3d 1206. The Ninth Circuit distinguished that decision by noting that the issue in *Chappell* did not involve a debtor's entitlement to post-petition property value appreciation up to the statutory maximum (the trustee had waived that issue), but instead involved whether the estate retained an interest in the debtor's property when the value of the debtor's homestead equals or exceeds the equity in the home.

The Ninth Circuit also distinguished *Woodson v. Fireman's Fund Insurance Company*, 839 F.2d 610 (9th Cir. 1988), observing *Woodson* involved the difference between a debtor's right to exempt the ownership interest in a life insurance policy and the debtor's exemption rights in life insurance proceeds (which did not exist at the time the petition was filed). Consequently, this decision – involving the debtor's ability to claim an exemption at the time he received them – presented an exemption issue "entirely distinct" from the debtor's claimed exemption in her condominium: "The value of [the condominium] may change over time, but it is not constantly subject to a new round of exemptions as the value goes up or down."

Finally, the Ninth Circuit dismissed the debtor's suggestion that an exemption amount fixed as of the petition date would lead debtors to routinely schedule inflated values of their homes, noting that debtors must always act in good faith. The Ninth Circuit noted further that no value scheduled by the debtor is binding on the trustee, who must make his or her own determination as to the value and equity in estate property.

The Ninth Circuit concluded that the petition date is the relevant point in time for valuing the exemption and that Washington law limits the homestead exemption to the debtor's equity at the time of the bankruptcy filing, which was $3,560.

AUTHOR'S COMMENTARY

This decision is sound and logical. To rule otherwise would effectively require that a new round of exemptions be scheduled as the value of the exempt property fluctuated up or down. This decision is also fair: Under the debtor's logic, debtors would be exposed to decreases in their exemptions resulting from any post-petition decrease in the value of exempt property – a potentially draconian outcome.

These materials were prepared by ILC member Gary Rudolph of Sullivan Hill Rez & Engel in San Diego (rudolph@sullivanhill.com), with editorial contributions from ILC advisor Michael Good of South Bay Law Firm in Torrance (mgood@southbaylawfirm.com).

Best regards,
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