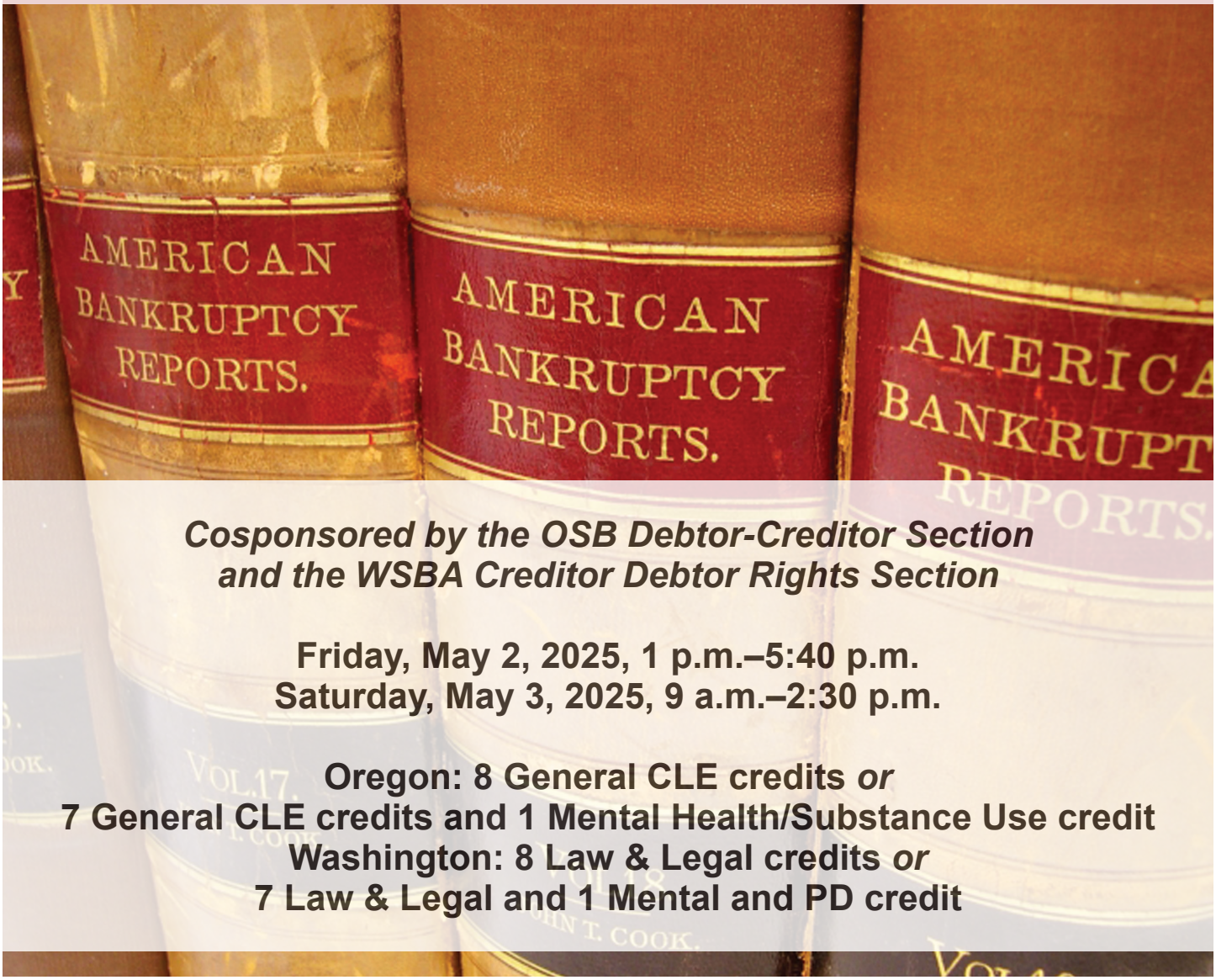
Oregon State Bar CLE Seminars

38th Annual Northwest Bankruptcy Institute



Cosponsored by the OSB Debtor-Creditor Section and the WSBA Creditor Debtor Rights Section

Friday, May 2, 2025, 1 p.m.–5:40 p.m.
Saturday, May 3, 2025, 9 a.m.–2:30 p.m.

Oregon: 8 General CLE credits *or*
7 General CLE credits and 1 Mental Health/Substance Use credit
Washington: 8 Law & Legal credits *or*
7 Law & Legal and 1 Mental and PD credit

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Friday Reception

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Friday Break

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SCHEDULE

Friday, May 2, 2025

1:00 Plenary I—Bankruptcy Trial Essentials: Litigating with Confidence

Jeanne Kallage Sinnott, *Wildwood Law Group LLC, Portland*
Jovita Wang, *Allegiant Law, Portland*

2:00 Transition Break

2:10 Breakout A—Nonconsumer Debt: Opening Pathways for Individual Debtors

Laura Donaldson, *Laura L Donaldson LLC, Gladstone, Oregon*
Jamie McFarlane, *The Tracy Law Group PLLC, Seattle*

Breakout B—Unpacking the Aftermath of *Purdue:* Releases, Exculpations, and the Possible Application of Rule 7023

Moderator: Christine Tobin-Presser, *Bush Kornfeld LLP, Seattle*
Jeffrey Garfinkle, *Buchalter, Los Angeles*
Marc Levinson, *Orrick Herrington & Sutcliffe LLP, San Francisco*
Colleen Restel, *Lowenstein Sandler LLP, Roseland, New Jersey*

3:10 Neworking Break

3:30 Breakout C—Shaping Your Practice So You Can Thrive

Darcel Lobo, *DAL Law Firm, Normandy Park, Washington*
Bryan Welch, *Oregon Attorney Assistance Program, Portland*

Breakout D—The Complex World of Ponzi Litigation: Bankruptcy Implications

John Bender, *K&L Gates, Seattle*
Jay Kornfeld, *Bush Kornfeld, Seattle*
Brian Peterson, *K&L Gates, Seattle*

4:30 Transition Break

4:40 Plenary II—Judges Panel

The Honorable Mary Jo Heston, *U.S. Bankruptcy Court, Western District of Washington, Tacoma*
The Honorable Whitman Holt, *U.S. Bankruptcy Court, Eastern District of Washington, Yakima*
The Honorable Peter McKittrick, *U.S. Bankruptcy Court, Oregon District, Portland*
The Honorable Thomas Renn, *U.S. Bankruptcy Court, Oregon District, Eugene*

5:40 Adjourn

Saturday, May 3, 2025

9:00 Plenary III—Navigating SBA Bankruptcy Issues After COVID-19

Matthew Koos, *Office of General Counsel, U.S. Small Business Administration, Denver*

10:00 Transition Break

10:10 Plenary IV—Untangling the Web of Our Homestead Laws: Trouble Afoot? Can a Husky Help a Duck?

Matthew Anderton, *Chapter 7 Panel Trustee, Yakima*
Ann Chapman, *Sussman Shank LLP, Portland*
Russell Garrett, *Jordan Ramis PC, Portland*
Christina Henry, *Seattle Consumer Justice, Seattle*

11:10 Lunch

12:10 Plenary V—Merchant Cash Advances and Bankruptcy Reorganization

Christopher Coyle, *Sussman Shank LLP, Portland*
Thomas Neeleman, *Neeleman Law Group PC, Marysville, Washington*

1:10 Networking Break

1:30 Plenary VI—Ninth Circuit Case Law Update

The Honorable Whitman Holt, *U.S. Bankruptcy Court, Eastern District of Washington, Yakima*
Dominique Scalia, *DBS Law, Seattle*
Ava Schoen, *Tonkon Torp LLP, Portland*

2:30 Adjourn

Save the Date!

39th Annual NW Bankruptcy Institute

Cosponsored by the OSB Debtor-Creditor Section and the WSBA Creditor Debtor Rights Section

Friday, April 17, 2026
Saturday, April 18, 2026
(in person only)

Hilton Bellevue
Bellevue, Washington

FACULTY

Matthew Anderton, *Chapter 7 Panel Trustee, Yakima*

John Bender, *K&L Gates, Seattle.* Mr. Bender is a partner in the firm's Commercial Disputes practice group. He represents public and private companies and entrepreneurs in cases involving exposure in the tens and hundreds of millions of dollars in high-stakes commercial litigation and investigations. Mr. Bender has extensive experience in complex commercial cases involving investment fraud and Ponzi scheme litigation in state, federal, and bankruptcy courts, including serving as court-approved special litigation counsel for creditors' committees in bankruptcy. As a lawyer with experience at the intersection of emerging tech, DeFi, and US law, Mr. Bender frequently speaks and provides legal commentary and analysis covering this emerging area; his analysis has been featured in major publications, including Time magazine. He is a member of the Washington Technology Industry Association Cascadia Blockchain Council Steering Committee and the Federal Bar Association of the Western District of Washington. Mr. Bender holds an LL.M. from the University of California, Berkeley.

Ann Chapman, *Sussman Shank LLP, Portland.* Ms. Chapman, Special Counsel at Sussman Shank LLP, has nearly 40 years of experience practicing in the bankruptcy field, with a focus on complex consumer and small business matters. She is an active member of the Oregon State Bar Debtor/Creditor Section and a frequent speaker on bankruptcy-related topics. Ms. Chapman was honored with the William N. Stiles Award of Merit by the Debtor/Creditor Section in 2014.

Christopher Coyle (he/him), *Sussman Shank LLP, Portland.* Mr. Coyle dedicates his practice to representing both individuals and businesses, as debtors or creditors, with work-out agreements or bankruptcy, ranging from straightforward chapter 7 liquidation cases to complex chapter 11 reorganizations. He has provided representation for individuals, family enterprises, and agricultural entities (including farmers, ranchers, and fishers), as well as larger businesses.

Laura Donaldson, *Laura L Donaldson LLC, Gladstone, Oregon.* Ms. Donaldson has over 20 years of experience in her consumer bankruptcy practice assisting individuals and small businesses in resolving financial distress. Her primary focus is helping consumers restructure their debt through chapters 7 or 13 of the Bankruptcy Code or debt resolution/workouts outside of bankruptcy. She also is a member of a student loan workshop group, where she follows the ever-changing landscape of student loan law. She has been a speaker and planner for the 2023 American Bankruptcy Institute CPEX Conference and was the 2023 William N. Stiles Award of Merit recipient for extraordinary service to the section. She is past chair of the Oregon State Bar Debtor/Creditor Section.

Jeffrey Garfinkle, *Buchalter, Los Angeles.* Mr. Garfinkle is a shareholder with Buchalter and practices in both its Irvine, California, and Seattle offices. His primary practice involves the representation of a variety of parties in bankruptcy, restructuring cases, and collection matters, including out-of-court workouts throughout the United States. He also specializes in matters pertaining to Articles 2 and 9 of the Uniform Commercial Code and in representing purchasers of assets from bankrupt companies and financially troubled companies. Mr. Garfinkle is one of the nation's leading pharmaceutical and health care insolvency attorneys; over his career, Mr. Garfinkle has been involved in hundreds of pharmaceutical and health care bankruptcy cases. Mr. Garfinkle has argued appeals in six Federal Courts of Appeals and handled bankruptcy and bankruptcy-related litigation matters in dozens of districts throughout the United States. He serves as president of the Financial Lawyers Conference, an organization consisting of leading California commercial finance and commercial insolvency attorneys, and recently served as chair of the American Bankruptcy Institute Commercial and Regulatory Law Committee.

Russell Garrett, *Jordan Ramis PC, Portland.* Mr. Garrett has over 35 years of experience representing clients in complex business and financial issues both in and out of the courtroom. He routinely advises businesses and individuals on strategic issues, particularly where there are shareholder/management disputes and where financial distress exists. He has represented creditors, chapter 7, 12, and 13 trustees, debtors, creditors' committees, and asset purchasers in bankruptcy, as well as both state and federal receivers. He is an experienced trial lawyer in and out of bankruptcy court and has appeared before the Bankruptcy Appellate Panel and the Ninth Circuit Court of Appeals. Mr. Garrett is president of the National Association of Bankruptcy Trustees, has served as a panel Chapter 7 Trustee for the Western District of Washington since 1998, has served from time to time as a Chapter 11 Trustee, examiner, and court-appointed receiver/referee, has served on both the Oregon State Bar Debtor/Creditor Section and Washington State Bar Association Creditor-Debtor Rights Section executive committees, and is a former Ninth Circuit Lawyer Representative. He is a regular speaker on bankruptcy and creditors' rights topics. Mr. Garrett is also a mediator in bankruptcy and insolvency related disputes.

Christina Henry, *Seattle Consumer Justice, Seattle.* Ms. Henry focuses her practice on helping consumers resolve their legal issues and fight back against companies and debt collectors that utilize illegal and improper business practices. She is a respected voice on consumer protection law, with a special emphasis on litigation related to unfair and deceptive practices involving mortgages, debt collection, bankruptcy stay violations, garnishment abuses, and private student loans. Ms. Henry also has recent experience in holding solar panel installers and their credit unions financiers accountable for deceptive solar sales tactics, shoddy installation practices, and predatory loan financing. Ms. Henry is the 2022 recipient of the Hammes-Shulman Award from the National Association of Consumer Bankruptcy Attorneys for Legislative Advocacy in the passage of the homestead bill. She is also a member of the Washington State Bar Association Creditor-Debtor Section board and serves as the National Association of Consumer Advocates Washington State Chair. Ms. Henry regularly contributes to preserving the rights of consumers as an amicus brief writer in support of cases before the Ninth Circuit Court of Appeals. Ms. Henry is admitted to practice before the U.S. Supreme Court.

The Honorable Mary Jo Heston, *U.S. Bankruptcy Court, Western District of Washington, Tacoma*

The Honorable Whitman Holt, *U.S. Bankruptcy Court, Eastern District of Washington, Yakima.* Judge Holt has served as a United States Bankruptcy Judge for the Eastern District of Washington in Yakima since November 2019. Before taking the bench, Judge Holt practiced law at two bankruptcy boutique firms in Los Angeles. Judge Holt is coauthor of Bankruptcy and the Supreme Court: 1801–2014, a contributing author for the Collier on Bankruptcy treatise, and a conferee of the National Bankruptcy Conference, which advises Congress about the operation of bankruptcy and related laws.

Matthew Koos (he/him), *Office of General Counsel, U.S. Small Business Administration, Denver.* Mr. Koos serves as General Attorney in the SBA Office of General Counsel. While physically located in Denver, he serves as the District Counsel for both the Wyoming District Office and the Portland District Office. In that role, he is the designated ethics official for each of those offices and reviews incoming litigation matters, primarily bankruptcy cases, arising out of those jurisdictions. Mr. Koos began his career with the U.S. Small Business Administration in December 2012 with the Office of Disaster Assistance, in response to the Hurricane Sandy disaster event. He worked for 10 years with the Office of Disaster Assistance, taking on various legal and supervisory roles during his time there in Texas, before moving to Colorado in June 2022. Mr. Koos is an active member of the State Bar of Texas.

Jay Kornfeld, *Bush Kornfeld, Seattle.* Mr. Kornfeld's practice focuses primarily on the representation of businesses in creditor/debtor matters, emphasizing out-of-court workouts, restructurings, and chapter 11 reorganizations, as well as on the representation of receivers and companies in state court receiverships. He has represented clients in diverse industries, including tech, retail, agricultural (farming and processing), dairy, grocery, wholesale, manufacturing, aerospace, telecom, wood products, biotech, commercial and residential real estate, and commercial fishing. Mr. Kornfeld also serves as a mediator and has handled countless creditor/debtor and general commercial matters over the last 10 years. Mr. Kornfeld is a Fellow of the American College of Bankruptcy.

Marc Levinson, *Orrick Herrington & Sutcliffe LLP, San Francisco.* Mr. Levinson joined Orrick, Herrington & Sutcliffe LLP in 1990. Resident in the San Francisco office, he resigned his partnership and moved to Senior Counsel in 2016 in what so far has been an unsuccessful attempt to ease into retirement. Mr. Levinson's practice always has been limited to insolvency planning, bankruptcy cases, and out-of-court restructurings. He is past chair of the American College of Bankruptcy and has served as its president and Board of Regents chair, among other positions. Mr. Levinson has been a Conferee of the National Bankruptcy Conference since 2005 and currently serves on the Executive Committee and chairs the Governmental Units Committee.

Darcel Lobo, *DAL Law Firm, Normandy Park, Washington.* Ms. Lobo's practice areas are estate planning, real estate, and bankruptcy. She opened DAL Law Firm as a working lawyer mom who was seeking a fulfilling career that would allow her the flexibility she wanted to take care of her family while also continuing to develop her career as an attorney. Through opening her own law firm, she has not only navigated all that comes along with law firm ownership and raising two (then) small children, but she also has taken a proactive approach to prioritizing her health and merging all things law firm ownership, motherhood, and personal well-being. She has spent a significant amount of time mentoring and coaching other lawyers who are seeking happiness and fulfillment in both their personal and professional lives. Ms. Lobo opened her coaching business, DAL Coaching & Consulting, in 2022 to help lawyers build better lives and law firms. She coaches lawyers who are seeking to open their own law firms, manage their law firms, and avoid the burnout that can come with juggling work and family life.

Jamie McFarlane, *The Tracy Law Group PLLC, Seattle.* Mr. McFarlane represents debtors and creditors in the areas of reorganization, insolvency, receivership, and bankruptcy. He assists individuals and businesses in resolving financial distress, whether it be relief under chapter 7, 11, or 13 of the Bankruptcy Code or negotiating a workout with creditors. He is an experienced researcher of complex litigation, commercial, and bankruptcy-related issues. He is also experienced in the complicated relationship between family law and insolvency law.

The Honorable Peter McKittrick, *U.S. Bankruptcy Court, Oregon District, Portland.* Before joining the bench in 2015, Judge McKittrick practiced law in Portland for nearly 30 years. He served as a panel Chapter 7 Trustee from 2005 to 2015 and frequently served as a Chapter 11 Trustee and Receiver in state and federal court.

Thomas Neeleman, *Neeleman Law Group PC, Marysville, Washington.* Mr. Neeleman has been practicing law since 1982, concentrating his practice in all facets of debt relief, including business and consumer bankruptcy, complex settlement negotiation, and tax controversy. Mr. Neeleman is a trained mediator and received post-graduate certification in Mediation and Alternative Dispute Resolution from the University of Utah department of Communications. Mr. Neeleman has been a presenter on topics including bankruptcy including chapter 11, subchapter V issues, debt negotiation, implementing the paperless law office, and remote computer access to the law firm environment.

Brian Peterson, *K&L Gates, Seattle.* Mr. Peterson is a partner in the firm's Finance practice. He focuses on bankruptcy and insolvency matters. He has experience representing borrowers, committees, chapter 7 and 11 trustees, creditors, and asset purchasers in connection with both transactional and litigation matters in a variety of contexts, including federal bankruptcy proceedings, state court receiverships, foreclosures, and out-of-court workouts. Mr. Peterson has significant experience representing bankruptcy trustees in Ponzi scheme cases, including fraudulent transfer litigation. He also has experience litigating various commercial disputes in both state and federal courts, and advises clients with respect to the structuring of transactions involving distressed situations. He is a member of the Turnaround Management Association.

The Honorable Thomas Renn, *U.S. Bankruptcy Court, Oregon District, Eugene*

Colleen Restel, *Lowenstein Sandler LLP, Roseland, New Jersey.* Ms. Restel advises clients on all aspects of complex financial restructuring matters. She represents creditors' committees, tort claimant committees, individual creditors, post-confirmation fiduciaries, securities plaintiffs, and other interested parties. She has a strong track record in bankruptcy-related litigation involving the investigation, prosecution, and defense of actions against officers, directors, and lenders, including fraudulent transfer actions; and in representing clients in contested confirmation hearings. She is a member of the Lawyers Advisory Committee for the New Jersey Bankruptcy Court and as an active member and board member of several restructuring-industry related organizations; she also frequently writes and speaks on bankruptcy and credit-related trends. Ms. Restel is admitted to practice in New Jersey and New York.

Dominique Scalia (she/her), *DBS Law, Seattle*

Ava Schoen, *Tonkon Torp LLP, Portland.* Ms. Schoen is a partner at Tonkon Torp LLP, where she serves as cochair of the firm's Bankruptcy & Reorganization Practice Group. Her practice is focused on Chapter 11 corporate reorganizations, out-of-court workouts, state-court receiverships, and debtor-creditor law. Ms. Schoen provides services to clients in a wide range of industries including real estate, retail, manufacturing, farming, and technology. She is experienced representing Chapter 11 debtors-in-possession, as well as creditors, and has worked on some of the largest chapter 11 cases in the Pacific Northwest.

Jeanne Kallage Sinnott (she/her), *Wildwood Law Group LLC, Portland.* Ms. Sinnott's practice focuses on civil litigation, with an emphasis on real estate, probate, and contract disputes. She served on the board of the Oregon U.S. District Court Historical Society for many years and has also been a member of the Oregon State Bar Debtor-Creditor Executive Committee. She is past president of the Multnomah Bar Association Young Lawyers Section.

Christine Tobin-Presser, *Bush Kornfeld LLP, Seattle.* Ms. Tobin-Presser represents debtors, secured creditors, trustees, and receivers. Her practice emphasizes commercial creditor-debtor issues, out-of-court workout agreements, receiverships, and Chapter 11 bankruptcy reorganizations and liquidations.

Jovita Wang (she/her), *Allegiant Law, Portland.* Ms. Wang is a partner at Allegiant Law LLP, where her practice focuses on complex commercial litigation, including contractual claims, economic torts, and professional liability as well as trust and estate litigation. She is a board member of the Oregon Trials Lawyer Association and serves as the Multnomah Bar Association's delegate to the American Bar Association House of Delegates.

Bryan Welch (he/him/his), *Oregon Attorney Assistance Program, Portland.* Mr. Welch is an attorney counselor with the Oregon Attorney Assistance Program. He is a Certified Alcohol and Drug Counselor (CADC I) and will earn his Master's degree in Clinical Mental Health Counseling through Oregon State University later this year. Prior to joining the OAAP staff in 2015, he was in the private practice of law focusing primarily on family law and family mediation. In addition to his work at the OAAP, his experience includes providing drug and alcohol counseling services for a court-mandated DUII treatment program and for a local nonprofit working with people impacted by homelessness, poverty, and addiction. As a group facilitator, Mr. Welch leads peer support groups for lawyers practicing law with ADHD, practicing while experiencing anxiety and depression, and others. He presents regularly on topics relating to lawyer well-being.

NOTES

Chapter 1

Bankruptcy Trial Essentials: Litigating with Confidence

Jeanne Kallage Sinnott
Wildwood Law Group LLC
Portland, Oregon

Jovita Wang
Allegiant Law
Portland, Oregon

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NOTES

Considerations for Trial

1. **Pleadings**
    a. Success starts at the pleading stage. If you are the Plaintiff, carefully research the elements of your claims and make sure you have alleged facts to meet **each** element. Do not be afraid to amend your pleadings after discovery or learning new facts.
    b. If you are the Defendant, make sure you have raised all applicable defenses and be careful about defenses that can be **waived**.
    c. If any of your facts require expert testimony to establish, make sure you are aware of that and are prepared to retain an expert for trial.
2. **Pre-Trial Preparation**
    a. Court Rules and Procedures
        i. Adversary Proceedings
            1. FRBP (Rule 7001 *et seq*).
            2. Not all FRCPs apply in adversary proceedings
            3. Local Bankruptcy Rules (LBR)
            4. Case Scheduling Order (***example attached***)
        ii. Federal Court
            1. FRCP
            2. Local Rules (LR)
            3. Case Scheduling Order
        iii. State Court:
            1. ORCP
            2. Uniform Trial Court Rules (UTCR)
            3. Supplementary Local Rules (SLR)
            4. Attorney Guides?
            5. Special Orders? (For example, remote appearances).
        iv. Review court websites and see if your particular judge has any more information on their web page.
    b. Exhibit Preparation and Exhibit List
        i. Ensure correct numbering (you would be surprised about how disruptive this can be at trial).
            1. Local rules govern.

2. LBRs provide that plaintiff's exhibits start with "1" and defendant's exhibits start with "A"

ii. Confirm whether paper exhibits should be provided to the court (LBRs require electronic filing, but local practice will govern in other courts).

iii. Make sure to provide enough copies. If you are using paper copies, binders are helpful with exhibit list and tabs.

iv. Reach out to opposing counsel before trial for to see about filing stipulated facts, to cull through duplicative exhibits, and to determine whether the parties can agree to stipulate to admissibility of exhibits.

v. Finalize demonstratives with enough copies for judge, jury, and opposing counsel.

vi. Prepare foundation questions for all exhibits.

vii. Create clips from deposition videos.

viii. For electronic-only exhibits, confirm court's preferred format (many courts won't accept flash drives or links).

ix. Would a summary exhibit be helpful? If so, review FRE 1006.

c. Witnesses

i. Witness lists: Review local rules to determine whether witness lists are required.

ii. Trial subpoenas: Make sure to send subpoenas on time and by the proper method. Err on the conservative side and subpoena anyone who you do not know for a fact will appear voluntarily.

iii. Witness preparation

1. Meet with and prepare all witnesses. Practice direct examination as if you are at trial and discuss potential objections.
2. Review with witnesses past testimony (declarations, deposition transcripts, prior lawsuits).

3. Confirm availability early and often!
4. For remote testimony, follow local rules and verify witness has adequate technology and the ability to use the technology.
5. Prepare cross-examination of adverse witnesses and be ready to pivot at trial depending on their testimony. Make copies of deposition transcripts for impeachment.

iv. Expert witnesses

1. In state court, no advance disclosure necessary.
2. Case scheduling order will provide expert disclosure schedule for federal court (including adversary proceedings). Federal court has very strict expert requirements, make sure to review the rules, starting with FRCP 26 (made applicable to adversary proceedings through FRBP 7026).
3. Conduct opposition research on opposing experts
4. Prepare expert file for sharing.

d. Trial Notebooks (one set for each attorney)

i. Pleadings
ii. Motions
iii. Examination outlines
iv. Relevant case law/legal support
v. Deposition transcripts

e. Technology & Logistics

i. Assess audio/visual needs for trial
ii. Test technology in the courtroom (with the clerk's permission)
iii. Visit courtroom to familiarize with layout
iv. Arrange for necessary equipment (charges, office supplies)
v. Plan for lunch arrangements during trial

3. **Pre-Trial Filings**
    a. Trial Memorandum
    b. Exhibit List (***example attached***)
    c. Witness List
    d. Motions in Limine
    e. Jury Instructions (for jury trials)[1]
    f. Verdict Form (for jury trials)
4. **Trial**
    a. Always remember to think about the record and ensure that the record is preserved for appeal.
    b. Preliminary matters
        i. Witness availability issues
        ii. Stipulations
        iii. Other housekeeping items
    c. Opening Statement
        i. Keep it brief and know your audience.
        ii. Summarize claims/defenses and the elements you must prove.
        iii. Then, summarize the evidence supporting each element. "The evidence will show * * *."
    d. Plaintiff's case-in-chief
    e. Motions after plaintiff's case-in-chief
    f. Defendant's case-in-chief
    g. Plaintiff's rebuttal
    h. Closing Arguments
        i. Summarize key elements of each claim or defense.
        ii. Point to evidence that supports the elements of each claim or defense.

[1] For Jury Trials, you will need to do the following:
i. Prepare voir dire questions
ii. Review jury questionnaires (if available)
iii. Prepare juror profiles and jury selection chart
iv. Prepare for potential Batson challenges
v. Draft proposed jury instructions (OSB Bar Books Uniform Instructions)
vii. Prepare verdict form

iii. Know your audience.

i. Post-trial motions

j. Miscellaneous considerations

i. Arrive early.

ii. Keep witnesses updated throughout trial on timing.

iii. Track exhibits admitted. You can ask for help from the court clerk to ensure your exhibits are entered in the record. Before dismissing a witness, take a moment to review your exhibit list and make sure you have admitted everything you need.

iv. Do not be afraid to preserve your objections. You will not offend the judge, and you will avoid malpractice issues later.

5. Post Trial

a. Ensure accuracy of judgment before entry.

b. Make sure to docket post-trial motion and appeal deadlines.

NOTES

U.S. BANKRUPTCY COURT
DISTRICT OF OREGON
F I L E D

February 26, 2025

Clerk, U.S. Bankruptcy Court

Below is an order of the Court.

Teresa H. Pearson
U.S. Bankruptcy Judge

OSCH (1/12/24) kam

UNITED STATES BANKRUPTCY COURT
District of Oregon

In re **CHAP** Debtor(s)	) Case No. **00−50001−thp7**)) ORDER RE SCHEDULING, APPLICATION) OF FRCP 26, TRIAL DATE, AND) PROCEDURES))

The court held a pretrial and scheduling conference in this action on **2/26/2025**. To facilitate discovery and the effective management of this action, the court orders the parties to comply with the following deadlines and procedures:

Case Scheduling. It is ORDERED that the following deadlines apply in this case:

1.	Deadline to join parties:	**4/23/2025**
2.	Deadline to amend pleadings:	**4/23/2025**
3.	Deadline to complete discovery:	**5/21/2025**
4.	Deadline to file all pretrial, discovery, and dispositive motions (including motions for summary judgment):	**5/28/2025**

Application of FRCP 26. It is ORDERED that FRCP 26, made applicable by FRBP 7026, applies to this action as follows:

1. Discovery planning conference. The parties:

☑ are not required to hold a discovery planning conference. Discovery may commence at any time.

☐ must hold a discovery planning conference. The deadline to hold the discovery planning process is: . Discovery may not commence until the conference has occurred.

☐ A report of the conference is not required.

☐ A report of the conference is required. The deadline to file the report is: .

Page 1 of 3

2. Initial disclosures. The parties:

☑ are not required to make initial disclosures under FRCP 26 (a)(1).

☐ must make initial disclosures under FRCP 26(a)(1) in the form required by FRCP 26(a)(4). The deadline to make initial disclosures is: .

3. Scope of discovery. The scope of discovery in this action is as follows:

☑ discovery may proceed in accordance with the scope of discovery defined in FRCP 26(b)(1).

☐ discovery is limited as follows:

☐ no discovery shall be permitted because the court determines that the burden or expense of discovery outweighs its likely benefit, considering the importance of the issues at stake in this action, the amount in controversy, the parties' relative access to relevant information, the parties' resources, and the importance of discovery in resolving the issues.

Trial Date: It is ORDERED that the trial in this action will be scheduled as follows:

☑ The trial date is: at

☐ the court will hold a further scheduling conference to set the trial date on: **6/26/2025**

☐ the parties must contact the courtroom deputy to schedule the trial date. The deadline to contact the courtroom deputy is: .

Trial Location: It is ORDERED that the trial in this case will be held in the following place or manner:

☑ Courtroom # **4**, 1050 SW 6th Ave., #700, Portland, OR 97204

☐ Courtroom # , 408 E. 8th Ave., #2600, Eugene, OR 97401

☐ Video. For connection information, see www.orb.uscourts.gov/video−hearings.

☐ Other:

Pretrial Order: It is ORDERED that

☑ A pretrial order is not required.

☐ A pretrial order is required. Deadline for plaintiff to file the proposed pretrial order: .

Pretrial Deadlines: It is ORDERED that the following deadlines apply in this action:

1.	Deadline to disclose expert testimony under FRCP 26(a)(2):	**28 days before trial**
2.	Deadline to file witness lists under FRCP 26(a)(3)(A)(i):	**14 days before trial**
3.	Deadline to file exhibit lists and copy of exhibits under FRCP 26(a)(3)(A)(iii):	**14 days before trial**
4.	Deadline to file joint statements of agreed facts:	**14 days before trial**
5.	Deadline to file any trial briefs:	**14 days before trial**
6.	Deadline to file designation of testimony to be presented by deposition under FRCP 26(a)(3)(A)(ii):	**14 days before trial**
7.	Deadline to disclose rebuttal expert testimony under FRCP 26(a)(2)(D)(ii):	**14 days before trial**

8.	Deadline to file objections to witness testimony to be presented by deposition:	**7 days before trial**
9.	Deadline to object to authenticity of exhibits:	**7 days before trial**

Procedures: It is ORDERED that the following procedures apply:

1. Witnesses: Any witness whose name is not included on a party's witness list for trial will not be allowed to testify, except for good cause shown or solely for impeachment or rebuttal.

2. Exhibits: The parties must electronically file their exhibits. Plaintiff's exhibits must be numbered and listed starting with "1." Defendant's exhibits should be lettered and listed starting with "A." Unless all witnesses will testify only remotely and not in a courtroom, each party must bring a paper set of its exhibits for the witness, and, if there are more than 10 exhibits, the paper exhibits must be tabbed and presented in a three−ring binder. If there are more than two parties or numerous exhibits, contact the courtroom deputy at **503−326−1566** for label assignments. Except for good cause shown, no exhibit will be received in evidence at trial unless presented in accordance with this order.

3. Statement of agreed facts: The parties should indicate in the joint statement of agreed facts whether any party contends that any agreed fact is irrelevant.

4. Trial briefs: Trial briefs must not exceed 20 pages. Any motion to authorize the filing of an over−length brief must be filed no later than three business days before the brief is due.

5. Testimony to be presented by deposition: Any party offering a deposition transcript as substantive evidence must electronically file a copy of that transcript, with those portions sought to be admitted highlighted or underlined. This requirement does not apply to a deposition transcript used to refresh recollection or for impeachment or rebuttal. If a party does not make a timely objection to marked deposition testimony, the objection will be waived.

6. Objections to authenticity: In the absence of a timely objection to authenticity, an exhibit will be deemed authenticated. All other objections to admission of an exhibit may be raised at trial.

Modifications to this Order: It is ORDERED that requests for modification of any deadline to date in this order must be made by written motion, even if the parties have agreed to the modification. The motion shall be supported by an affidavit or declaration demonstrating good cause, appropriate use of prior time, and that the relief is being requested at the earliest time practical. The affidavit or declaration must state the number of prior extensions or continuances, that the moving party has consulted with opposing counsel regarding the request, and whether the opposing counsel consents or objects to the requested extension or continuance. If a motion to extend a discovery deadline arises from the opposing party's failure to comply with a discovery obligation, the motion must be accompanied by a motion to compel discovery.

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NOTES

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Attorneys for Defendant

IN THE UNITED STATES BANKRUPTCY COURT

IN THE DISTRICT OF OREGON

In re: Deborah Debtor, Debtor.	Case No. 99-999999-dwh Chapter 13
Deborah Debtor, Plaintiff, v. Cranky Creditor, Defendant.	Adv. Proceeding No. 99-9999-dwh DEFENDANT'S EXHIBIT LIST Judge David W. Hercher Trial Date: May 1, 2025

Defendant Cranky Creditor submits the following Exhibit List for the trial beginning May 1, 2025:

Exhibit	Description	Objection	Admitted
A			
B			
C			

PAGE 1 DEFENDANT'S EXHIBIT LIST

Exhibit	Description	Objection?	Admitted?

DATED this 30th day of April, 2025.

WILDWOOD LAW GROUP LLC

By /s/ *Jeanne Sinnott*

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Attorneys for Defendant

PAGE 2 DEFENDANT'S EXHIBIT LIST

CERTIFICATE OF SERVICE

I hereby certify that I served a copy of DEFENDANT'S EXHIBIT LIST on all CM/ECF participants through the Court's Case Management Electronic Case File system on the date set forth below:

DATED: April 30, 2025

WILDWOOD LAW GROUP LLC

By /s/ *Jeanne Sinnott*

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Of Attorneys for Defendant

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NOTES

Common Evidentiary Objections for Trial

Relevance (FRE 401 & 402)

Used when the evidence or question doesn't relate to any material fact in the case.

"Objection, relevance."

Hearsay (FRE 802)

Used when a witness uses an out-of-court statement to prove the truth of the matter asserted.

"Objection, hearsay"

Leading Question (FRE 611)

Used on direct examination when the question suggests an answer.

"Objection, leading."

Speculation (FRE 602)

Used when the witness is asked to guess or infer beyond personal knowledge.

"Objection, calls for speculation."

Lack of Personal Knowledge (FRE 602)

Used when a witness testifies about something that is not based on what they know or observed.

"Objection, lack of personal knowledge."

Lack of Foundation (FRE 901)

Used when an attorney fails to lay the groundwork when attempting to admit evidence.

"Objection, lack of foundation."

Argumentative

Used when the attorney is arguing with the witness instead of asking a question.

"Objection, argumentative."

Asked and Answered

Used to prevent repetitive questioning.

"Objection, asked and answered."

Compound Question

Used when the attorney has asked a question containing multiple questions that call for multiple answers (for example, where and when do you go to work?”).

Say: "Objection, compound."

Misstates Evidence

Used when an attorney inaccurately restates previous testimony or exhibits.

"Objection, misstates the testimony” or “Objection, misstates the exhibit."

Beyond the Scope (FRE 611)

Used during cross-examination or re-direct when the attorney asks questions about things that were not previously addressed.

"Objection, beyond the scope of direct [or cross]."

Expert Opinion by Lay Witness (FRE 701)

Used when a lay witness attempts to provide an opinion that is based on scientific, technical, or other specialized knowledge.

“Objection, calls for expert opinion.”

Ways to Admit Evidence at Trial

1. Stipulation with Counsel
    a. Use this when you can to minimize wasting time at trial.
    b. Ask early if possible.
    c. You still may want to draw the Court's attention to the evidence that was admitted by stipulation, but you don't have to worry about authenticating the exhibit after it is admitted.
    d. Common examples for stipulations include business records (FRE 803(6)).
2. Through a Witness
    a. Must lay a foundation (FRE 901)
        i. Do you recognize this document?
        ii. What is it?
        iii. If challenged, you may have to ask more questions (How do you recognize the document? How do you know what the document is?).
    b. Evidence must be otherwise admissible
        i. Relevant
        ii. Based on personal knowledge (FRE 602)
        iii. Not hearsay without an exception
        iv. Otherwise admissible under the applicable evidentiary rules
    c. ***Explicitly offer the exhibit into evidence after authentication***.
3. Self-Authenticating Exhibits (FRE 902)
    a. Certain public records
    b. Certain notarized documents
    c. Certain electronic records (FRE 902)(13)
4. Summary Exhibits (FRE 1006)
    a. You can submit a summary of voluminous documents.
    b. The voluminous documents must be available for review by the Court and the parties and may be required to be admitted as an exhibit.
5. Judicial Notice (FRE 201)
    a. Public records (court records), government records, well-established business facts (market interest rates, etc.), scientific facts, etc.
    b. More appropriate for background/contextual facts than contested issues.

Have a back-up plan for key exhibits!

NOTES

Chapter 2

Non-Consumer Debt: Opening Pathways for Individual Debtors

Laura Donaldson
Laura L Donaldson LLC
Gladstone, Oregon

Jamie McFarlane
The Tracy Law Group PLLC
Seattle, Washington

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Non-Consumer Debt: Opening Pathways for Individual Debtors

Jamie McFarlane, The Tracy Law Group, PLLC
Laura Donaldson, Law Office of Laura L. Donaldson, LLC

Chapter choice challenges

- Debtors who are high-income earners generally don't qualify for Chapter 7 unless their debt is deemed "non-consumer" due to the means test requirement.
- In non-consumer cases, large net disposable income on Schedules I and J may still be viewed as utilizing bankruptcy for an improper purpose.
- Debtors with large debt loads (including non-dischargeable debts) don't qualify for Chapter 13 due to exceeding debt limits.
- In Chapter 13, *usually* cannot discriminate in favor of non-dischargeable debts that will survive as to other debts; cost to maintain regular payment plus Chapter 13 plan payment not feasible.
- Chapter 11 or Subchapter V may be too costly for the debtor.

Avoiding the Means Test

11 u.s.c. § 707 – prevents debtors from obtaining shelter in Chapter 7 if they have ability to pay creditors.

a. §707(b)(1) – specifically limits its scope to a "case filed by an individual debtor…whose debts are ***primarily consumer debts…"*** So, if individual or non-consumer, cannot be dismissed as abuse.

c. §707(b)(2) – the "means test provision" – difficult test for high-income earners to qualify given median income generally exceeds household size.

d. §707 (b)(3) – when determining abuse, language references §707(b)(2)(A)(i), and that section is only applicable to consumer filings. No totality of circumstances test for non-consumer debtors.

e. Use of §706(b) rather than §707 – does cause to convert exist? In Chapter 11, conversion doesn't require debtor consent. Disposable income on I and J may be cited as cause left to judge's discretion. In re Dara Parvin, 538 BR 96 (Bankr Ct. West Dist WA 2015). See also, In re Decker, 535 B.R. 828 (Bankr. D. Alaska 2015).

Consumer case - cause to dismiss – 707(b)

General inquiry:

- Does debt constitute a consumer debt?
- If there is a question (classification falls within a gray area), burden of proof lies with movant in motion to dismiss. Proof is by preponderance of the evidence.
- Is there a special circumstance that can be claimed for using the ongoing payment on the means test? May evidence that a debt cannot be deferred or discharged through bankruptcy constitute a special circumstance, allowing a deduction for their monthly payment on the means test? (Varied cases - yes *In re Howell, 477 B.R. 314 (Bankr. W.D. N.Y. 2012*, no In re Carillo, 421 B.R. 540, 545 (Bankr. D. Az. 2009).

Benefits of Non-Consumer Debt Classification

- Avoids the means test!
- Avoids result of carrying non-dischargeable debt accumulating interest over a three-to-five year period (Chapter 13).
- Allows debtors opportunity to begin repayment on non-dischargeable debts earlier or file adversary proceedings to establish hardship earlier (such as student loans), providing for greater fresh start.
- Not so beneficial – Fee recovery under Section 523(d) not available for non-consumer debts. In re Bushkin, 2016 Bankr. LEXIS 2688, 2016 WL 4040679, at *6 (B.A.P. 9th Cir. July 22, 2016)

Classifying and Scheduling Debt

- Consumer debt is defined as debt incurred by an individual primarily for a personal, family, or household purpose. [11 U.S.C. § 101(8)]
- "The Bankruptcy Code's definition of consumer debt is adapted from the definition used in various consumer protection laws. H.Rep. No. 95-595, 95th Cong. 1st Sess. 309 (1977); S.Rep. No. 95-989, 2nd Sess. 22 (1978), U.S.Code Cong. & Admin.News 1978, pp. 5787, 5808." In re Stine, 254 B.R. 244 (B.A.P. 9th Cir. 2000)
- Debt incurred for business ventures or other profit-seeking activities is plainly not consumer debt for purposes of section §707(b)." *Zolg v. Kelly (In re Kelly)*, 841 F. 2d 908, 913 (9th Cir. 1988)
- Debts neither incurred primarily (or plainly) for business or consumer purposes ("gray areas"). (Example: taxes, tort judgments, housing stipends via employment, court fines/fees).
- "Primarily" in §101(8) means more than half of the overall debt, without consideration of secured and unsecured debts. Zolg v Kelly, above.

What was the debt's primary purpose?

Residential loans generally found to have a consumer purpose if used for purchase of real estate. Kelly v. Solot (In re Kelly), 70 B.R. 109, 112 (B.A.P. 9th Cir. 1986); See also, In re Price, 353 F.3d 1135 (9th Cir. 2004).

In re Cherrett ("Cherrett I"), 523 B.R. 660 670 (9th Cir. BAP 2014). A "key factor" in determining whether mortgage debt is consumer debt is the debtor's purpose in incurring that debt. If the debt was incurred for more than one purpose, "the primary purpose of the debt will determine its nature." Id. "Court's determine the debtor's purpose as of the time the debt was incurred." Cherrett II, 873 F.3d at 1067.

But consider: Centennial Bank v. Kane, 616 F. Supp. 3d 990 (N.D. Cal. 2022) where multiple mortgages against separate properties in California and Canada, loans used to pay off prior loans (not to purchase real estate). Was new debt for consumption or other purpose?

Where ambiguity exists, argue the purpose and shift the burden!

Student loan classification

Consumer or business debt?

No court has held that student loans are per se consumer debts. See In re Steiner, 2020 WL 2027250 (Bankr. S.D. Ill. 2020) (declining to adopt a per se rule and noting that the United States Trustee acknowledged that no courts have taken this position); In re Ferreira , 549 B.R. 232, 237 (Bankr. E.D. Cal. 2016) ("The United States trustee cites no case in which a court has held that student loans are per se consumer debt and conceded during the hearing none were found."); In re Rucker , 454 B.R. 554 (Bankr. M.D. Ga. 2011) (declining to adopt a per se rule to characterize a student loan debt as consumer debt or nonconsumer debt). (Townson v. Ruff (In re Ruff), 639 B.R. 772 (Bankr. N.D. Ga. 2022))

Aren't all student loans incurred with an eye toward profit ("the profit motive test")?

Student loans – "for profit?"

Debt used for living expenses & tuition-Stewart cases- 10th Circuit discussing standards for student loans as consumer/non-consumer where loan can be like a loan for a new business, although an investment in "oneself". In Stewart v. United States Trustee (In re Stewart), 215 B.R. 456 (10th Cir. B.A.P. 1997) ("Stewart II").

Debt used for tuition and books only (Held: Non-consumer)– Court not required to find benefit to current employer or existing business to find student loans to be business debt, profit motive shown where debtor's motive was to own his own business and education furthered that profit motive. Palmer v. Laying, 559 B.R. 746 (D.Colo. 2016). (Palmer II).

Debtor incurred student loan debt as Parent PLUS Loans and Grad PLUS Loans (Held: Non-consumer (Presumption of student loans as consumer can be overcome by showing the debt is directly tied to advancement of a tangible and impending business opportunity and related to work the debtor was engaged in when the education was undertaken.) In re: Missick, 2019 WL 8756605 (Bankr. M.D. Fla 2019).

To get a better job, increase income (Held: consumer debt)- (Student loans for nursing school to "get a better job" showed no tangible benefit to an existing job or business). In re Ferreira , 549 B.R. 232 (Bankr. E.D. Cal. 2016); (loans for nursing school to increase income not tied to existing job or business) In re Validvia, 2020 WL 4939161 (Bankr. E.D. N.C. 2020).

Student loans – arguments against non-consumer classification

- Profit motive test difficult to apply, evaluating based on the student's motivation may lead to disparate results.
- Characterization of the student loan placed in the hands of the debtor; debtors can tailor their testimony to sway the debt classification.
- Debts not granted priority for payment under §507 of the code shouldn't be given priority treatment.
- If profit motive not interpreted narrowly, it can be applied to all student loans.
- Consumer protections under Fair Debt Collection Practices Act, Truth In Lending Act, etc. (we want to maintain those protections).

Student loans – Subchapter V

- To qualify for Sub V, Courts must examine whether the student loans arose from a commercial or business activity *(See 11 U.S.C. § 1182(1)(A)).*
- Bankruptcy Code does not define "commercial or business activity". See 11 U.S.C. §101(51D).
- Unpublished decision – Reis v. Garvin (In re Reis), 24-4201 (9th Cir. Feb 26, 2025)
- This Ninth Circuit decision was very fact-driven and didn't close the door to finding in another case that student loans for a professional degree could make the debtor eligible for Subchapter V of Chapter 11.

The problem that survives….

- Debtors have both private and federal loans, difficult to navigate reasonable payment for loans given large sums due, limited income, interest that continues to accrue
- The acceleration of private student loans and the threat of a wage garnishment present unique problems to those carrying student loan debts. Unlike federal student loans, which allow borrowers to rehabilitate their loans after acceleration, see 34 C.F.R. § 682.405, private student loans offer no loss mitigation or rehabilitation options after acceleration. Longo v. Discover Bank (In re Longo), 654 B.R. 1 (Bankr. Conn. 2023).

File an Adversary – 11 usc §523(a)(8)

- Attestation process still available despite political climate.
- Understand Brunner, requirements to meet eligibility.
  - (1) they cannot maintain a minimal standard of living if forced to repay the student loans, (2) circumstances exist indicating this situation is likely to persist for a significant portion of the repayment period, and (3) they have made good faith efforts to repay the loans - In re Brunner, 46 B.R. 752, 753 (S.D.N.Y., 1985) (Aff'd by 831 F.2d 395 (2d Cir.1987)).
- In re Pena (what is undue hardship) In re Pena, 207 B.R. 919 (9th Cir.BAP, 1997).
- Can come back and reopen bankruptcy case later to file adversary after setting up client for success.
- Cases are fact intensive, some effort to repay must be present.

If Chapter 13 - consider classification and payment of debt using §1322(b)(5)

- Non-dischargeable debts <u>not</u> a basis for discrimination – View §1322(b)(5) considering §1322(b)(1).
- Not just used for home mortgages, can be used for other non-dischargeable long-term debt.
- In re Wolff, 22 B.R. 510 (9th Cir. BAP, 1982) (four part discrimination test)
- In re Sperna, 173 B.R. 654 (9th Cir. BAP, 1994) "discriminatory treatment of unsecured creditors through classification is not prohibited, <u>unfair</u> discrimination is.
- Co-debtor stay does not apply to non-consumer debts. 11 U.S.C. Sec. 1301(a)(1); See also, In re Nicolas, No. 02-00211, 2002 Bankr. LEXIS 2140, 2002 WL 32332461, at *2 (Bankruptcy D. Haw. Mar. 22, 2002).

Examples – Courts and outcomes

- Roth v. Educ. Credit Mgmt. Corp. (In re Roth), 490 B.R. 908 (B.A.P. 9th Cir. 2013)
- Mitchell v. V-A Loan Acquisition Trust (In re Mitchell), Adversary No. 13-04415, Case No. 09-44678 (Bankr. W.D. Wash. Oct 20, 2014)
- In Ferreira, (In re Ferreira, 549 B.R. 232 (Bankr. E.D. Cal. 2016)
- Coplin v. U.S. Department of Education, Case No. 13-46108, Adversary No. 16-04122, 2017 WL 6061580 (Bankr. W.D. Wash. December 6, 2017).
- Nitcher v. Educ. Credit Mgmt. Corp. (In re Nitcher), 606 B.R. 67 (Bankr. Or. 2019)
- Hurley v. United States (In re Hurley), 601 B.R. 529 (B.A.P. 9th Cir. 2019)
- Wolfson v. DeVos (In re Wolfson), 19-11618 (LSS), Adv. 19-50717 (Bankr. Del. Jan 14, 2022)
- Chase v. U.S. Department of Education, Case no. 23-10093, Adversary No. 23-1005, (Bankr. ME, December 12, 2024) – Cautionary Tale!

Torts

- Generally, tort liability does not fit the definition of a consumer debt.
  - The inability to classify a debt as a business debt does not automatically relegate it to the status of a consumer debt. See In re Tinjareo, 2020 Bankr. LEXIS 2157, 2020 WL 4673235, at *7 (9th Cir. BAP 2020), citing In re Marshalek, 158 B.R. 704, 708 (Bankr. N.D. Ohio 1993).
- Did the Debtor incur the debt voluntarily?
  - Negligence – Debts incurred unintentionally are often considered non-consumer debts even though they were incurred while attempting to complete a familial task.
  - Example – Negligent driving
    - Judgments resulting from automobile accidents were not, per se, "consumer debt," as defined under the Code. See In re Marshalek cited above.

Tax Debts

- For purposes of the Bankruptcy Code, tax debt is categorized as non-consumer debt. In re Decker, 535 B.R. 828 (Bankr. D. Alaska 2015), citing In re Westberry, 215 F.3d 589 (6th Cir. 2000).
  - Tax debts are incurred for a public purpose, not incurred of a debtor's own volition.
  - Example – Individual income taxes resulting from wages earned are non-consumer debts.

Preferences for Non-Consumer Debtor

- Threshold for non-insider creditors is **$8,575.00** in cases where debts are not primarily consumer debts. 11 U.S.C. § 547(c)(9).
  - Section 11 U.S.C. § 547(c)(9) if, in a case filed by an individual whose debts are not primarily consumer debts, the aggregate value of all property that constitutes or is affected by such transfers is less than $8,575.
    - Recent change to the dollar amount took place on April 1, 2025.
      - Threshold changes every three years. 11 U.S.C. § 104. Next adjustment to threshold will take effect on April 1, 2028.

Debts Primarily Arose from Commercial or Business Activities Requirement for Sub V Eligibility for Individuals

- Small Business Debtor – a person engaged in commercial or business activities that has an aggregate noncontingent liquidated secured and unsecured debts as of the date of the filing of the petition or date of the order for relief in an amount not more than $3,424,000 (excluding debts owed to 1 or more affiliates or insiders) not less than 50 percent of which arose from the commercial or business activities of the debtor. See 11 U.S.C. § 101(51D) and 11 U.SC. §1182(1).
  - A profit motive is not required. Scope of commercial or business activities is very broad and apply a totality of circumstances standard. In re RS Air, LLC, 638 B.R. 403 (B.A.P. 9th Cir. 2022).
  - Not a commercial or business activity – Providing tree-falling service for family member that the debtor regularly performs in scope of employment free of charge without a contract. In re Bennion, 2022 Bankr. LEXIS 2100 (Bankr. D. Idaho July 29, 2022).
  - Practice point - Pay off debts not arising from commercial or business activities to become eligible for Sub V. Does it matter if it is a preference payment? Wait?

Sub V Cramdown of Mortgage on Residence Incurred for Debtor's Small Business

- Subchapter V case has a unique ability to modify the rights of creditors who hold claims secured by a debtor's primary residence, so long as the debt was not primarily a purchase-money mortgage and instead was used primarily in connection with the debtor's small business. 11 U.S.C. § 1190(3).
  - Example – Home equity loan used for business purposes or cash-out refinance.

Contact Page

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NOTES

Chapter 3

Unpacking the Aftermath of *Purdue:* Releases, Exculpations, and the Possible Application of Rule 7023

Moderator: Christine Tobin-Presser
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Jeffrey Garfinkle
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Los Angeles, California

Marc Levinson
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Unpacking the Aftermath of Purdue:

Releases, Exculpations, and the Possible Application of Rule 7023

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CONSENSUAL THIRD-PARTY RELEASES

- In the wake of the Supreme Court's holding in *Purdue*, a reignited interest has developed concerning the requirements needed for a bankruptcy court to approve a debtor's consensual third-party release. In other words, **what type of consent must a creditor provide for a court to release their claims against a non-debtor third-party consensually?**

> Today's decision is a narrow one. Nothing in the opinion should be construed to call into question consensual third-party releases offered in connection with a bankruptcy reorganization plan. **Nor does the Court express a view on what qualifies as a consensual release** or pass upon a plan that provides for the full satisfaction of claims against a third-party nondebtor.
>
> *Harrington v. Purdue Pharma L.P.*, 603 U.S. 204, 206, 144 S. Ct. 2071 (2024)

- **Two schools of thought have developed regarding the standard that courts should use to determine whether a creditor has consented to a release of its third-party claims:**
  - **Majority View**: Default/Opt-Out Consent
  - **Minority View**: Contract/Opt-In Consent

MAJORITY VIEW: DEFAULT / OPT-OUT CONSENT

- A majority of jurisdictions adopt the Default/Opt-Out Consent standard when reviewing consensual third-party releases tied to a debtor's proposed reorganization plan.
- **Default/Opt-Out Consent**: A creditor consents to a release of their claim against a non-debtor third-party upon confirmation of a debtor's bankruptcy as long they are informed of the proposed release through clear and conspicuous notice on their creditor's ballot and the creditor:

    1. **Fails to return their ballot or**
    2. **Fails to check the "opt-out" box on their ballot**

- Absent a creditor's affirmative opt-out election on a timely returned ballot, a bankruptcy court will find it consented to release its third-party claim upon the debtor's emergence from bankruptcy.
- Courts frequently compare the consequences a creditor bears for not submitting their opt-out election on time to the consequences a non-responding party faces upon a court's entry of a default judgment against them.

Permissibility of Opt-Out Third Party Releases	Mandatory Opt-In Third Party Releases
	***In re Quincy Med. Ctr.*, No. 11-16394-MSH, 2011 Bankr. LEXIS 4405** (Bankr. D. Mass. Nov. 16, 2011)
	***In re Taing*, No. 22-40896-CJP, 2024 Bankr. LEXIS 1899** (Bankr. D. Mass. Aug. 12, 2024)
***In re Robertshaw US Holding Corp.*, 662 B.R. 300** (Bankr. S. D. Tex. Aug. 16, 2024)	
	***In re Tonawanda Coke Corp.*, 662 B.R. 220** (Bankr. W.D.N.Y. Aug. 27, 2024)
	***In re Smallhold, Inc.*, 665 B.R. 704** (Bankr. D. Del. Sep. 25, 2024)
***In re Lavie Care Ctrs.*, No. 24-55507- PMB, 2024 Bankr. LEXIS 2900** (Bankr. N.D. Ga. Dec. 5, 2024)	
***In re Pipeline Health Sys., LLC*, No. 22-90291, 2025 Bankr. LEXIS 495** (Bankr. S.D. Tex. Mar. 3, 2025)	
***In re Spirit Airlines, Inc.*, No. 24-11988, 2025 Bankr. LEXIS 553** (Bankr. S.D.N.Y. Mar. 7, 2025)	

DEFAULT/OPT-OUT CONSENT CASE STUDY:
***In re Robertshaw US Holding Corp.*, 662 B.R. 300**
(Bankr. S. D. Tex. Aug. 16, 2024)

- In February 2024, Robertshaw and its affiliates, a large design system and component manufacturing company, (the "Debtors") filed for chapter 11 bankruptcy protection.
- In June 2024, the Court entered an order which approved the Debtors' disclosure statement and plan confirmation deadline.
- The US Trustee objected to the Debtors' plan based on its inclusion of opt-out consensual third-party releases for, *inter alia*, the Debtors, the Debtors' current and former officers, directors, and managers, as well as various professional parties hired to facilitate the Debtors through bankruptcy for claims related to, *inter alia*, the chapter 11 case and the sale and purchase of estate assets.
- The Court rejected the U.S. Trustee's objection and held: "There is nothing improper with an opt-out feature for consensual third-party releases in a chapter 11 plan… **Hundreds of chapter 11 cases have been confirmed in this District with consensual third-party releases with an opt-out. And, again, *Purdue* did not change the law in this Circuit.**" *In re Robertshaw US Holding Corp.*, 662 B.R. 300, 323.
- The Court referenced the extensive notice that Debtors provided parties in interest, including publishing the release in the Wall Street Journal.

DEFAULT/OPT-OUT CONSENT CASE STUDY:
***In re Spirit Airlines, Inc., No. 24-11988,* 2025 Bankr. LEXIS 553 (Bankr. S.D.N.Y. Mar. 7, 2025)**

- In November 2024, Spirit Airlines, Inc. and its affiliates, a low-cost commercial airline providing flights throughout the U.S., Latin America and the Caribbean (the "Debtors"), filed for chapter 11 bankruptcy protection.
- The Debtors' Plan was based on a restructuring support agreement ("RSA") entered into pre-petition by the Debtors and certain stakeholders who held 80% of the total debt to be restructured and two-third in debt amount by each voting class ("Consenting Stakeholders") and included the use of opt-out third-party releases.
- The U.S. Trustee and the SEC filed objections to the Debtors' plan, which argued that the opt-out third-party releases could not constitute creditor consent and thus violated the Supreme Court's holding in *Purdue*.
- The Court rejected the U.S. Trustee and the SEC's objections and held:

  > **Decisions in this District** generally **permit use of an opt-out mechanism if** the affected **parties receive clear and prominent notice** and **explanation of the releases** and **are provided an opportunity to decline to grant them**. In assessing the permissibility of an opt-out, courts also look to the circumstances of each case to determine whether consent exists. *In re Spirit Airlines, Inc.*, No. 24-11988, 2025 Bankr. LEXIS 553, at *28 (Bankr. S.D.N.Y. Mar. 7, 2025).

- The Court also extensively cited Restatement (Second) of Contracts § 69 to illustrate examples where courts have found a party consented to be bound by an agreement even absent explicit assent to the agreement.

MINORITY VIEW: CONTRACT / OPT-IN CONSENT

- A minority of jurisdictions adopt the Contract/Opt-In Consent standard when reviewing consensual third-party releases tied to a debtor's proposed reorganization plan.
- **Default Opt-In Consent**: A creditor consents to a release of their claims against a third-party non-debtor by checking the "Opt-In" box and timely returning their ballot.
- Courts that adopt this standard hold that a **creditor's consent to a consensual release should be clearly manifested and consistent with ordinary contract principles** (i.e. offer and acceptance).
- Critics of this standard argue that adding this procedural step provides a barrier to a creditor's recovery and point to the low rate of ballot return in ordinary chapter 11 cases as evidence of the impracticality of this standard.

CONTRACT/OPT-IN CONSENT CASE STUDY: *In re Smallhold, Inc.*, No. 24-10267 (CTG), 2024 Bankr. LEXIS 2332 (Bankr. D. Del. Sep. 25, 2024)

- In February 2024, Smallhold, Inc., a specialty New York mushroom farming company, (the "Debtor") filed for chapter 11 bankruptcy protection.
- The Debtor filed its amended plan which included opt-out releases for, *inter alia*, the Debtor's DIP lender and other estate representatives with respect to any liability related to pre-petition activity.
- On August 14, 2024, the US Trustee objected to the Debtor's plan based on its inclusion of opt-out consensual third-party releases.
- The Court ruled in favor of the U.S. Trustee's objection and held:

> **After *Purdue Pharma*, a third-party release is no longer an ordinary plan provision that can properly be entered by "default" in the absence of an objection**... The nonconsensual third-party release is now per se unlawful. As such, **it is not the kind of provision that would be imposed on a creditor on account of that creditor's default**. *In re Smallhold, Inc.*, No. 24-10267 (CTG), 2024 Bankr. LEXIS 2332, at *4-5 (Bankr. D. Del. Sep. 25, 2024)

HYBRID OPTION CASE STUDY:
***In re The Roman Catholic Bishop of Oakland*, No. 23-40523 (WJL)**
Bankruptcy Court for the Northern District of California, Oakland Division

- The case was primarily filed to address hundreds of claims of childhood sexual abuse by persons associated with the Debtor.
- The Debtor filed its Third Amended Plan of Reorganization on March 17, 2025. The Court has not held a confirmation hearing or ruled on the permissibility of the proposed Plan's releases.
- The proposed Plan contains an opt out third party release but indicates that any claimant that fails to return a ballot will be deemed to have *opted out*.
- The proposed Plan includes a release by holders of abuse claims against one of the Debtor's affiliates ("RCWC") in exchange for a $28,500,000 over four years following confirmation. However, "if less than 100% of all RCWC Claimants [Abuse Claimants with claims against RCWC] grant RCWC a release . . . The RCWC Cash Contribution . . . *shall be reduced by a percentage proportional to the percentage of RCWC Claimants who either opt out of granting RCWC such release or fail to return a ballot.*"

Thirteenth Amended Joint Chapter 11 Plan
Debtors Purdue Pharma L.P., et al.

- On March 18-19, 2025, Purdue Pharma L.P., and its affiliates (the "Debtors") filed their *Thirteenth Amended Joint Chapter 11 Plan of Reorganization* and *Disclosure Statement*, respectively.
- In response to the Supreme Court's categorical prohibition of nonconsensual third-party releases, the Debtors stated in their *Disclosure Statement* "**Consistent with the decision of the United States Supreme Court in *Harrington v. Purdue Pharma, L.P.***, 603 U.S. 204 (2024), **the Plan will not contain non-consensual Third-Party Releases. Instead, the Plan will provide public and private claimants the choice of whether to provide Third-Party Releases**."
- The Debtors utilized both opt-out and opt-in third-party releases:
  - Opt-out releases were utilized to obtain the consent of certain school districts, hospitals, and ER physicians.
  - Opt-In releases were utilized to obtain the consent of all other voting class creditors.

EXCULPATION CLAUSES

- Common plan provisions that limit or eliminate the liability of estate fiduciaries and often other specified parties relating to claims arising from their work related to the restructuring of the estate performed *during the case*.
- Bad faith, gross negligence and willful misconduct excluded.
- Narrowly tailored clauses accepted in the Ninth Circuit and other Circuits.

  Blixseth v. Credit Suisse, 961 F.3d 1074 (9th Cir. 2019), *cert. denied*, 141 S.Ct. 1394 (2021)

  In re Astria Health, 623 B.R. 2021 (E.D. Wash. 2021)

  In re PWS Holding Corp., 228 F.3d 224 (3d Cir. 2000)

  In the Matter of Highland Capital Mgmt., L.P. 2025 WL 841189 (5th Mar. 18, 2025)

  Patterson v. Mahwah Bergen Retail Group, Inc., 636 B.R. 641 (E.D. Va. 2022)

  In re Instant Brands Acquisition Holdings, Inc., 2025 WL 685756 (Bankr. S.D. Tex. March 3, 2025)

HAVE EXCULPATIONS SURVIVED *PURDUE*?

- In the wake of the Supreme Court's holding in Purdue, a reignited interest has developed concerning the requirements needed for a bankruptcy court to approve a debtor's consensual third-party release. In other words, **what type of consent must a creditor provide for a court to release their claims against a non-debtor third-party consensually**? As noted in a previous slide, the Purdue majority stressed that its ruling was very narrow.

  > Confining ourselves to the question presented, we hold only that the bankruptcy code does not authorize a release and injunction, that as part of a plan of reorganization under Chapter 11, effectively seeks to discharge claims against a nondebtor without the consent of the affected claimants."

- The majority was joined by Justices Thomas, Alito, Barrett and Jackson.
- Justice Kavanaugh's dissent urged the Court not to sweep with too broad a brush:

  > Exculpation clauses shield the estate's fiduciaries and other professionals (non-debtors) from liability for their work on the reorganization plan. [citing the amicus brief of the American College of Bankruptcy]. Without such exculpation clauses 'competent professionals would be deterred from engaging in the bankruptcy process, which would undermine the main purpose of chapter 11 – achieving a successful restructuring.'" [quoting from the amicus brief of Highland Capital]

- The dissent was joined by Chief Justice Roberts and by Justices Sotomayor and Kagan.

ARGUMENTS IN SUPPORT OF EXCULPATIONS

- Claims for postpetition misconduct are derivative and are property of the estate. The estate may release *its* claims in a plan. § 1123(b)(3)(A)
  - Per *Purdue*, claims held by individuals (as opposed to the estate) are not released absent consent (i.e., opt-in or opt-out)
  - But what claims arising from postpetition conduct do individual creditors hold?
- *Purdue* does not impact consensual releases, and a release of estate claims as part of a plan approved by the requisite majorities is consensual.
- Section 524(e) is a red herring because it releases claims ***against*** the debtor and exculpations release claims ***held by*** the debtor.
- Prohibiting releases of estate professionals might/would have a chilling effect the willingness to serve of professionals and outside directors.
- Members of official committees enjoy limited immunity for acts taken in connection with the case absent bad faith, etc.

GATEKEEPING CLAUSES AND THE BARTON DOCTRINE

- *Barton v. Barbour*, 104 U.S.126 (1881), a receivership case that has been expanded by many decisions to apply to the postpetition conduct of estate professionals.
- Prior to commencing any such action, the bankruptcy court must first determine that the claims are colorable.
- The recent *Highland Capital* Fifth Circuit decision held that gatekeeping clauses and exculpations must include the same parties.

ARGUMENTS AGAINST EXCULPATIONS

- *Purdue* reflects the SCOTUS view that unless the Bankruptcy Code expressly authorizes a release, there is no release.
- Professionals negotiating releases for themselves may be committing an ethical violation according to Professor Bruce Markell because, among other things, such clauses release malpractice claims. *Bankruptcy Law Letter*, Volume 42, Issue 6 (June 2022).
- Few, if any, post-*Purdue* cases that address exculpations have been published other than *Highland Capital*.

RULE 23(B)(3) ANALYSIS FOR OPT-OUT RELEASES

- Judge Goldblatt in *In Re Smallhold, Inc* raised the prospect of ruling differently on the permissibility of opt-out third-party releases to the extent that "**the plan process builds in the protections of the class action mechanism under Rule 23(b)(3)**, where an "opt-out" mechanism is deemed appropriate." *In re Smallhold, Inc.*, No. 24-10267 (CTG), 2024 Bankr. LEXIS 2332, at *25 (Bankr. D. Del. Sep. 25, 2024).
- F.R.C.P. 23(b)(3):

  A class action may be maintained if Rule 23(a) is satisfied and if:

  the court finds that the **questions of law or fact common to class members predominate over any questions affecting only individual members**, and that a class action is superior to other available methods for fairly and efficiently adjudicating the controversy. **The matters pertinent to these findings include**:

  A. the class members' interests in individually controlling the prosecution or defense of separate actions;

  B. the extent and nature of any litigation concerning the controversy already begun by or against class members;

  C. the desirability or undesirability of concentrating the litigation of the claims in the particular forum; and

  D. the likely difficulties in managing a class action.

Bar Orders in Equity Receiverships

***United States SEC v. Peterson*, 129 F.4th 599 (9th Cir. 2025)**

- In 2019, the Securities and Exchange Commission ("SEC") brought a civil enforcement action against Gina Campion-Cain ("Cain") and her Company ANI Development, LLC ("ANI") in connection to a Ponzi scheme Cain ran throughout San Diego, CA which received $389 million from over 400 investors.
- Cain offered investors the opportunity to fund short-term, high-interest loans extended to fictitious liquor license transferee applicants who purportedly were willing to pay interest fees to avoid tying up their own money in escrow accounts pursuant to state law while their applications were pending review by the State's Department of Alcohol Beverage Control.
- The District Court appointed a receiver for and temporarily stayed litigation against ANI.
- In response to the temporary stay, defrauded investors sued, *inter alia*, third-parties Chicago Title Company ("Chicago Title") and the Nossaman Law firm and one of its partners ("Nossaman") for their alleged complicity in furthering the Ponzi Scheme.
- Ultimately, the District Court authorized a global settlement between the Receiver and Chicago Title which, in exchange for $25 million from Chicago Title, would permanently bar all current and future claims against Chicago Title and Nossaman.
- Kim Peterson ("Peterson") and Ovation Fund Management II, LLC ("Ovation", and along with Peterson collectively "Appellants") challenged the District Court's order on the grounds that, *inter alia*, the District Court lacked authority to enter the bar orders and the bar orders were further prohibited by the Anti-Injunction Act ("AIA"), 28 U.S.C. § 2283.

Bar Orders in Equity Receiverships

***United States SEC v. Peterson*, 129 F.4th 599 (9th Cir. 2025)**

- The Court affirmed the District Court's order permanently barring all current and future litigation against Chicago Title and Nossaman in connection with their involvement in the Ponzi scheme.
- The Court held:

  > **A district court overseeing the SEC enforcement action has "wide discretion to determine the appropriate relief in an equity receivership**." One way in which a district court overseeing an equitable receivership may aid a receiver in gathering and distributing the receivership's assets equitably among defrauded investors is by issuing bar orders like the ones challenged here. *United States SEC v. Peterson*, 129 F.4th 599 (9th Cir. 2025)

- The Court also rejected Ovation's argument that the Supreme Court's decision in *Purdue* reinforced its argument that a district court cannot bar independent, non-derivative third-party claims that do not impact the res of the receivership estate:

  > **Harrington does not apply here** because it specifically addressed whether the bankruptcy code permitted the court overseeing Purdue Pharma's bankruptcy to bar claims against, not the debtor itself, but individuals who own the corporate debtor. **That case construed several specific bankruptcy code provisions that are not implicated here.** *United States SEC v. Peterson*, 129 F.4th 599 (9th Cir. 2025)

Outlook

The Future of Third-Party Releases in Chapter 11 Plans

- Questions surrounding what constitutes creditor consent for third-party releases are actively being litigated in Bankruptcy courts nationwide.
- As these cases move forward, Circuit courts are expected to weigh in on the unresolved issues left open by SCOTUS—issues that may ultimately return to SCOTUS for final determination.

Chapter 4

Shaping Your Practice So You Can Thrive

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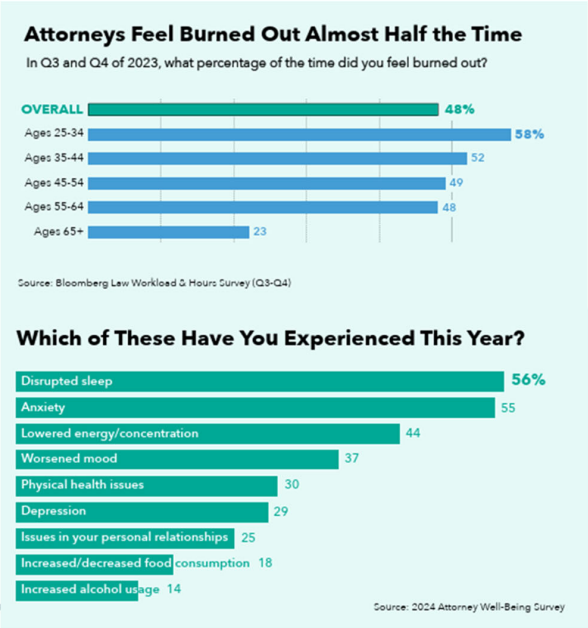
SHAPING YOUR PRACTICE SO YOU CAN THRIVE

Oregon State Bar
38th Annual NW Bankruptcy Institute
May 2, 2025 | Hyatt Regency Portland

Bryan Welch

Darcel Lobo

- What Brought You To This Work?
- What Is Meaningful To You About It?
- Why Do You Do It?
- What Do You Bring To It?



Challenges in 2024

Trouble focusing on work tasks	**48%**
Inability to "disconnect" from work	45
Sadness/anxiety/fear about world events	38
Feelings of inadequacy/ Imposter syndrome	35
Unmanageable workload	32
Feeling a lack of meaning or purpose in life	31
Loneliness or isolation	26

Source: 2024 Attorney Well-Being Survey

WHY THIS IS IMPORTANT

- Hazardous, harmful or potentially dependent drinking at 20% (nearly twice the rate of the general population).
- Rates highest among lawyers under 30 and new lawyers.
- Significant levels of stress (23%), anxiety (19% / 61%) and depression (28% / 46%).
- Suicidal Ideation at 8.5% (twice the general population)
  Perceived stress (22x, 5x); Gender (male 2x); Loneliness (3x)
- Burned Out Employees Are:
  - 2.6 times more likely to be looking for a new job
  - 63% more likely to take a sick day
  - 23% more likely to visit an emergency room

(APA)

WHAT LAW FIRMS CAN DO

SYSTEMIC FACTORS THAT CAUSE DISENGAGEMENT, INEFFICACY, AND EXHAUSTION

- **UNFAIR TREATMENT AT WORK**
  Favoritism, arbitrary decision-making, bias
- **UNMANAGEABLE WORKLOAD**
  High workload and time pressure coupled with insufficient resources to meet the demand.
- **PERCEIVED LACK OF CONTROL / AUTONOMY**
  Lack of choice about what to work on, who you work with, when you work, etc. Feeling micromanaged.
- **LACK OF COMMUNICATION, SUPPORT, CONNECTION**
  Feeling isolated / not having a sense of belonging at work.
- **LACK OF RECOGNITION AND REWARD**
  Being paid appropriately is a necessary, but not sufficient, condition.
- **VALUES DISCONNECT**
  What you find important about work doesn't match the environment you're in.

MANAGE WORKLOAD AND REST (RESPECT)

WHY IT MATTERS

- Unmanageable workloads are the top predictor of burnout.

ACTIONABLE CHANGE

- Regularly assess workload distribution.
- Use tools like staffing dashboards or check-ins to prevent chronic overwork.
- Leverage tech to minimize routine tasks.
- Provide support (not just encouragement) to say "no" when needed.
- Encourage and model protected time away from work.

AUTONOMY AND CONTROL (TRUST)

- **WHY IT MATTERS**
  - Low morale, disengagement, decreased productivity, turnover.
- **ACTIONABLE CHANGE**
  - Train supervisors away from micromanagement (micromanagement is a stress response);
  - Support flexibility in where, when, and how people choose to do their work.

BUILD A CULTURE OF SAFETY AND CONNECTION (BELONGING)

- **WHY IT MATTERS**
  - Lawyers are the loneliest profession, and often hesitate to admit struggle or ask for help due to stigma or competitiveness.
- **ACTIONABLE CHANGE**
  - Foster meaningful, culturally supportive mentorship; Provide timely, meaningful, strengths-based feedback. Celebrate collaboration, well-being, and successes, not just billables. Model help-seeking behavior.

FAIRNESS, TRANSPARENCY, AND RECOGNITION (VALUE)

- **WHY IT MATTERS**
  - When people perceive unfairness or feel invisible, burnout accelerates.
- **ACTIONABLE CHANGE**
  - Be transparent about how decisions are made—promotions, assignments, evaluations.
  - Recognize effort consistently, not just outcomes.
  - Employees have a voice in what matters to them.
  - People are clear on how their work contributes to the overall success of the business.

LEADERSHIP COMMITMENT TO WELL-BEING

- **WHY IT MATTERS**
  - LEADERS set the tone.
- **ACTIONABLE CHANGE**
  - Train supervisors in empathy, feedback, and management—not just legal expertise.
  - Make emotional intelligence a leadership standard.
  - Actively work to support help-seeking and self-care.

WHAT LAWYERS CAN DO

RECONNECT WITH VALUES AND PURPOSE

WHY IT MATTERS

- Burnout thrives when work feels meaningless.

ACTIONABLE CHANGE

- Regularly reflect on why you do this work.
- Who do you help? What drew you to law?
- Even a weekly check-in on this can reframe the grind as meaningful.

SET AND PROTECT BOUNDARIES

WHY IT MATTERS

- Without boundaries, work will take up all available space, cause resentment, make it harder to meet obligations outside of work.

ACTIONABLE CHANGE

- Set clear limits around when you'll check email, take meetings, or engage with work.
- Communicate these expectations and honor them yourself.
- Set emotional boundaries.

PRIORITIZE RECOVERY (NOT JUST REST)

WHY IT MATTERS

- True recovery involves doing things that restore energy—not just unplugging.

ACTIONABLE CHANGE

- Carve out space for movement, sleep, creativity, laughter, or whatever replenishes you.
- Don't just zone out—actively restore.

CULTIVATE CONNECTION

WHY IT MATTERS

- Isolation is both a cause and symptom of burnout.

ACTIONABLE CHANGE:

- Nurture relationships inside and outside of work.
- Find your "go-to" people.
- Even one close connection at work can dramatically improve engagement and satisfaction.
- Debrief difficult emotional content.

ADVOCATE FOR YOURSELF—SKILLFULLY

WHY IT MATTERS

- Being passive in a high-demand environment = slow burnout.

ACTIONABLE CHANGE

- Speak up early about workload, unclear expectations, or needed support.
- Use curiosity, collaboration, and clarity—not defensiveness—to get what you need.

Well-being Resources

- ABA Well-being Pledge Campaign
- ABA Well-being Toolkit
- Washington State Well-being Task Force
- Oregon 2023 Well-being Workgroup Report
- Assess Workplace Well-being: ProQOL

3 TAKEAWAYS

THANK YOU!

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NOTES

Chapter 5

The Complex World of Ponzi Litigation: Navigating Ponzi Scheme Adjudication in Insolvency Proceedings

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THE COMPLEX WORLD OF PONZI LITIGATION:

NAVIGATING PONZI SCHEME ADJUDICATION IN INSOLVENCY PROCEEDINGS

JOHN BENDER & BRIAN PETERSON, K&L GATES

JAY KORNFELD, BUSH KORNFELD

NWBI 2025

PRESENTATION OVERVIEW

1. How do Ponzi Cases Arise?
2. Elements of a Ponzi Scheme
3. Issues to Consider in Bankruptcy
4. Substantive Consolidation
5. Litigation to Recover from Third Parties after Ponzi Finding
6. Avoidance of Action Claims against Vendors/Contract Counterparties
7. Potential Tax Relief – IRC 165

1. HOW ARE PONZI CASES DEVELOPED?

a. Pre-bankruptcy litigation

b. Markers for litigators

c. Priorities in investigation

d. Transition from litigation to Bankruptcy – Trajectory

i. Direct transition from litigation to bankruptcy (iCap)

ii. Indirect transitions – receivership, delays prior to bankruptcy (WS)

e. What to expect from the fraudster/architect of the Ponzi

f. DOJ/SEC other regulatory overlay

2. ELEMENTS OF A PONZI SCHEME

a. Ninth Circuit (*In re EPD Inv. Col, LLC,* 114 F4th 1148 (9th Cir. 2024)

i. Funneling of money from new investors to pay old investors, and

ii. No legitimate profit-making business opportunity for investors

b. Other criteria evidencing a Ponzi Scheme (*In re EPD*)

i. Absence of legitimate business connected to investment program

ii. Unrealistic promises of low risk and high returns

iii. Commingling investor funds

iv. Use of agents and brokers paid high commissions to perpetuate scheme

v. Misuse of investor funds

vi. Payment of excessively large fees to the perpetrator

vii. Use of false financial statement

3. ISSUES TO CONSIDER IN BANKRUPTCY

a. Investigation/Development of Ponzi Elements

i. Focus of investigation

i. Company records, bank accounts, intercompany transfers

ii. Sources of funds/uses of funds

iii. Legitimate business revenues

iv. Commissions paid to brokers/agents

v. Payments/transfers to perpetrator

vi. Financial statements/representations to investors & third parties

ii. Interviews

iii. 2004 discovery

iv. Expert analysis

3. ISSUES TO CONSIDER IN BANKRUPTCY

b. Timing and procedural posture of Ponzi finding

i. Ponzi finding can be obtained in a contested matter (*In re Bonham,* 229 F.3d 750 (9th Cir. 2000); *Leslie v. Mihranian (In re Mihranian),* 937 F.3d (9th Cir. 2019))

ii. Challenges can be confronted with standalone motion

i. Notice & right to be heard

ii. Complicated adversary proceeding?

iii. Plan process is efficient vehicle

i. Limited active participation

ii. Adversary proceeding not required

iii. Notice achieved through plan process

iv. Examples of this: *In re Woodbridge (D. Del); In re iCap (E.D. Wa)*

4. TRYING THE PONZI CASE

a. **Elements of an effective trial**
   i. Telling the story effectively
      i. Communicating what happened to both judge and victims
      ii. Themes and archetypes
         i. Essential ingredients to any trial
      iii. Fact witnesses and testimony
      iv. Use of authentic evidence (documents, audio, visual)

4. TRYING THE PONZI CASE

b. **Challenges to overcome along the way –**
   i. Volume of / access to information
   ii. Cooperation between estate/committee
   iii. Witness cooperation
   iv. 5th Amendment issues / requests to stay proceedings
   v. Pre-trial / expedited discovery

5. SUBSTANTIVE CONSOLIDATION

a. **Substantive Consolidation vs. Alter Ego Determination with respect to non-debtor entities**
b. **Pros and cons and ability of estate to obtain recourse with respect to transfers by non-debtors**
c. **Is Nunc Pro Tunc relief available?**

6. CONSEQUENCES OF PONZI FINDING

a. **Ponzi presumption**
b. **Deadline to commence avoidance actions**
c. **Litigation targets:**
    i. **Winners/losers**
    ii. **Lenders and operating banks**
    iii. **Professionals and brokers**
    iv. **Aiders and abettors**
d. **Avoidance Action claims**
    a. **Defenses**
    b. **Good faith defense under Section 546(c)**

7. POTENTIAL TAX RELIEF - VICTIMS

a. **Internal Revenue Code Section 165**
b. **Allows investor in a Ponzi scheme to deduct losses as theft loss instead of capital loss from an investment**
c. **No limit for theft losses vs $3,000/year limit for capital losses**

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HONORABLE WHITMAN L. HOLT

HEARING DATE: October 16, 2024
HEARING TIME: 9:30 a.m. (PT)
LOCATION: Tower Bldg.
2nd Floor Courtroom
402 East Yakima Avenue
Yakima, WA 98901

UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF WASHINGTON

In re: ICAP ENTERPRISES, INC., et al., Debtors.[1]	Chapter 11 Lead Case No. 23-01243-WLH11 Jointly Administered **SUPPLEMENTAL BRIEF REGARDING PONZI FINDINGS IN SUPPORT OF CONFIRMATION OF MODIFIED SECOND AMENDED JOINT CHAPTER 11 PLAN OF LIQUIDATION**

[1] The Debtors (along with their case numbers) are iCap Enterprises, Inc. (23-01243-11); iCap Pacific NW Management, LLC (23-01261-11); iCap Vault Management, LLC (23-01258-11); iCap Vault, LLC (23-01256-11); iCap Vault 1, LLC (23-01257-11); Vault Holding 1, LLC (23-01265-11); iCap Investments, LLC (23-01255-11); iCap Pacific Northwest Opportunity and Income Fund, LLC (23-01248-11); iCap Equity, LLC (23-01247-11); iCap Pacific Income 4 Fund, LLC (23-01251-11); iCap Pacific Income 5 Fund, LLC (23-01249-11); iCap Northwest Opportunity Fund, LLC (23-01253-11); 725 Broadway, LLC (23-01245-11); Senza Kenmore, LLC (23-01254-11); iCap Campbell Way, LLC (23-01250-11); UW 17th Ave, LLC (23-01267-11); iCap Broadway, LLC (23-01252-11); VH 1121 14th LLC (23-01264-11); VH Senior Care LLC (23-01266-11); VH Willows Townhomes LLC (23-01262-11); iCap @ UW, LLC (23-01244-11); VH 2nd Street Office, LLC (23-01259-11); VH Pioneer Village LLC (23-01263-11); iCap Funding LLC (23-01246-11); iCap Management LLC (23-01268-11); iCap Realty, LLC (23-01260-11); Vault Holding, LLC (23-01270-11); iCap Pacific Development LLC (23-01271-11); iCap Holding LLC (23-01272-11); iCap Holding 5 LLC (23-01273-11); iCap Holding 6 LLC (23-01274-11); Colpitts Sunset, LLC (23-01432-11); CS2 Real Estate Development LLC (23-01434-11); and iCap International Investments, LLC (23-01464-11).

I. RELIEF REQUESTED

iCap Enterprises, Inc. and the above-captioned debtors and debtors in possession (the "Debtors") in the above-captioned chapter 11 cases (the "Chapter 11 Cases") and the Official Committee of Unsecured Creditors ("UCC") respectfully request that this court make a finding that beginning no later than October 2018 through the conclusion of the prepetition time period analyzed by the Chief Restructuring Officer and his advisors, iCap Enterprises, Inc. and the other Debtors ("iCap" or "Debtors") operated as a Ponzi scheme ("Ponzi Findings"). *See Modified Second Amended Joint Chapter 11 Plan of Liquidation of iCap Enterprises, Inc. and its Affiliated Debtors Proposed by the Debtors and Official Committee of Unsecured Creditors* [ECF No. 1249] (as may be amended, modified, or supplemented from time to time, the "Plan") at 27.[2]

II. INTRODUCTION

"[A] Ponzi scheme is a phony investment plan in which monies paid by later investors are used to pay artificially high returns to the initial investors, with the goal of attracting more investors." *Alexander v. Compton (In re Bonham)*, 229 F.3d 750, 759 n.1 (9th Cir. 2000).[3] That is exactly what iCap did here and it was destined to fail from the beginning. iCap's Ponzi scheme arose out of the company's use of an unusual investment vehicle—debt instruments requiring iCap to make monthly payments to its investors—combined with its unrealistic business model of investing in real estate development projects that lacked a regular source of cash flow. *See Supplemental Declaration of Lance Miller in Support of Ponzi Findings* [ECF No. 1370] ("Miller Decl.") ¶ 8. The company's real estate investment funds lost tens of millions and the company could not cover investor repayment obligations. To cover its dramatic shortfall of cash, the company consistently relied on new fundraising proceeds to pay

[2] Capitalized terms used but not otherwise defined herein have the meanings ascribed to them in the Plan.
[3] Unless otherwise noted, all citations and internal quotations are omitted and emphases are added.

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ongoing investor obligations. *Id.* The company told investors—falsely—that its development projects were highly profitable, business was strong, and new fundraised proceeds would be "secured" by real estate assets. *Id.* In reality, "fundraising new debt was the Company's business; real estate development was an incidental activity." *Id.*

Because the Debtors' business enterprise operated as a Ponzi scheme, the Debtors (and any successor in interest, including any liquidating trustee appointed pursuant to a Chapter 11 plan of liquidation or Chapter 7 trustee), are entitled to the benefit of the Ponzi Presumption —i.e., that transfers and business transactions were done with actual intent to hinder, delay, or defraud creditors—in recovery efforts and litigation against third parties. *See Donell v. Kowell*, 533 F.3d 762, 770 (9th Cir. 2008) ("[T]he mere existence of a Ponzi scheme is sufficient to establish actual intent to defraud."). The Debtors respectfully submit that the evidence clearly warrants this determination—and it is this determination it now requests in conjunction with the October 16, 2024 confirmation hearing.

III. FACTUAL BACKGROUND

A. iCap (Mis)represented That It Was a Legitimate, Profitable Real Estate Business.

iCap was founded in 2011 by Christopher Christensen, a licensed attorney who, before founding iCap, focused his practice on advising clients about financing for real estate transactions in the Greater Seattle area. Miller Decl. ¶ 9. iCap's original stated business model was to invest money in developers who would take the laboring oar of development for specific projects and then iCap would take a preferred equity position in the developer. *Id.* ¶ 10. Accordingly, iCap would be focused on finding new investment deals and monitoring the activity of development partners. *Id.*

iCap operated two divisions with different investment strategies: the "Portfolio Business" and the "Vault Business." *Amended Supplemental Declaration of Jeffrey H.*

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Kinrich in Support of the Ponzi Findings and Confirmation of the Plan [ECF No. 1262] at Ex. 1 ("Kinrich Rep.") ¶ 6. The Portfolio Business raised its first Fund in 2014 and ostensibly focused on multifamily real estate projects with development potential, ranging from completely new construction to improving existing structures. *Id.* The Portfolio Business operated under the entity iCap Equity, LLC, and various subsidiaries. *Id.* iCap started its "Vault Business" in 2018. Kinrich Rep. ¶ 7. The Vault Business ostensibly focused on investing in real estate that already was or had the potential to be cash flow positive. *Id.* The Vault Business primarily operated under the entity iCap Vault, LLC, as well as various subsidiaries, including SEC-registered entities. *Id.*

Both the Portfolio Business and the Vault Business operated under iCap Enterprises, Inc. in the organization's corporate structure; their properties were held by various single purpose entities ("SPEs"). Kinrich Rep. ¶ 8. iCap Enterprises, Inc., operated as the parent for all entities (other than iCap Investments, LLC) that directly owned equity in the various SPEs. Chris Christensen was the sole shareholder of both iCap Enterprises, Inc., and iCap Investments, LLC. *Id.*

B. iCap Raised Debt Capital from Investors and Purported to Invest in Real Estate Development Projects

Typically, real estate investments are completed through various forms of equity. Miller Decl. ¶ 11. Equity investments make sense for commercial real estate because the time it takes to develop positive cash flow can be unpredictable and because the industry is notoriously sensitive to macroeconomic conditions. *Id.* These same features make debt instruments a challenging vehicle for commercial real estate. *Id.*

Despite the risks associated with using debt instruments to raise investment funds for real estate development, iCap financed its operations primarily by raising debt capital in the form of debentures and promissory notes. Kinrich Rep. ¶ 9; Miller

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Decl., ¶ 11. These debt instruments required monthly interest payments regardless of whether the underlying real estate investments were themselves producing positive cash flow. Miller Decl. ¶ 11. iCap primarily relied on private placements to fund these investments. Kinrich Rep. ¶ 9. Many individual investors were introduced to iCap through a network of registered investment advisors and investment brokerages. Miller Decl. ¶ 14. For example, the Portfolio Business was funded through private placements of debentures and promissory notes under which investors were promised interest rates ranging from 6% to 15% to the investors. *Id.* ¶ 9. Similarly, the Vault Business financed its operations through Private Placement Notes and Public Demand notes that accrued interest at a floating rate equal to the Average Savings Account Rate posted by the FDIC plus a 2% premium. *Id.*

iCap's investors sometimes questioned iCap's investment choices. For example, in an email dated June 26, 2018, Michael Norvet of Evolution Real Estate communicated to Christensen and others at iCap that (1) they were not properly informed of pending real estate transactions, and (2) if they were, they would not have accepted the sales price that Mr. Christensen agreed to—which resulted in an estimated loss of $500,000. Kinrich Rep. ¶ 56, Ex. 16.; *see also id.* ¶ 9 (Norvet stating the loss on the transaction was "completely unacceptable" and "this affair has shaken our trust in ICAP"). As explained in more detail below, this was not an isolated incident—iCap's funds lost substantial amounts of money and, ultimately, iCap could not support its repayment obligations to investors based on its cash flows, leading it to rely more and more heavily on fundraising to cover operating and investor interest expenses. In short, iCap became a Ponzi scheme.

The Debtors hired accounting expert Jeffrey H. Kinrich to provide an opinion as to whether iCap's transactions with their investors have the economic and financial indicia of a Ponzi scheme. Kinrich Rep. ¶ 1. Mr. Kinrich is a Certified Public

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Accountant (CPA) and Managing Principal at Analysis Group, an economic consulting firm. *Id.* ¶ 4. Mr. Kinrich has testified at trial, arbitration, or deposition on financial and economic issues over 400 times. *Id.* As Mr. Kinrich's Report explains, and Mr. Kinrich will testify, iCap exhibited many of the key features of a Ponzi scheme. There were typical indicia of fraud: commingling of funds between related companies, complex intercompany transfers, and iCap simply failing to invest investors' funds in projects it promised to invest in. *Id.* ¶ 14. There was also financial evidence demonstrating the central features of any Ponzi scheme, *i.e.*, taking funds from later investors to pay earlier investors instead of earning profits through legitimate business operations. *Id.*

IV. JURISDICTION

District courts, and this court pursuant to 28 U.S.C. § 157(a) and the standing order of reference in this district, "have original but not exclusive jurisdiction of all civil proceedings arising under Title 11, or arising in or related to cases under title 11." *See* 28 U.S.C. § 1334(b); *In re Harris*, 590 F.3d 730, 737 (9th Cir. 2009). A proceeding "arises in" a case under title 11 "when it is not created or determined by the bankruptcy code, but where it would have no existence outside of a bankruptcy case." *In re Harris,* 590 F.3d at 737 (citation omitted). Claims that arise in a Title 11 proceeding "are deemed to be 'core' proceedings, while claims that are related to Title 11 are 'noncore' proceedings." *Schultze v. Chandler*, 765 F.3d 945, 948 (9th Cir. 2014), *as amended* (Aug. 1, 2014) (*citing Maitland v. Mitchell (In re Harris Pine Mills)*, 44 F.3d 1431, 1435 (9th Cir. 1995)). Section 157(b)(2) sets forth a non-exhaustive list of core proceedings, including "matters concerning the administration of the estate," "confirmation of plans," and "other proceedings affecting the liquidation of the assets of the estate." 28 U.S.C. §§ 157(b)(2)(A); (b)(2)(L); (b)(2)(O).

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Here, the relief requested by the Debtors is a core proceeding arising under 28 U.S.C. §§ 157(b)(2)(L). The Debtors are seeking entry of the Ponzi Findings in connection with approval of Plan, which is explicitly a core proceeding under 28 U.S.C. §§ 157(b)(2)(L). Further, approval of the Ponzi scheme findings in connection with confirmation of the Plan not only concerns the administration of the Debtors' estates but will also affect the liquidation of the of the assets of the estates. *See* 28 U.S.C. §§ 157(b)(2)(A); (b)(2)(O).

V. ARGUMENT

"A Ponzi scheme is a financial fraud that induces investment by promising high returns, usually in a short time period, where in fact no legitimate profit-making business opportunity exists." *In re EPD Inv. Co., LLC*, 114 F.4th 1148, 1158 (9th Cir. 2024). "[T]he fraud consists of funneling money from new investors to pay old investors while cultivating the illusion of a legitimate profit-making business." *Id.*; *see also Hayes v. Palm Seedlings Partners–A* (*In re Agricultural Research and Technology Group, Inc.*), 916 F.2d 528, 536 (9th Cir. 1990) (the "hallmark" of Ponzi schemes is "[d]istributing funds to earlier investors from the receipt of monies from later investors"). The "presence of legitimate investments or assets does not necessarily negate the existence of a Ponzi scheme"—"determining whether a debtor who made some legitimate investments nevertheless operated a Ponzi scheme calls for a case-specific and fact-intensive inquiry." *In re EPD*, 114 F.4th at 1163.

The Ninth Circuit's definition of a Ponzi scheme recognizes two essential elements: "(1) the funneling of money from new investors to pay old investors, and (2) no legitimate profit-making business opportunity exists for investors." *In re EPD*, 114 F.4th at 1159; *Winkler v. McCloskey*, 83 F.4th 720, 723 n.1 (9th Cir. 2023); *In re United Energy Corp.*, 944 F.2d 589, 590 n. 1 (9th Cir. 1991). Additional criteria that weigh in favor of finding a Ponzi scheme include: "(1) the absence of any legitimate

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business connected to the investment program; (2) the unrealistic promises of low risk and high returns; (3) commingling investor money; (4) the use of agents and brokers paid high commissions to perpetuate the scheme; (5) misuse of investor funds; (6) the payment of excessively large fees to the perpetrator; and (7) the use of false financial statements." *In re EPD*, 114 F.4th at 1159 (citing David R. Hague, *Expanding the Ponzi Scheme Presumption*, 64 DePaul L. Rev. 867, 868 (2015)).

Here, as explained below and the Debtors will show at the Confirmation Hearing, the hallmarks of a Ponzi scheme are present. iCap paid earlier investors with funds from later investors, and despite its representations to the contrary, no legitimate profit-making opportunity existed for iCap investors—and numerous other indicia support a Ponzi finding. Accordingly, the court should find that iCap operated as a Ponzi scheme during the prepetition period.

A. iCap Used New Investor Funds, Not Legitimate Business Proceeds, to Return Money to Earlier Investors.

The evidence is overwhelming that iCap "funnel[ed] proceeds received from new investors to previous investors." *Winkler*, 83 F.4th at 723 n.1. iCap conducted little to no legitimate business, and its business revenue was never sufficient to cover its obligations to investors. Through a combination of intercompany transfers and outside loans, iCap covered up this shortfall by paying old investors and lenders with proceeds from new investors and lenders. The first essential element of a Ponzi scheme is met. *In re EPD*, 114 F.4th at 1159.

1. iCap conducted little or no legitimate business operations.

The amount of money iCap received in investments from investors and returned to other investors dwarfed how much revenue it made through legitimate business operations. *See Debtors' Motion for Adverse Inferences* [Dkt. 1366], Ex. 120 ("Christensen Dep."), Jim Christensen Dep. Tr. 20:4–23:5 (refusing to answer on Fifth

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Amendment grounds whether "iCap's legitimate business operations, if any, generated little or no profits").[4]

Between 2018 and 2023, iCap entities received $286.8 million in investments from investors, $202.6 million in intercompany transfers from other iCap entities, $55.8 million in loans, and only $34.9 million from legitimate business operations. Kinrich Rep., Ex. 1.1. In other words, 84% of deposits were related to investments from investors or intercompany transfers, *id.* ¶ 25, and only about 6% to 9% were related to legitimate business operations (depending on how intercompany transfers are treated in the calculation), *id.* ¶¶ 29–30; *see also* Christensen Dep. 48:6–10 (refusing to answer on Fifth Amendment grounds, "Q: As a whole, between 2018 and 2023, over 80 percent of iCap funds deposited in iCap's bank accounts were from subscribers and third-party loans?").

But even this overstates iCap's volume of legitimate business operations because a significant amount of the revenue booked by iCap entities was for services performed by one iCap entity for another iCap entity. Kinrich Rep. ¶ 52. After excluding those transactions, iCap's balance sheet is even more dire: between 2018 to 2023, it received just over ***$3 million in revenues***. *Id.* ¶ 54 & Tbl. 2. Notably, it also suffered a ***net loss of over $13.5 million*** on property sales during that time period. *Id.* Despite its limited revenues and large capital losses, iCap ***returned $236.1 million*** to investors during the same period. *Id.* ¶¶ 53–54, Tbl. 2, Ex. 1.1.

Individual iCap Funds exhibited the same pattern: large inflows and outflows of

[4] As explained in detail in the Debtors' Motion for Adverse Inferences, the court may draw an adverse inference from Mr. Christensen's invocation of the Fifth Amendment because there is ample independent evidence of the facts on which Mr. Christensen was being questioned. *See Keating v. Off. of Thrift Supervision,* 45 F.3d 322, 326 (9th Cir. 1995) ("Not only is it permissible to conduct a civil proceeding at the same time as a related criminal proceeding, even if that necessitates invocation of the Fifth Amendment privilege, but it is even permissible for the trier of fact to draw adverse inferences from the invocation of the Fifth Amendment in a civil proceeding."); *Doe ex rel. Rudy-Glanzer v. Glanzer*, 232 F.3d 1258, 1264 (9th Cir. 2000) ("[A]n adverse inference can be drawn when silence is countered by independent evidence of the fact being questioned."); *In re Nat'l Audit Def. Network*, 367 B.R. 207, 217 (Bankr. D. Nev. 2007)(drawing negative inference from debtor's former officers' invocation of the Fifth Amendment during their depositions).

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cash from and to investors, with little to no legitimate business revenue. For example, iCap's Fund 4 received $23.9 million in deposits, of which 51.9%, or $12.4 million, was from investors, 47.9% percent, or $11.4 million, was from intercompany transfers, and only 0.2%, or $41,996, was from business operations. Kinrich Rep. ¶ 62, Ex. 4.4. Despite generating barely any revenue, the Fund paid almost $5 million to investors; expensed over $3.0 million in general, operating, and administrative expenses; and redistributed $9.5 million to other entities within the organization. *Id.* Other iCap funds similarly had "almost no real estate related activity," with "deposits and withdrawals . . . mostly money from and to [investors], along with intercompany transfers." Kinrich Rep. ¶ 42 (discussing Fund 3); *see also* Kinrich Rep. ¶¶ 43–49 (analyzing other Funds). Some iCap funds conducted ***no*** real estate investment ***at all***. *See* Miller Decl., ¶ 32 (discussing Fund 3).

2. The source of payments to investors was cash from new investors.

Because iCap did not generate enough legitimate business proceeds to cover its payment obligations, iCap had to rely on fundraising to pay earlier investors. *See* Christensen Dep. 20:4–23:5 (refusing to answer on Fifth Amendment grounds whether "iCap made investor interest payments with cash sourced from later investors").

It is beyond dispute that iCap's business operations were "insufficient to make its payments to [investors]." Kinrich Rep., ¶ 54.[5] In fact, iCap has admitted that its

[5] To the extent iCap did conduct some legitimate business operations, it does not preclude a finding of a Ponzi scheme. *See In re Slatkin*, 525 F.3d 805, 816 (9th Cir. 2008) ("Further, that Slatkin may have invested a small percentage of the funds he received from investors, and may have received a profit from such investments, does not create a genuine issue of material fact as to the actual existence of the Ponzi scheme."); *Sender v. Simon*, 84 F.3d 1299, 1307 (10th Cir. 1996) (existence of a Ponzi scheme conceded despite the fact that it was "not clear whether [the principal] intended to run a Ponzi scheme from the moment he began Hedged Investments"); *Scholes v. Lehmann*, 56 F.3d 750, 757 (7th Cir. 1995) ("It is no answer that some or for that matter all of [the investor's] profit may have come from 'legitimate' trades made by the corporations. They were not legitimate. The money used for the trades came from investors gulled by fraudulent representations."); *In re Bonham*, 251 B.R. 113, 131 (Bankr. D. Alaska 2000) ("Many Ponzi schemes, if not most, have some legitimate business operation, or at least the facade of one."); *see also In re Bullion Reserve of North America*, 836 F.2d 1214 (9th Cir. 1988) (describing a Ponzi scheme in which perpetrators stored some bullion as represented to

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entities "operated with ***negative*** cash flows ***since inception***." Miller Decl. ¶ 21. iCap's financial and internal documents create a picture of liquidity problems from the inception of its original funds, Funds 1 and 2. *See id.* ¶ 65. iCap used fundraising to fill the gap between project-related receipts and its disbursement obligations, to the point where fundraising became the near-exclusive source for iCap's capital. *Id.* ¶ 67.

At both the individual fund level and Company-wide level, iCap's source of funds were primarily investments from subscribers and intercompany transfers, discussed further in Section V.A.3. below, and it used those funds primarily to make returns to subscribers and further intercompany transfers. Kinrich Rpt. ¶ 49. As just one example, in June 2019, after receiving $660,000 in subscriptions from seven investors in Fund 3, iCap turned around and transferred the funds to Fund 1 to make investor interest payments and directly made interest payments to existing investors in Fund 3. *Declaration of Stanley Ho in Support of the Ponzi Findings and Confirmation of the Plan* ("Ho Decl.") [ECF No. 1369], ¶¶ 13–14. The Declaration of former iCap employee Nickisha Haine confirms that the company used intercompany transfers to cover interest payments when a given iCap fund "did not have sufficient funds to cover th[e] interest payments." *Declaration of Nickisha Haine in Support of Ponzi Findings and Plan Confirmation* [ECF No. 1368] ("Haine Decl.") ¶¶ 9–11. This direct evidence that iCap transferred funds from later investors to make earlier investors' interest payments establishes the Company was operating as a Ponzi scheme.

iCap executives acknowledged iCap's precarious position. For example, in January 2017, TD Croshaw, iCap's Controller, provided a management budget to Chris Christensen stating, "we are going to be in a significant deficit at the end of February and the first of March. . . . January was a bad month for us." Kinrich Rep. ¶ 78, Ex. 33. Later that year in November 2017, Mr. Croshaw provided another management budget

investors).

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to Mr. Christensen stating, "as you can see we are significantly in the Red for [November and December 2017]," and iCap would "need to come up with" $320,000 in order to make its November and December 2017 payroll payments. *Id.* ¶ 78, Ex. 34. The only way iCap could do so was through more and more fundraising.

3. iCap commingled investor money.

iCap commingled funds between various iCap entities through complicated intercompany transfers intended to perpetuate the Ponzi scheme. Christensen Dep. 48:20-23 (refusing to answer on Fifth Amendment grounds whether iCap "commingled funds raised from investors between the various funds").

The commingling of funds is a common feature of Ponzi schemes. *See, e.g.*, *In re EPD*, 114 F.4th at 1162 (9th Cir. 2024) (substantial evidence, including that the debtor "commingled the funds he received from investors," supported Ponzi finding); *In re Ramirez Rodriguez*, 209 B.R. 424, 429 (Bankr. S.D. Tex. 1997) (commingled investor funds were used to pay earlier investors, operating expenses, and debtor's personal expenses); *In re Taubman*, 160 B.R. 964, 978–79 (Bankr. S.D. Ohio 1993) (debtor who commingled investor funds without distinction was engaged in a Ponzi scheme); *Miller v. Wulf*, 84 F. Supp. 3d 1266, 1274 (D. Utah) ("When a company commingles funds and operates at a loss while continuing to pay the old investors, the money to pay the old investors necessarily comes from new investments."), *aff'd*, 632 F. App'x 937 (10th Cir. 2015). Moreover, as Mr. Kinrich explains, "in a typical Ponzi scheme, one would expect large transfers of funds among businesses, often unrelated to business-related operations or investments, to sustain the scheme." Kinrich Rep. ¶ 58; *accord Wing v. Dockstader*, 2010 WL 5020959, at *5 (D. Utah Dec. 3, 2010) ("[W]hen there wasn't enough money in one account to satisfy one entities' obligations, [the Ponzi scheme orchestrator] would transfer money between accounts in order to meet [the corporations'] obligations.").

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Here, iCap's consolidated balance sheets reflect over $200 million in intercompany transfers during the 2018–2023 period. Kinrich Rep. ¶¶ 25–26. As explained in the concurrently-filed declaration of Stanley Ho, iCap devised a complicated series of transfers that routinely "cascade[d] through a waterfall involving multiple iCap-affiliated entities." Ho Decl. ¶ 10. In the month before interest payments were due, an iCap Fund would receive cash from new investors; shortly before mid-month, when iCap's interest payments were due, the Fund would initiate transfers to iCap-affiliated entities; those entities would then transfer some or all of the cash to other entities; eventually, the sequence of transfers would stop in a Fund, which would make distributions to existing investors. *Id.*; *see also id.* ¶¶ 13–20 (describing examples of the transfer cascade).

The accounting department prepared cash forecast reports on a bi-monthly basis to show what entities had immediate cash shortfalls and to propose intercompany transfers to cover the shortfalls. *See* Haine Decl. ¶¶ 9–11. These intercompany transfers had to be approved by iCap's Senior Management Team, Chris Christensen and Jim Christensen. *Id.* ¶ 12; *see also* Christensen Dep. Tr 48:20–23 (invoking Fifth Amendment in response to "Q: iCap, in fact, commingled funds raised from investors between the various funds?").

iCap's internal communications confirm that the purpose of these "waterfalls" of intercompany transfers was to sustain the Ponzi scheme, not to conduct legitimate business. For example, in an April 14, 2022 email from Chris Christensen, Mr. Christensen explains that transfers are regularly made between funds "two times each month" and that "The 15th of the month is the big one for the interest payments." Kinrich Rep. ¶ 64, Ex. 18. Mr. Christensen then stated "iCap Equity is covering a big portion of the expenses from funds we have raised" and a transfer of $285,000 would be made "to Fund 4 to cover Fund 4 investor payoffs." *Id.*; *see also id.* (noting that

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iCap Investment would need to transfer $885,000 to iCap Equity, which would then distribute the funds to various individual iCap Funds, including $285,000 to Fund 4). In another email, dated May 17, 2019, in response to a question about a $200,000 transfer to Fund 1, iCap's Chief Financial Officer, TD Croshaw, confirmed "I transferred it to cover the interest payment." Kinrich Rep. ¶ 69, Ex. 24; *see also id.* ¶¶ 63–71, Exs. 19–25; Miller Decl. ¶ 30 (describing how iCap used proceeds from investment in Fund 3 "to address payments owed to Fund 1 and Fund 2 investors"); Haine Decl. ¶¶ 13–24 (discussing examples of transfers made to cover required investor interest payments).[6]

In addition to intercompany transfers, to sustain the Ponzi scheme, iCap induced investors to "roll over" their investments, either by extending the life of the same Fund or by rolling investments into other iCap funds when the time came to pay investors back their principal. *See* Miller Decl. ¶¶ 22–27 (Funds 1 and 2), 33 (Fund 3), 64 (rollovers into the Broadway Fund); Kinrich Rep. ¶ 83, Ex. 35 (internal analysis indicating that meeting repayment demands of potential Fund 6 would require "most or all of the Fund 1 and Fund 2 investors roll over to Fund 6, while agreeing to not receive a monthly interest payment"). "Rolling over" obligations in this manner is a common characteristic of Ponzi schemes. *See, e.g.*, *In re Taubman*, 160 B.R. at 987 ("To acquire the funds to make the promised returns to existing investors, the Debtor induced new investors to provide her with funds or induced existing investors to reinvest or rollover their prior investments, or, in some cases, increase their existing investments, all allowing the Debtor forego paying her existing obligations.").

Accordingly, later investors in iCap tended to receive lower returns than earlier

[6] In addition to intercompany transfers, when raising investor funds became more difficult, iCap also relied on mortgages as a source of funds for investor payments. *See* Ho Decl. ¶¶ 21–29 (describing how mortgage proceeds were transferred between iCap entities to eventually meet investor payment demands); *In re EPD*, 114 F.4th at 1162 (debtor operating as Ponzi scheme "us[ed] money from lenders to pay other lenders").

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investors, which is another one of the "hallmarks of a 'classic' Ponzi scheme." *In re Taubman*, 160 B.R. at 973. Typically, in a Ponzi scheme, while there may be some "[n]et [w]inners . . . among early investors," many "[n]et [l]osers will be found among later investors." *Sec. Investor Prot. Corp. v. Bernard L. Madoff Inv. Sec. LLC*, (*In re Bernard L. Madoff Inv. Sec. LLC*), 424 B.R. 122, 132 (Bankr. S.D.N.Y. 2010), *aff'd*, 654 F.3d 229 (2d Cir. 2011). Here, the only iCap fund with average positive distributions was its first fund, Fund 1, which managed to achieve 12% distributions in excess of investments; all seven later Funds had average negative distributions, with losses ranging from 8% to 81%. Kinrich Rep. ¶ 88, Ex. 6. Again, this fits the classic pattern of a Ponzi scheme.

B. iCap Knowingly Cultivated the Illusion of a Legitimate Profit-Making Business When No Such Opportunity Existed

The evidence overwhelmingly confirms that there was "no legitimate profit-making business opportunity for investors," yet iCap continued to mislead investors as to iCap's business and the use of their funds. The second essential element of a Ponzi scheme is easily met. *In re EPD*, 114 F.4th at 1159. Not only did iCap regularly "funnel[] proceeds received from new investors to previous investors," it committed fraud by doing so "in the guise of profits from the alleged business venture, thereby cultivating an illusion that a legitimate profit-making business opportunity exists and inducing further investment." *In re United Energy*, 944 F.2d at 590 n.1. iCap made numerous misleading and fraudulent statements and acts in furtherance of the Ponzi scheme.

1. iCap made unrealistic promises of low risk and/or high returns.

iCap's basic promise to generate near-immediate returns on real estate investments was unrealistic and misleading given the nature of iCap's investments. Christensen Dep. 20:4–23:5 (refusing to answer on Fifth Amendment grounds

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whether iCap "promised subscribers and investors unrealistic returns").

As noted above, iCap financed its operations primarily with debentures and promissory notes requiring monthly payments to investors at rates as high as 15 percent annual interest. *See* Kinrich Rep. ¶ 73. Some of those notes required payoffs within 12 to 18 months from the time of investment. *Id.* But iCap's investments—primarily in new real estate developments with little potential for short-term returns—did not generate sufficient returns to service iCap's payment obligations. Kinrich Rep. ¶ 75.

To meet their investor payment obligations, the Funds would have needed to generate annual returns ***orders of magnitude*** higher than what they actually realized. For example, Fund 1 (the only Fund that returned a positive average return to investors, as noted above) would need to have generated a ***17.6%*** annual return on its overall investment to service its guaranteed 12% interest payments. Kinrich Rep. ¶ 80. It actually made an average return of ***0.4%*** per year. *Id.* Not only did iCap's funds not generate the necessary returns, it appears iCap made ***no effort*** to ***achieve*** those types of returns: For example, an internal iCap analysis about Fund 6 determined that iCap would need to invest in between ***959 to 1,056*** projects to meet its repayment demands of between $310 million to $470 million. Kinrich Rep. ¶ 83. It actually invested in only ***87*** projects. *Id.*

2. iCap made false and misleading statements to investors, and misused investor funds.

iCap did not live up to the promises it made in Private Placement Memoranda ("PPM"), which iCap used to cultivate the illusion that iCap's Funds were legitimate business opportunities. *See* Christensen Dep. 20:4–23:5 (refusing to answer on Fifth Amendment grounds whether iCap "promised subscribers and investors these returns with little or no risk" and "did not use investor or subscriber funds as it promised

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those investors and subscribers").

False statements about how funds will be invested and how investors will be compensated are another common characteristic of Ponzi schemes. *See, e.g.*, *In re Slatkin*, 525 F.3d at 813–14 (in long-running Ponzi scheme, the perpetrator "did not invest the vast majority of investor funds . . . but instead disbursed those funds to other investors as fraudulent returns"). iCap marketed its funds through PPMs, which described the intended nature of the Funds and financial terms of the investment. *See generally* Kinrich Rep. ¶ 73. For example, the PPM for Fund 4 states that "the primary purpose of the Company is to acquire real estate investments in the United States and provide a rate of return to its investors" and that the "proceeds [] will be used to pay expenses related to its formation and operations and for this Offering, and to purchase and manage preferred equity real estate positions through Portfolio SPEs." Kinrich Rep. ¶ 85. It further states that the "revenue generated from the Investment Portfolio will be used to pay interest and principal on the Notes." Miller Decl., Ex. 41 at 9. Despite the Fund's purported "primary purpose" of acquiring real estate assets and its statement that it would use "revenue" to make interest payments, between October 2018 and September 2023, the fund ***received $12.4 million*** from investors, ***invested only $2.2 million***, and ***paid out $4.9 million*** to investors. Kinrich Rep. ¶ 86, Ex. 4.4. In short, the "primary" activity of the Fund was not investing in real estate, and the primary source of funding for interest payments was not "revenue."

iCap also made numerous specific misrepresentations to investors, including misrepresentations about the source of funds used to return money to investors, further cultivating the illusion that iCap was a legitimate business enterprise. For example, in a call with Fund 2 investors in November 2018, in response to a question about the sources of funds that iCap relies on to pay investors, Mr. Christensen represented that interest payments were carved out of payoffs from real estate projects and ***not*** from

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funds received from other investors. Kinrich Rep. ¶ 79. But Mr. Christensen's statement was false: between October 2018 and September 2023, Fund 2 paid out a sum of ***$20.2 million*** to its investors but generated only ***$10.4 million*** from business operations. *Id.* The Fund also received $22.9 million in intercompany transfers and transferred $11.8 million to other iCap entities. *Id.* While these transfers somewhat obscure the source of Fund 2's payouts to investors, as discussed above, iCap's other Funds operated in a similar manner, and "[w]hen a company commingles funds and operates at a loss while continuing to pay the old investors, the money to pay the old investors necessarily comes from new investments." *Miller*, 84 F. Supp. 3d at 1274.

iCap misrepresented other aspects of its investments and operations. iCap advertised certain Funds as "secured" even when they were not. Miller Decl. ¶¶ 36, 58, 63; *see Wing v. Dockstader*, 2010 WL 5020959, at *4 (D. Utah Dec. 3, 2010), *aff'd*, 482 F. App'x 361 (10th Cir. 2012) (company operating as Ponzi scheme told investors "their investment was secured by real property . . . when they were not"); *In re EPD*, 114 F.4th at 1163 (9th Cir. 2024) (Ponzi scheme purported to facilitate certain leases, but those leases were not reflected in its financial statements and records). iCap failed to honor the promises it made in Fund 1 and Fund 2 offering documents to secure the debentures with liens. Miller Decl. ¶¶ 15, 19. Despite consistent statements that Fund 1 and 2 were performing well, their actual results were "abysmal"—through 2021 Fund 1's and Fund 2's real estate investments lost approximately $38 million and $18.5 million, respectively. *Id.* ¶ 21. And iCap marketed its "Vault" accounts as a banking alternative but did not register with any governmental entity as a banking institution and did not maintain the 10% cash reserves it promised investors that it would. *Id.* ¶¶ 46–49.

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3. iCap paid excessively large fees to agents and brokers, and the perpetrator of the scheme.

The payment of high fees and commissions to brokers are a common feature of Ponzi schemes. *In re EPD*, 114 F.4th at 1159; *see also In re Vaughan Co. Realtors*, 500 B.R. 778, 789 (Bankr. D.N.M. 2013) (Ponzi scheme paid referral fees exceeding $700,000 to defendants who referred additional investors); *In re World Vision Ent., Inc.*, 275 B.R. 641, 646 (Bankr. M.D. Fla. 2002) (high commissions paid to broker were in furtherance of Ponzi scheme). iCap's funds were structured to pay out excessive commission fees. *See* Kinrich Rpt. ¶ 80 (Fund 1 expected to incur 13% in commissions and administrative fees); Miller Decl. ¶ 14 (explaining that "Fund 1 offering was designed to be attractive to both investors and the brokers and registered investment advisors who connected them with the Company," including by offering "a 7.0% selling commission, a 1% due diligence fee, a 2% managing dealer fee, and a 3% fee for marketing and underwriting"). In many instances, the commission fees dwarfed how much income and profits were generated by the relevant iCap fund. For example, of the $12.4 million deposits into iCap Funding, $1.7 million, or 13.8%, was paid out as commissions. Kinrich Rpt. ¶ 46. At the same time, there "was no real estate activity" conducted by iCap Funding. *Id.*

Like other Ponzi schemers and fraudsters, Chris Christensen used the scheme to personally enrich himself. *See, e.g.*, *In re Slatkin*, 525 F.3d at 813–14 (Ponzi schemer "did not invest the vast majority of investor funds he received during this time but instead disbursed those funds to other investors as fraudulent returns [and] diverted funds for his own personal benefit"); *In re Ramirez Rodriguez*, 209 B.R. 424 (payment of personal expenses of the perpetrator); *In re World Vision Entertainment, Inc.*, 275 B.R. at 649 (debtor used funds to enrich insiders); *In re Taubman*, 160 B.R. 964 (perpetrator and husband's personal and other business expenses paid). While

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iCap represented to investors that it owned a "single family home in Issaquah, Washington," the home was in fact Christensen's, and iCap ultimately transferred it directly to him in exchange for refinancing the construction loan and no additional consideration. Miller Decl. ¶ 42; *see* Christensen Dep. 46:3–7 (refusing to answer on Fifth Amendment grounds whether Chris Christensen used investor funds to build his house).

VI. CONCLUSION

Based on the overwhelming evidence described above, the Debtors and UCC respectfully request that the court make a finding that during the prepetition period, iCap operated as a Ponzi scheme.

DATED this 10th day of October, 2024.

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HONORABLE WHITMAN L. HOLT

UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF WASHINGTON

In re: ICAP ENTERPRISES, INC., et al., Debtors.[1]	Chapter 11 Lead Case No. 23-01243-WLH11 Jointly Administered **DECLARATION OF STANLEY HO IN SUPPORT OF THE PONZI FINDINGS AND CONFIRMATION OF THE PLAN**

[1] The Debtors (along with their case numbers) are iCap Enterprises, Inc. (23-01243-11); iCap Pacific NW Management, LLC (23-01261-11); iCap Vault Management, LLC (23-01258-11); iCap Vault, LLC (23-01256-11); iCap Vault 1, LLC (23-01257-11); Vault Holding 1, LLC (23-01265-11); iCap Investments, LLC (23-01255-11); iCap Pacific Northwest Opportunity and Income Fund, LLC (23-01248-11); iCap Equity, LLC (23-01247-11); iCap Pacific Income 4 Fund, LLC (23-01251-11); iCap Pacific Income 5 Fund, LLC (23-01249-11); iCap Northwest Opportunity Fund, LLC (23-01253-11); 725 Broadway, LLC (23-01245-11); Senza Kenmore, LLC (23-01254-11); iCap Campbell Way, LLC (23-01250-11); UW 17th Ave, LLC (23-01267-11); iCap Broadway, LLC (23-01252-11); VH 1121 14th LLC (23-01264-11); VH Senior Care LLC (23-01266-11); VH Willows Townhomes LLC (23-01262-11); iCap @ UW, LLC (23-01244-11); VH 2nd Street Office, LLC (23-01259-11); VH Pioneer Village LLC (23-01263-11); iCap Funding LLC (23-01246-11); iCap Management LLC (23-01268-11); iCap Realty, LLC (23-01260-11); Vault Holding, LLC (23-01270-11); iCap Pacific Development LLC (23-01271-11); iCap Holding LLC (23-01272-11); iCap Holding 5 LLC (23-01273-11); iCap Holding 6 LLC (23-01274-11); Colpitts Sunset, LLC (23-01432-11); CS2 Real Estate Development LLC (23-01434-11); and iCap International Investments, LLC (23-01464-11).

I, Stanley Ho, hereby state and declare as follows:

1. I am a Senior Director at Pivot Management Group, LLC ("Pivot"), a financial advisory firm with an office located at 1230 Rosecrans Avenue, Suite 530, Manhattan Beach, California 90266. Pivot provides a broad range of corporate advisory services to its clients including, without limitation, restructuring, strategic and transaction advisory, and strategic communications services. As a financial advisory consultant, I have extensive experience in corporate finance, capital markets, and the reorganization and restructuring of troubled companies. Prior to joining Pivot, I was the CEO of Bernstein Research Canada in Toronto (a capital markets broker-dealer), a Managing Director at AllianceBernstein in New York City (a global asset management firm), a consultant at McKinsey & Company in San Francisco (a global management consulting firm), and founding employee of Closedloop Solutions, Inc. in Palo Alto (a venture capital-funded enterprise software startup for corporate finance and planning). I earned a Bachelor of Commerce degree with high distinction from the University of Toronto, and a master's degree in economics from the University of Toronto. I have approximately 30 years of experience as an advisor, investor, and executive. I have advised companies, creditors, shareholders, and other stakeholders regarding restructurings and recapitalizations, Chapter 11 re-organizations, and mergers and acquisitions. Pivot has been engaged by the above-captioned debtors and debtors in possession (together, the "Debtors" or the "Company") to reorganize and restructure the Company through the commencement of these bankruptcy proceedings.

2. I have been working on these bankruptcy proceedings since October 2023, at the request and at the direction of the Debtors' Chief Restructuring Officer, Lance Miller. My work has involved, among other things, a detailed understanding

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and analysis of the Debtors' books and records in order to support investigations into prepetition transfers and transactions. As a Senior Director at Pivot assigned to analyze the Debtors' books and records in these bankruptcy proceedings, I am generally familiar with the company's business, financial affairs, and books and records. I am above 18 years of age and I am competent to testify.

3. I am authorized to submit this declaration on behalf of the Debtors. Except as otherwise indicated, all facts set forth in this declaration are based upon my personal knowledge of the Company's operations, finances, records, and information learned from my review of relevant documents, and information I have received from the Company's advisors. If I were called upon to testify, I could and would testify competently to the facts set forth herein on that basis.

4. In preparing this declaration, I have relied upon data from Accounting Seed ("A/S"), the accounting platform within the Company's Salesforce cloud-based software platform. I have also relied on the Company's archives in Box (a cloud storage platform used by the Company), financial statements, internal and external Company communications, and other sources.

A. <u>General background and Overview</u>[2]

5. The Debtors' organizational structure is reflected in Exhibit 9 to the *Amended Supplemental Declaration of Jeffrey H. Kinrich in Support of the Ponzi Findings and Confirmation of the Plan* [Dkt. 1262]. The Company is comprised of four main categories of entities:

[2] The terms used throughout this declaration are consistent with the terms as defined in the previously filed documents in support of the Post-petition financing. *See Joint Motion Authorizing Debtors To Obtain Supplemental Debtor-In-Possession Financing* [Dkt. 467]; *Declaration of Lance Miller in Support of the Supplemental Debtor in Possession Financing Motion* [Dkt. 467-1]; *Supplemental Declaration of Lance Miller in Support of Postpetition Financing and Related Relief* [Dkt. 468, Supplemented at Dkt. 473]; *Declaration of Jeffrey H. Kinrich in Support of Postpetition Financing and Related Relief* [Dkt. 469]; *Amended Supplemental Declaration of Jeffrey H. Kinrich in Support of the Ponzi Findings and Confirmation of the Plan* [Dkt. 1262].

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a. Special Purpose Entities ("SPEs"), which made direct ownership investments into real estate projects,

b. Fund entities ("Funds"), which were marketed to and received money from accredited investors' subscriptions in interest-bearing debentures and did not typically invest directly in real estate but instead invested in other iCap entities through intercompany transfers (for a list of relevant Funds, see Appendix A);

c. iCap Vault 1, LLC and/or related Vault entities ("Vault"), an SEC-regulated fund that received money from investor subscriptions, and

d. Various corporate entities serving different functions related to the SPEs and/or Funds.

B. <u>Data and sources</u>

6. I worked to extract the Company's raw transactional data directly from A/S in the form of General Ledgers ("GL"). I did this for the entire Company for all its entities and for all time periods recorded in A/S.

7. The result was a Consolidated General Ledger database ("GL DB") with over 795,000 individual transaction entries across 73 legal entities, involving over 1,700 days of transactions, and over 750,000 subscriber ("Investor") [3] postings for over 1,550 unique Investors.

8. For each transaction, the GL DB captures the following information where relevant and available:

- Date
- Amount
- Entity

[3] The term "Investor" is used in this Declaration to refer to subscribers. In the GL, some individual persons were identified as having made investments in multiple subscriptions and in multiple Funds. Thus, it is possible for the same individual person to receive multiple investor payments.

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- Counterparty
- Project
- Subscription
- Type
- GL Account
- Transaction ID
- Source

9. Among other things, the consolidated GL DB captures both sides of each transaction, providing a clear view of money movements out of a disbursing (transferring) entity and into a recipient (transferee) entity. Accordingly, the GL DB provides an understanding of the intercompany transactions **between** iCap-Affiliated entities.

C. <u>Investor Cash, Intercompany Transfers, Distributions to Existing Investors</u>

10. The GL entries demonstrate a distinct pattern of transactions relating to investors. Specifically, from at least 2019 onwards, the GL exhibits a common fact pattern as follows:

a. In the 30 days leading up to the time interest payment were due (typically mid-month), one or more of the Funds received cash from Investors through subscriptions.

b. On a single date near the mid-month interest payment due date, the Fund(s) initiated same-day Intercompany Transfers ("Intercompany Transfers" or "Transfers") to iCap-Affiliated entities.

(1) Descriptions of these Intercompany Transfers would typically indicate some sort of "intercompany loan" in the GL.

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(2) Intercompany Transfers were not restricted solely to transfers between Funds, but could also involve SPEs, Vault, or affiliated corporate entities as the recipient or disbursing entities for the Transfers.

c. The recipient of the Intercompany Transfer would, ***on the same day***, make a disbursement Transfer to another iCap-Affiliated entity. Typically, this disbursement would nearly match, if not wholly, the total cash that the entity received from the incoming Transfer. At times these Intercompany Transfers would move through multiple chains, circulating cash across the organization and creating multiple intercompany loan obligations. Ultimately, the sequence of transfers would stop in one of the Funds.

d. Funds receiving the Intercompany Transfer(s) would make distributions to existing Investors. In most instances, the total amount of the interest payments was close to, if not equal to the amount of the Transfer(s) received.

(1) There are notable timing differences between various payments methods. Check payments typically took 2 days (and as many as 4 days) to post, where ACH payments would post with a 1-day delay or on the same day that payment was booked in the GL.

(2) The company (typically) booked check payments in the GL within two days of the Intercompany Transfer(s).

11. The charts and analysis below depict four examples of this fact pattern as it occurred on select dates in 2019, 2020, 2021, and 2022, during periods of active fundraising at Fund 3, iCap Investments, LLC ("iCap Investments"), a May 2020 "fund," iCap Funding, LLC ("iCap Funding"), a May 2021 "fund," and Vault. Each

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analysis contains:

a. A discussion of cash receipts from Investors.

b. A description of the Intercompany Transfers.

c. A discussion of distributions made by Intercompany Transfer recipients to existing Investors.

d. A schematic showing the cascading waterfall of iCap-Affiliated entities involved in Intercompany Transfers and Investor distributions.

12. Appendix A to this Declaration includes a list of key terms and additional information about transactions not depicted in the diagrams below.

D. <u>Example 1 – June 14, 2019</u>

13. The first illustrative example of Intercompany Transfers is taken from the week of June 14, 2019. At this point, use of the new A/S accounting system was still recent, with limited details in A/S regarding pre-2019 transactions, such as the original investments into prior Funds (Fund 1, Fund 2 and other funds no longer active in 2019). Funds 1 and 2 were recording transactions and Fund 3 was in active operation.

14. Between May 15 and June 14, 2019, seven (7) investors paid $660,000 into Fund 3. The chart below shows the use of funds in mid-June.

a. Step 1 (June 11): Fund 3 transferred $400,000 to Fund 1.

b. Step 2: Distributions were made to existing Investors in Fund 1 and Fund 3. Payments were made within the window of payment-method timing differences noted above.

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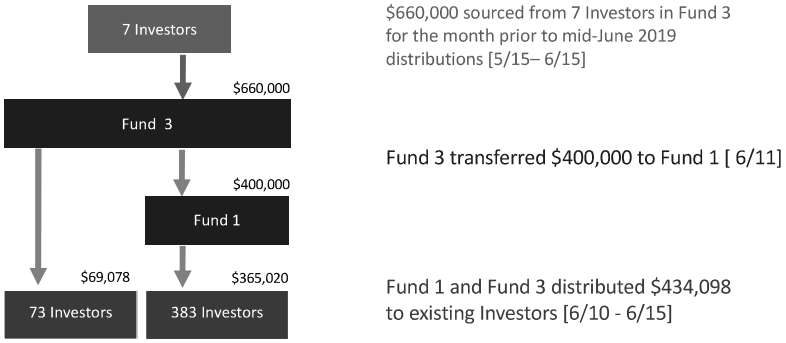
Transfers for mid-June, 2019



Note: See Appendix for a more complete accounting of transactions during period under review. Specific transactions highlighted in schematic pertain to pattern of investor cash receipts over the month, intercompany transfers taking place on a single day, and distribution to existing investors for around the same day as the transfers, reflecting timing differences.
Source: Accounting Seed (Salesforce) GL Data, Pivot Analysis

E. Example 2– August 13, 2020

15. The second illustrative example of Intercompany Transfers is taken from the week of August 13, 2020. At this point in the Company's evolution, Fund 1, Fund 2, and Fund 3 were recording GL transactions and iCap Investments had recently launched. Relative to the earlier 2019 example, a greater number of entities were involved in increasingly complex Intercompany Transfers as observed in the example.

16. Between July 14 and August 13, Fund 3 and iCap Investments received cash from seven (7) investors totaling $560,000. The table below shows the use of funds on August 13, 2020.

a. Step 1 (August 13): iCap Investments transferred $200,000 to Fund 3 and $161,000 to Management.

b. Step 2 (same day): Fund 3 transferred $370,000 to Fund 1.

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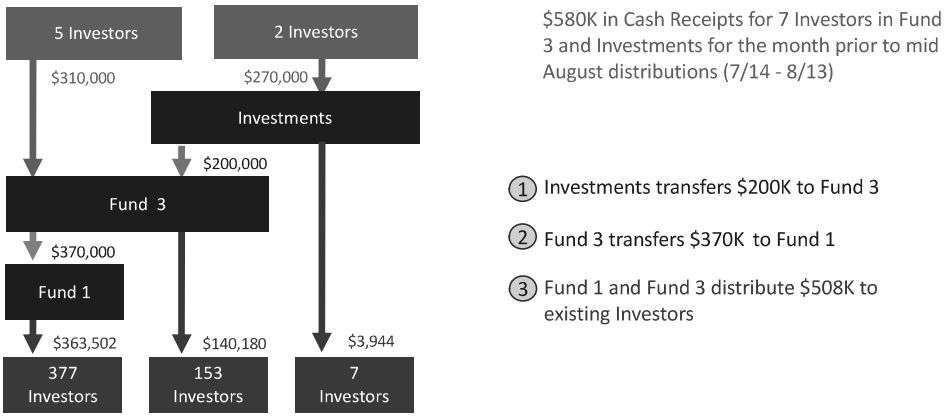
c. Step 3 (same day): Distributions were made to Fund 1 and Fund 3 Investors (monthly interest). Some payments were initiated in the two days prior due to the payment-method timing differences noted above.

Transfers for mid-August 2020



Note: See Appendix for a more complete accounting of transactions during period under review. Specific transactions highlighted in schematic pertain to pattern of investor cash receipts over the month, intercompany transfers taking place on a single day, and distribution to existing investors for around the same day as the transfers, reflecting timing differences.
Source: Accounting Seed (Salesforce) GL Data, Pivot Analysis

F. 2021 Example – July 14, 2021 Transfers

17. The third illustrative example of Intercompany Transfers is taken from the week of July 13, 2021. At this point in time, Funds 1 through 5 and iCap Investments were recording GL transactions, and iCap Funding had recently launched and was contributing to the company's investor cash receipts. Intercompany Transfers in 2021 involved even more entities in a pattern of increasingly structured Intercompany Transfers.

18. Between June 14 and July 14, Fund 3 and iCap Funding together had total subscription cash receipts of $2,320,946 from ten (18) investors. The table below shows the flow of funds on July 14, 2021.

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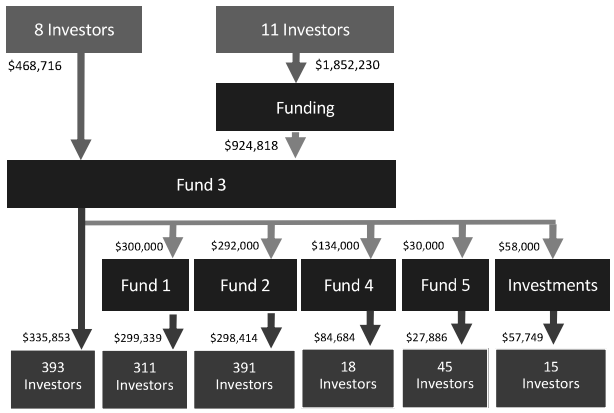
a. Step 1 (July 14): Funding transferred $924,818 to Fund 3.

b. Step 2 (Same day): Fund 3 transferred $814,000 to 4 fund entities, including $300,000 to Fund 1, $292,000 to Fund 2, $134,000 to Fund 4 and $31,000 to Fund 5.

c. Step 3 (Same day): Distributions were made to existing investors (monthly interest). Specifically, $299,339 was distributed to Fund 1 Investors, $298,414 was distributed to Fund 2 Investors, $335,853 was distributed to Fund 3 Investors, and $27,886 was distributed to Fund 5 Investors. Some payments were initiated in prior days due to the payment-method timing differences noted above.

Transfers for mid-July 2021



Cash receipts for the month prior to mid-July accumulated at Fund entities (Funding, Fund 3 and Investments) [6/15– 7/14]

① Funding transferred $0.9M to Fund 3 [7/14]

② Fund 3 transferred $0.8M to 5 fund entities [7/14]

③ Fund 3 distributes $0.3M [7/12 - 7/13]

Fund 1, Fund 2, Fund 4, Fund 5, and Investments distribute $1M to existing investors. [7/9 – 7/13]

Note: See Appendix for a more complete accounting of transactions during period under review. Specific transactions highlighted in schematic pertain to pattern of investor cash receipts over the month, intercompany transfers taking place on a single day, and distribution to existing investors for around the same day as the transfers, reflecting timing differences.

Source: Accounting Seed (Salesforce) GL Data, Pivot Analysis

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G. 2022 Example – September 14, 2022 Transfers

19. The fourth illustrative example of Intercompany Transfers is taken from the week of September 14, 2022. iCap Vault 1 ("Vault"), launched in 2018 as an SEC-registered entity, and thereafter represented a significantly greater share of cash receipts and cash disbursements than the Company's other Funds. Multiple Intercompany Transfers can be observed in the GL DB for September 14, 2022 in a complex pattern of same-day transfers.

20. Vault was the largest source of cash receipts in the month prior to September 14, 2022, with $4,233,311 from Vault, $427,106 from Fund 3 and iCap Investments with $100,000. It should be noted that Vault's substantial cash receipts were for the period offset by even greater cash disbursements during the same period, such that Vault's net cash generation was negative through the interest payment due date (that is, net cash disbursements). The table below illustrates the movement of cash across various company entities, ultimately resulting in interest payments to investors for one specific date, September 14, 2022:

a. Step 1 (September 14): Vault transferred $1.5 million to Colpitts Sunset, LLC ("Colpitts").

b. Step 2 (Same day): Colpitts transferred $1.5 million to iCap Investments.

c. Step 3 (Same day): iCap Investments transferred $1.4 million to Fund 3.

d. Step 4 (Same day): Fund 3 transferred $0.9 million to five different Company entities, including Fund 1, Fund 2, Fund 4, Fund 5 and iCap Funding.

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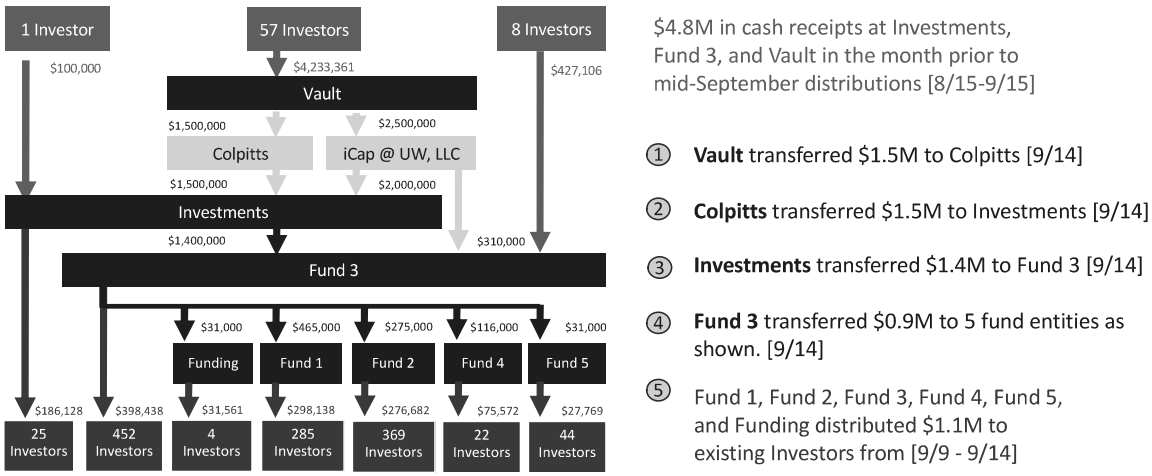
e. Step 5 (Same day): Distributions of monthly interest were paid to existing investors. Specifically, $298,138 was paid to Fund 1 Investors, $276,682 was paid to Fund 2 Investors, $398,438 was paid to Fund 3 Investors, $75,572 was paid to Fund 4 Investors, $27,769 was paid to Fund 5 Investors, and $31,561 was paid to Funding Investors. Some payments were initiated in the days prior due to the payment-method timing differences noted above.

Transfers for mid-September 2022



Note: See Appendix for a more complete accounting of transactions during period under review. Specific transactions highlighted in schematic pertain to pattern of investor cash receipts over the month, intercompany transfers taking place on a single day, and distribution to existing investors for around the same day as the transfers, reflecting timing differences.

Source: Accounting Seed (Salesforce) GL Data, Pivot Analysis

H. Mortgages Became a Source of Cash

21. By 2022, presumably as investor cash became increasingly difficult to raise, the Company began using mortgage proceeds as a source of funds for investor payments. These transactions bear a striking resemblance to the fact pattern discussed above for investor fundraising, but where instead of investors as cash sources, cash sources were coming from mortgage lenders. Loans from Lima One are a prime example.

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I. 2022 Mortgage Lender Example – Lima One February 2022 Transfers

22. As reflected in the attached Exhibit 100, on January 27, 2022, an administrative assistant at iCap emailed a group of Company leaders announcing a new subscription from an existing client (labeled "Client Y" in the chart below) in the amount of $5.5 million; this investment would be made using the client's existing Vault balance, to invest into Investments. Approximately three hours later and on the same day, the administrative assistant emailed the Company's finance team to ask that money be moved from the investor's Vault account to the account for Investments. The previous day's Vault bank balance prior to this request was only $4.5 million. Two hours after the transfer request, Vera Rohlfing (a member of the Company's finance team) responded with a request that the new investment should be "de-activate[d] . . . since funds are not going to be moved today."

23. As reflected in the attached Exhibit 104, the following Monday, January 31, 2022, Ms. Rohlfing emailed Chris Christensen saying that the team "is asking when we can process $5.5M and we don't have enough funds in our account," and asking "[a]re we expecting more f[u]nds coming in?" Two minutes later, Mr. Christensen responded: "Yes, we have about $6 million coming in. The wire should be sent today. I spoke with Cindy, and we won't transfer the $5.5 until these funds have arrived." Upon information and belief, the $6 million referenced in Mr. Christensen's email was the combined total of loan proceeds that Lima One was about to make to VH 1121 14th Ave, LLC and to VH Willows Townhomes, LLC – loans that, by their terms, were required to be used by those specific borrowers for their projects. Those loans ultimately closed the next day, on February 1, 2022 – Lima One extended mortgage loans to VH 1121 14th Ave, LLC and VH Willows

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Townhomes, LLC in the amount of $2,976,277 and $2,960,922, respectively, for a total of $5,937,199.

24. As reflected in Exhibit 100, the Company's plans for using the Lima One loan proceeds were explained in an email on February 3, 2022, from Chris Christensen to Vera Rohlfing: "The funds in VH Willows and VH 1121 14th should go to the Vault. I thought they were going directly there, but it looks like they will need to be transferred. Then, we can transfer the $5.5M." Approximately 20 minutes later, Ms. Rohlfing asked Mr. Christensen to approve each of these transfers, and Mr. Christensen approved them immediately. As discussed in these emails, the Lima One loan proceeds were first sent to Vault and then immediately transferred from Vault to Investments, documented as Investor Y's new subscription in Investments. In this way, the Company was able to take the full amount of Lima One's proceeds and transfer them to Investments.

25. The Lima One loan proceeds were transferred to Investments on February 3. By the end of February, substantially all of these amounts had been used by Investments to fund investor payments.

26. The chart below explains these transactions.

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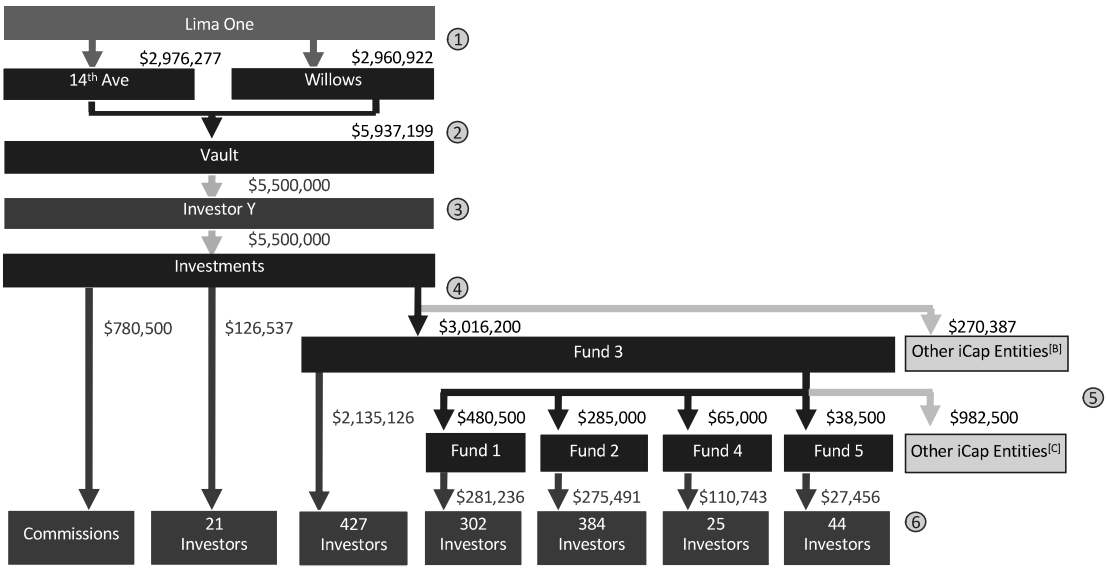
Lima One Loans (2) for $5,937,199 total, February 2022



Note: See Appendix for a more complete accounting of transactions during period under review. Specific transactions highlighted in schematic pertain to pattern of cash receipts, intercompany transfers, and distributions to existing investors.

Source: Accounting Seed (Salesforce) GL Data, Pivot Analysis

Steps for Lima One Loans:

a. Step 1 (February 1): Lima One funded mortgage loans of $2,976,277 to VH 1121 14th Ave, LLC (14th Ave) and $2,960,922 to VH Willows Townhomes, LLC (Willows) for total proceeds of $5,937,199.

b. Step 2 (February 2): 14th Ave and Willows transferred the total proceeds from the loans of $5,937,199 to Vault.

c. Step 3 (February 3): Vault transferred $5,500,000 to iCap Investments, LLC ("Investments"). The sum is recorded in the GL as a redemption by Investor Y from Vault, reinvested back into Investments.

d. Step 4 (Through February): Investments transferred $3,016,200 to Fund 3, $270,387 to other iCap entities, $780,500 for commissions to marketers (see Step 6).

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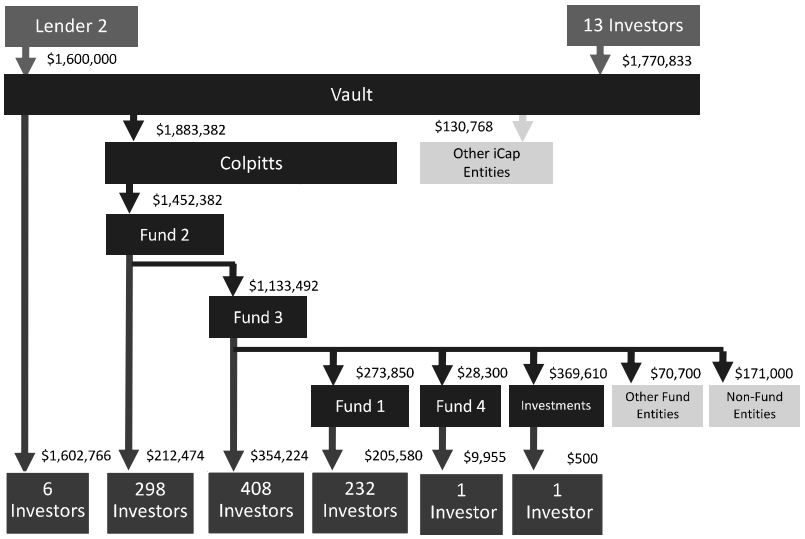
e. Step 5 (Through February): Fund 3 disbursed a total of $869,00 to Fund 1, Fund 2, Fund 4, and Fund 5.

f. Step 6 (Through February): Loans from Lima One at the beginning of February were (via Investor Y's subscription) followed by intercompany transfers to iCap fund entity recipients, that made disbursements of $3.8M.

Lima One Transfers were Not Unique

27. The Lima One transactions discussed above were part of a larger pattern evident in the illustrative charts below describing 2022 and 2023 transactions whereby mortgage proceeds were used to fund investor distributions.

Lender 2 - $1,600,000 Loan of 2022 November 10[A]



On 11/10, Lender 2 [ ] loaned $1,600,000 to Vault for "*VH Senior Care Loan*" [11/10]

Vault also receives $1,758,833 from 12 investors [11/10 - 11/15]

Vault transferred $2,014,150 to 4 iCap entities, including $1,883,382 to Colpitts "*Loan Increase to Colpitts*" [11/14 - 11/15]

Colpitts transferred $1,452,382 to Fund 2 [11/15]

Fund 2 transferred 1,133,492 to Fund 3 [11/15]

Fund 3 transferred $913,560 to 5 fund entities, 3 of which make investor distributions and 3 non fund entities [11/14-11/15]

Vault, Fund 1, Fund 2, Fund 3, Fund 4 and Investments make distributions to existing investors, a total of $2,385,499 [11/9 - 11/15]

[A] Date range of transactions analyzed comprises November 9 through 14
[B] See Appendix for a more complete accounting of transactions during period under review. Specific transactions highlighted in schematic pertain to pattern of cash receipts, intercompany transfers, and distributions to existing investors.
Source: iCap General Ledgers extracted through Salesforce Accounting Seed Module

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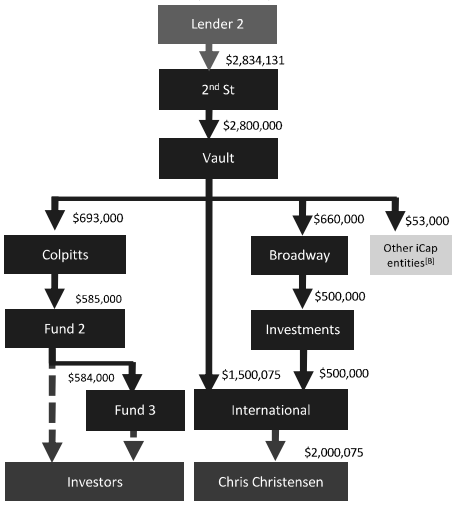
Lender 3 – $2,834,131 Loan of 2022 December 21[A]



On December 21, Mortgage Lender 3 loaned $2,834,131 to VH 2nd Street Office, LLC ("2nd St") *recorded in GL as a JE for "[ ] Bridge Loan Deposit")*

2nd St. transferred $2,800,000 to Vault *recorded in GL as "Internal transfer to iCap Vault"* [12/21]

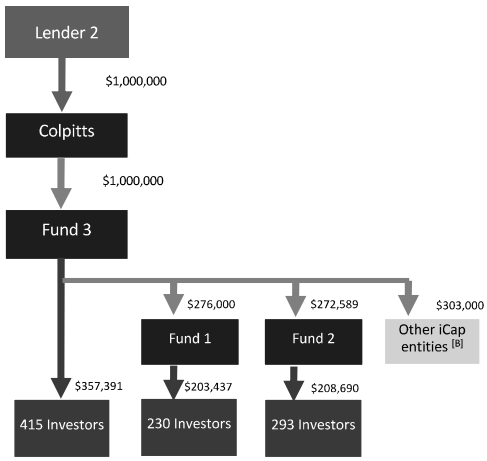
Vault transferred $1,406,074 to 6 iCap entities[B]:
Colpitts made onward transfers to Fund 2 and Fund 3
Broadway made onward transfers to Investments which made onward International. [12/21]

Loan proceeds received and accompanying intercompany transfers took place outside the mid-month distribution window for Fund 2 and Fund 3. Fund 2 distributions 12/8-12/9 were $276,682 for 383 investors and Fund 3 distributions 12/13 were $353,470 for 494 investors.

$2,000,075 Cash Draw by Chris Christensen for the benefit of Shandong ("Draw by Chris Christensen to Shandong Yongchang International Cooperation Park Co,. Ltd.") [12/22]

[A] Transactions analyzed comprise December 21-23 to account for timing latencies.
[B] See Appendix for a more complete accounting of transactions during period under review. Specific transactions highlighted in schematic pertain to pattern of cash receipts, intercompany transfers, and distributions to existing investors.
Source: iCap General Ledgers extracted through Salesforce Accounting Seed Module

Lender 2 – $1,000,000 Loan of 2023 February 15[A]



Lender 2 loans $1,000,000 to Colpitts
(Ledger entries record *"Colpitts received loan from [ ]")*

Colpitts transfers $1,000,000 to Fund 3

Fund 3 transfers $851,589 to 7 iCap entities[B], including 3 Fund entities shown that would make investor payments the same day

Fund 1, Fund 2, Fund 3 distribute $769,518 to 1054 existing Investors

[A] Transactions analyzed include February 14 and February 18 to account for timing latencies.
[B] See Appendix for a more complete accounting of transactions during period under review. Specific transactions highlighted in schematic pertain to pattern of cash receipts, intercompany transfers, and distributions to existing investors.
Source: iCap General Ledgers extracted through Salesforce Accounting Seed Module

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I declare under penalty of perjury under the laws of the State of California that the foregoing is true and correct.

Respectfully submitted,

Dated: October 10, 2024 STANLEY HO

Stanley Ho

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Co-Counsel to Debtors and Debtors in Possession

HONORABLE WHITMAN L. HOLT

HEARING DATE: October 16, 2024
HEARING TIME: 9:30 a.m. (PT)
OBJECTION DEADLINE: October 2, 2024 at 4:00 p.m. (PT)
LOCATION: Tower Bldg
2nd Floor Courtroom
402 East Yakima Avenue
Yakima, WA 98901

UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF WASHINGTON

In re: ICAP ENTERPRISES, INC., et al., Debtors.[1]	Chapter 11 Lead Case No. 23-01243-WLH11 Jointly Administered **AMENDED SUPPLEMENTAL DECLARATION OF JEFFREY H. KINRICH IN SUPPORT OF THE PONZI FINDINGS AND CONFIRMATION OF THE PLAN**

[1] The Debtors (along with their case numbers) are iCap Enterprises, Inc. (23-01243-11); iCap Pacific NW Management, LLC (23-01261-11); iCap Vault Management, LLC (23-01258-11); iCap Vault, LLC (23-01256-11); iCap Vault 1, LLC (23-01257-11); Vault Holding 1, LLC (23-01265-11); iCap Investments, LLC (23-01255-11); iCap Pacific Northwest Opportunity and Income Fund, LLC (23-01248-11); iCap Equity, LLC (23-01247-11); iCap Pacific Income 4 Fund, LLC (23-01251-11); iCap Pacific Income 5 Fund, LLC (23-01249-11); iCap Northwest Opportunity Fund, LLC (23-01253-11); 725 Broadway, LLC (23-01245-11); Senza Kenmore, LLC (23-01254-11); iCap Campbell Way, LLC (23-01250-11); UW 17th Ave, LLC (23-01267-11); iCap Broadway, LLC (23-01252-11); VH 1121 14th LLC (23-01264-11); VH Senior Care LLC (23-01266-11); VH Willows Townhomes LLC (23-01262-11); iCap @ UW, LLC (23-01244-11); VH 2nd Street Office, LLC (23-01259-11); VH Pioneer Village LLC (23-01263-11); iCap Funding LLC (23-01246-11); iCap Management LLC (23-01268-11); iCap Realty, LLC (23-01260-11); Vault Holding, LLC (23-01270-11); iCap Pacific Development LLC (23-01271-11); iCap Holding LLC (23-01272-11); iCap Holding 5 LLC (23-01273-11); iCap Holding 6 LLC (23-01274-11); Colpitts Sunset, LLC (23-01432-11); CS2 Real Estate Development LLC (23-01434-11); and iCap International Investments, LLC (23-01464-11).

AMENDED DECLARATION OF JEFFREY H. KINRICH

I, Jeffrey H. Kinrich, hereby declare as follows:

1. I have been engaged by counsel for the above-captioned Debtors and Debtors-in-Possession to provide expert testimony in the above-captioned jointly administered bankruptcy cases. Specifically, I have been asked to provide an opinion as to whether the Debtors' prepetition transactions with their investors have the economic and financial indicia of a Ponzi scheme.

2. As an expert consultant, I am providing my written report in compliance with Federal Rules of Civil Procedure 26(a)(2)(B) and Bankruptcy Rule 7026.

3. The opinions contained in my report are based on materials reviewed or considered as of the date of my report. I reserve the right to supplement my opinions or express additional opinions should additional and/or presently unknown information about this matter become known to me at or before trial.

4. I am a Certified Public Accountant (CPA) and Managing Principal at Analysis Group, an economic consulting firm with over 1,000 employees across the United States and around the world. I can be contacted through Julian I. Gurule and Oren Haker, counsel for the Debtors.

5. I previously submitted a declaration and accompanying report in this matter on February 23, 2024. Subsequent to submitting that declaration and report, I identified certain numbers and language in the exhibits to that report that were shown incorrectly. The reasons for this can be divided into four categories: (i) certain numbers in the exhibits were unintentionally displayed in thousands of dollars rather than dollars (although all calculations using those numbers were done properly), (ii) certain transactions were designated with a primary category but not a sub-category, (iii) certain words had typographical errors, and (iv) certain numbers

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unintentionally did not print in the final exhibits (although all calculations that relied on those numbers were done properly).

6. This amended declaration includes corrected exhibits addressing these four issues. None of these corrections have a material impact on any of the subtotals shown in the original exhibits. Nor do any of these corrections affect the total deposits or withdrawals shown in the sources and uses exhibits, or require any changes to any of the text, numbers, or conclusions in the body of my report.

7. In addition to the corrected exhibits, this amended declaration includes minor edits to the text of my report to (1) correct typographical errors and (2) clarify the time period to which my analyses and opinions apply .

8. Attached hereto as Exhibit 1 is a true and correct copy of the Amended Expert Report and accompanying exhibits of Jeffrey H. Kinrich, dated September 6, 2024, which I prepared on behalf of the Debtors pursuant to Federal Rules of Civil Procedure 26(a)(2)(B) and Bankruptcy Rule 7026. Exhibit 1 includes a copy of my curriculum vitae and a list of materials I considered in formulating my opinions in this matter.

9. Attached hereto as Exhibit 2 is a true and correct copy of Exhibits 1-6 to the Amended Expert Report of Jeffrey H. Kinrich, with the amended numbers and language indicated in red type along with a key indicating which of the four categories described above is the cause for the change.

10. Attached hereto as Exhibit 3 is a true and correct copy of a redline comparison between the text of my Amended Expert Report, dated September 6, 2024, showing all revisions to the text of my original Expert Report, dated February 23, 2024.

I declare under penalty of perjury under the laws of the United States that the foregoing is true and correct and that this declaration is executed on September 6, 2024, in Los Angeles, California.

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EXHIBIT 1

AMENDED EXPERT REPORT OF JEFFREY H. KINRICH PURSUANT TO FED. R. CIV. PRO. 26(A)(2)(B) AND 7026
SEPTEMBER 6, 2024

UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF WASHINGTON

In re: ICAP ENTERPRISES, INC., et al., Debtor.	Chapter 11 Lead Case No. 23-01243-WLH11

AMENDED EXPERT REPORT OF JEFFREY H. KINRICH PURSUANT TO FED. R. CIV. PRO. 26(A)(2)(B) AND 7026
SEPTEMBER 6, 2024

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I. INTRODUCTION AND QUALIFICATIONS

A. Assignment

1. I have been engaged by counsel for the above-captioned Debtors and Debtors-in-Possession to provide expert testimony in the matter of In re iCAP Enterprises, Inc., et al., pending in the United States Bankruptcy Court for the Eastern District of Washington under Case No. 23-01243-WLH11. Specifically, I have been asked to provide an opinion as to whether the iCAP Enterprises, Inc.'s ("iCAP" or "Debtors") transactions with their investors have the economic and financial indicia of a Ponzi scheme.

2. As an expert consultant, I am providing this written report in compliance with Federal Rules of Civil Procedure 26(a)(2)(B) and 7026.

3. The opinions contained in this report are based on materials reviewed or considered as of the date of this report. Discovery in this action is not complete. I reserve the right to supplement my opinions or express additional opinions should additional and/or presently unknown information about this matter become known to me at or before trial.

B. Qualifications

4. I am a Certified Public Accountant (CPA) and Managing Principal at Analysis Group, an economic consulting firm with over 1000 employees across the United States and around the world. I have testified at trial, arbitration, or deposition on financial and economic issues over 400 times. A copy of my CV, together with a list of the trial and deposition testimony I have given in the last six years, is attached as **Appendix A**. Analysis Group is compensated at the rate of $985 per hour for my time. Research and analysis for this declaration was also

performed by other Analysis Group personnel under my direction and guidance. Neither my compensation nor that of Analysis Group is contingent upon my findings, the testimony I may give, or the outcome of this litigation.

C. Facts and Data Considered

5. In forming my opinions, I have reviewed documents and other materials provided to me by the Debtors and their professionals, or obtained from publicly available sources. These sources include data from Accounting Seed (the accounting platform within Salesforce that iCAP utilized for its operational accounting), iCAP bank statements and bank production, iCAP financial statements, and internal iCAP spreadsheets, among others. The sources on which I rely are identified in this report or in **Appendix B**. Should additional relevant documents or information be made available to me, I may adjust or supplement my opinions as appropriate.

II. BACKGROUND

A. Overview of iCAP Enterprises, Inc.

6. iCAP was founded to invest in real estate opportunities in the Pacific Northwest region of the United States ("U.S."). iCAP operated two divisions with different investment strategies: the "Portfolio Business" and the "Vault Business." The Portfolio Business raised its first fund in 2014 and ostensibly focused on multifamily real estate projects with development potential, ranging from completely new construction to improving existing structures. The Portfolio Business operated under the entity iCAP Equity, LLC, and various subsidiaries.[1]

[1] Declaration of Lance Miller in Support of First Day Motions ("Miller First Day Declaration"), ¶¶ 5-8. Attached hereto as **Exhibit 7** is a copy of the Miller First Day Declaration.

7. iCAP started its "Vault Business" in 2018. The Vault Business ostensibly focused on investing in real estate that already was or had the potential to be cash flow positive.[2] The Vault Business was primarily operated under the entity iCAP Vault, LLC as well as various subsidiaries such as iCAP Vault 1 ("Vault 1"), LLC, an SEC registered entity, with cash flows in and out of the entity made via a Vault 1 bank account held with Umpqua Bank.[3]

8. Both the Portfolio Business and the Vault Business operated under iCAP Enterprises, Inc. ("iCAP Enterprises") in the organization's corporate structure; their properties were held by various single purpose entities (SPE's).[4] iCAP Enterprises operated as the parent for all entities (other than iCAP Investments, LLC) that directly owned equity in the various SPEs. Chris Christensen was the sole shareholder of both iCAP Enterprises and iCAP Investments, LLC.[5]

9. iCAP funded its operations by raising debt capital from investors and from cash flows from business operations.[6] iCAP primarily relied on private placements to fund its investments.[7] For example, the Portfolio Business was funded through private placements of debentures and promissory notes under which investors were promised interest rates ranging from 6% to 15% to the investors.[8] Similarly, the Vault Business financed its operations through

[2] Miller First Day Declaration, ¶ 9.

[3] The iCAP Vault 1 account with Umpqua Bank is bank account number xxxxxx4804. *See e.g.,* Umpqua Bank, iCAP Vault 1 LLC, December 31, 2020 account statement; *see also,* Miller First Day Declaration, ¶¶ 9, 14. Attached hereto as **Exhibit 8** is a copy of the iCAP Vault 1 Umpqua Bank account statement from December 2020.

[4] Miller First Day Declaration, ¶ 10.

[5] iCAP Organizational Chart_v5 092223.pptx. Attached hereto as **Exhibit 9** is a copy of the iCAP Organizational Chart.

[6] Miller First Day Declaration, ¶ 15.

[7] Miller First Day Declaration, ¶¶ 17-19.

[8] Miller First Day Declaration, ¶ 17.

Private Placement Notes and Public Demand notes.[9] In 2018, iCAP initiated a private placement of up to $500M to fund the Vault Business. In the same year, Vault 1 authorized up to $500 million in Variable Denomination Floating Rate Demand Notes that accrued interest at a floating rate equal to the Average Savings Account Rate posted by the FDIC plus a 2% premium, which was reset every quarter. Both businesses had investors from the United States and abroad, including China, Taiwan, the United Kingdom, and the British Virgin Islands.[10]

B. Relevant Timeframe of Financial Records

10. In 2014, iCAP raised its first fund, the iCAP Pacific Northwest Opportunity and Income Fund, LLC ("Fund 1"). To date, I have received investor trackers for various funds, including Fund 1, that track money to and from individual subscribers. These trackers do not contain information on internal accounting transactions at iCAP or any indication as to transactions involving its real estate business.[11]

11. I have more complete iCAP accounting data from its Accounting Seed database for the period October 2018 to September 2023, as well as various iCAP entity monthly bank statements for the period November 2019 to September 2023, as discussed further below. Accordingly, certain analyses in this Declaration are limited to the period for which I have the necessary data.

[9] Miller First Day Declaration, ¶ 19-20.

[10] Miller First Day Declaration, ¶¶ 20, 22.

[11] I understand iCAP initially used QuickBooks as its accounting software, but switched to Accounting Seed around October 2018. As of this filing, iCAP has been unable to gain access to the QuickBooks.

C. Accounting and Transaction Data Relied Upon

12. I understand iCAP used Accounting Seed to house its accounting data from at least October 2018 to September 2023. I have been provided with summary financial statements and transaction detail from Accounting Seed for this timeframe.

13. I have also been provided with iCAP entity bank statements and related records for November 2019 to September 2023. Within these bank statements, I have identified 56 unique iCAP bank accounts -- 49 of which are with Umpqua Bank -- with at least one monthly statement during this period. As discussed further below, I primarily rely on these bank records to cross-check the accuracy of the Accounting Seed data and to identify cashflows in and out of iCAP entities.

III. SUMMARY OF OPINIONS

14. On the basis of my review of the information identified herein, I have reached the following opinions:

a. The majority of iCAP's funds from October 2018 to September 2023 were from fund subscribers and loans from third parties, rather than cash generated from its business operations. *See* **Exhibit 1.1**.

b. The majority of iCAP's funds from October 2018 to September 2023 were used to make interest and principal payments to subscribers rather than investing in real estate and related operations. *See* **Exhibit 1.1**.

c. iCAP's real estate business from 2014 through 2022 did not generate sufficient cash flow to meet its interest and principal obligations to subscribers.

d. There were several large dollar transfers between iCAP entities from October 2018 to September 2023, indicating that subscriber funds from one entity were used to pay subscribers in another entity. This is indicative of commingling.

e. At least as early as October 2018, iCAP could only meet its obligations to repay its subscribers using proceeds from its real estate business if its real estate investments generated unrealistic (and unrealized) returns.

f. At least as early as October 2018, iCAP failed to invest subscribers' funds in the promised investments or as otherwise represented to subscribers.

g. Later investors in iCAP received lower returns than earlier investors.

h. Taken together, my analyses of iCAP's financial records and internal communications provides a strong indication that, at least as early as October 2018, iCAP was sustaining a Ponzi scheme in which it repeatedly repaid subscribers not from legitimate investment proceeds but through the commingling of funds and intercompany transfers.

IV. PONZI SCHEME DEFINED

A. General Factors of a Ponzi Scheme

15. A Ponzi scheme is an investor fraud scheme in which some or all of the returns generated from an investment are not legitimate and are merely transfers of funds from new investors to existing investors.[12] The SEC identifies this as the primary determinant of a Ponzi

[12] "Ponzi Scheme," Investor.gov, U.S. Securities and Exchange Commission, accessed on January 12, 2024, available at: https://www.investor.gov/protect-your-investments/fraud/types-fraud/ponzi-scheme; "Investor Protection Guide: Ponzi Scheme," Legal Information Institute, Cornell Law School, accessed on January 12, 2024,

scheme. In a Ponzi scheme, new investors are often encouraged to invest through the promise of high returns with low risk. Some or all of these funds are not invested in legitimate businesses, resulting in little to no legitimate returns.[13] In the absence of legitimate returns, these funds rely on the recruitment of new investors to pay existing investors in order to sustain the scheme. As a result, the early investors usually get relatively higher returns compared to the later investors, and particularly those that subscribe near the collapse of the scheme, suffer either partial or complete loss of their investments.[14] While Ponzi schemes manifest in different forms, they generally exhibit the following characteristics:[15]

1. *Deposits were made by investors;*

2. *Unrealistic returns promised to investors with little or no risk;*

3. *The company operating the Ponzi scheme conducted little or no legitimate business operations as represented to investors;*

4. *Purported business operations of the Ponzi scheme entity produced little or no profits or earnings;*

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available at: https://www.law.cornell.edu/wex/investor_protection_guide_ponzi_scheme; "Ponzi Schemes," Michigan Consumer Protection," accessed on January 12, 2024, available at: https://www.michigan.gov/consumerprotection/protect-yourself/consumer-alerts/invest/ponzi. Attached hereto as **Exhibit 10**, **Exhibit 11**, and **Exhibit 12**, respectively, are downloaded copies of these three websites.

[13] "Ponzi Scheme," Investor.gov, U.S. Securities and Exchange Commission, accessed on January 12, 2024, available at: https://www.investor.gov/protect-your-investments/fraud/types-fraud/ponzi-scheme.

[14] "Ponzi Schemes," Michigan Consumer Protection," accessed on January 12, 2024, available at: https://www.michigan.gov/consumerprotection/protect-yourself/consumer-alerts/invest/ponzi.

[15] *Rieser v. Hayslip (In re Canyon Sys. Corp.)*, 343 B.R. 615, 630 (Bankr. S.D. Ohio 2006)); *Fisher v. Sellas (In re Lake States Commodities, Inc.*), 272 B.R. 233, 242 (Bankr.N.D.Ill.2002) (citing *Floyd v. Dunson (In re Ramirez Rodriguez)*, 209 B.R. 424, 431 (Bankr.S.D.Tex.1997), aff'd sub nom. *Fisher v. Page*, 2002 WL 31749262 (N.D. Ill. Dec. 3, 2002); *see also Scholes v. Lehman*, 56 F.3d 750, 757 (7th Cir. 1995); *O'Halloran v. First Union Nat'l Bank of Fla*., 350 F.3d 1197, 1199 (11th Cir. 2003); *United States v.* Benson, 79 Fed. App'x 813, 817 (6th Cir. 2003); *In re Taubman*, 160 B.R. 964, 978 (Bankr. S.D. Ohio 1993); *Wing v. Williams*, 2011 U.S. Dist. LEXIS 25607, at *10 (D. Utah Mar. 11, 2011); *Cuthill v. Greenmark, LLC (In re World Vision Entm't, Inc.)*, 275 B.R. 641, 656-57 (Bankr. M.D. Fla. 2002); *Smith v. Suarez (In re IFS Fin. Corp.)*, 417 B.R. 419, 440 (Bankr. S.D. Tex. 2009); *Emerson v. Maples (In re Mark Benskin & Co.)*, 161 B.R. 664, 650 (Bankr. W.D. Tenn. 1993); *Wing v. Dockstader*, 2010 U.S. Dist. LEXIS 128571, at *11 (D. Utah Dec. 3, 2010).

5. *Source of payments to investors was not obtained by any business venture of the Ponzi scheme entity but was taken from cash infused by new investors;*

6. *Investors' funds cannot be traced to a specific investment;*

7. *The Ponzi scheme entity failed to invest all of the investors' funds in promised investments;*

8. *The Ponzi scheme entity used investor funds for non-investor purposes;*

9. *Later investors in the Ponzi scheme entity received lower returns than earlier investors; and*

10. *Money was transferred between related entities within the Ponzi scheme entity for no business purpose.*

V. DEVELOPMENT OF THE SOURCES & USES OF FUNDS

16. Several of the Ponzi Scheme characteristics listed above can be investigated at least in part through a Sources and Uses analysis. A Sources and Uses analysis attempts to identify and categorize all money coming into an entity (sources), and all money being withdrawn from an entity (uses). Generally, in a Ponzi Scheme, the Sources and Uses analysis would find that the cash inflows and outflows were more focused on investor activity rather than on the stated business purpose (in iCAP's case, real estate investment and related operations).

17. To develop a Sources and Uses analysis, I reviewed iCAP's Accounting Seed "Consolidated Funds Cash Detail" data ("Accounting Seed Data"), which contains transaction data on cash deposits and withdrawals from October 2018 through September 2023.[16] I understand that Debtors used their bank accounts at Umpqua bank to conduct their ordinary

[16] Consolidated Funds Cash Detail - 10.1.18-9.30.23.xlsx and other Accounting Seed data for individual iCAP entities. Due to the volume of transactions in these files and resulting document size, these documents are not attached as an exhibit to this declaration, but can be produced upon request.

course of business, and that the Accounting Seed Data reflects this cash activity.[17] In particular, I reviewed the cash transaction activity recorded in the "1000-Checking:Umpqua" account in the Accounting Seed Data, which appears to have been used to conduct the ordinary course of business of all major entities within iCAP.[18] This dataset contains over 75,000 records of cash activity.

18. As a check on the reliability of the Accounting Seed Data, I compared the dollar value of deposits and withdrawals to the iCAP bank statements produced to me. As discussed, the monthly bank account statements are in PDF format and cover the period November 2019 to September 2023. To make the comparison easier, I converted the PDF bank statements to a structured Excel database, which allowed me to easily calculate totals across multiple months and years. Filtering the Accounting Seed Data for transactions occurring during the same period as the provided bank statements results in the amounts in the table below.

[17] Miller First Day Declaration, ¶ 14.

[18] Consolidated Funds Cash Detail - 10.1.18-9.30.23.xlsx and other Accounting Seed data for individual iCAP entities.

Table 1: Comparison of Deposits and Withdrawals in iCAP Accounting Seed Data to iCAP Bank Statements

	Total Deposits	Total Withdrawals
iCAP Accounting Seed Data	$537.4 million	$546.4 million
iCAP Bank Statements	$556.7 million	$553.8 million
Percentage Difference	(3.5%)	(1.3%)

19. As presented in Table 1 above, while not an exact match, the deposits and withdrawals per the Accounting Seed Data, as compared to the iCAP bank statements, are similar, with the difference in deposits being approximately 3.5% and the difference in withdrawals being 1.3%. As such, the available data provides a reliable basis for these Ponzi-scheme-related analyses, including the Sources and Uses analysis.

20. I first considered iCAP as a whole, without consideration of individual entities. **Exhibit 1.1** provides a summary of the Sources and Uses of iCAP's funds per the Accounting Seed Data. To determine the appropriate category for deposits and withdrawals, I relied on three main data elements from the Accounting Seed Data: (1) the name of the entity involved (referred to as "Entity (GLAV1)" in the Accounting Seed Data), (2) the name of the counter-party involved in the transaction (referred to as "Account: Account Name" in the Accounting Seed Data), and (3) the description of the transaction (referred to as "Source Reference" in the Accounting Seed Data). Certain transactions were also informed by the subscriber number

contained in the "Subscription: Subscription Name" column and the entity name contained in the "Fund Project for Report" column.[19]

21. The results of the Sources and Uses analysis are shown in **Exhibit 1.1**. In summary, I identified four categories of deposits: (1) "Investments from Subscribers," (2) "Loans Obtained from Third Party Lenders," (3) "Money Received from Business Operations," and (4) "Intercompany Transfers." The deposits are further subdivided into sub-categories based on the nature of the deposits identified using the descriptions of the deposits as well as the parties involved in the deposits.

22. Similarly, I identified seven categories of withdrawals: (1) "Returns to Subscribers," (2) "Commission Payments," (3) "Real Estate Acquisition, Development, and Investment," (4) "Loan Repayment," (5) "General, Operating, and Admin Expenses," (6) "Money to Owner," and (7) "Intercompany Transfers."[20]

23. Of note, both the deposits and withdrawals sections of the Sources and Uses analysis contain a category called "Intercompany Transfers." This element is necessary to account for all deposits and withdrawals into and out of the company accounts, and it is relevant when analyzing individual funds. However, it should be (and will be) eliminated when considering the company as a whole, as discussed below.

24. I relied on the results of the Sources and Uses analysis in conducting several of the analyses discussed below.

[19] Consolidated Funds Cash Detail - 10.1.18-9.30.23.xlsx and other Accounting Seed data for individual iCAP entities.

[20] For additional detail on the Sources and Uses categorizations, see **Exhibit 1.2**.

VI. ANALYSIS AND OPINIONS

A. Analysis of iCAP's Sources and Uses of Funds

1. Deposits and Receipts

25. As discussed above in **Section V**, several indicators of a Ponzi scheme can be observed in a Sources and Uses analysis. The summary of the consolidated iCAP Sources and Uses, including deposits and receipts, per the Accounting Seed data is shown in **Exhibit 1.1**. The analysis indicates that approximately 84% of the amounts deposited to iCAP bank accounts from October 2018 to September 2023 were related to either investments from subscribers or intercompany transfers. Specifically, deposits and receipts totaled $580.2 million. Of this amount, $286.8 million, or 49.4%, was related to investments from subscribers.[21]

26. The next largest category of cash deposits is intercompany transfers, totaling $202.6 million, or 34.9% of total deposits. This category is not "new" money to iCAP, as it is money moving between iCAP entity accounts. Although it is not "new" money being deposited, the volume of transfers is still instructive in comparison to other deposit amounts. The purpose of these transfers is also important, as it could be for iCAP's stated business purpose (i.e., investing in real estate) or for a non-business purpose (i.e., returning money to investors). In this case, most intercompany transfers were not for business purposes, but funded payments to investors.

27. The third category of deposits is loans iCAP obtained from third party lenders. My understanding is that these were typically mortgage loans. This category totaled $55.8 million, or 9.6% of total deposits.

[21] Included in this amount is $21.7 million, or 3.7% of total deposits, of subscriber funds that were reallocated to other funds and are not necessarily "new" investments from subscribers.

28. The fourth category of deposits is from iCAP's business operations. This category totaled $34.9 million, or 6.0%, of total deposits.

29. Thus, deposits to iCAP entities were largely comprised of money from subscribers (49.4%), intercompany transfers (34.9%), and third-party loans (9.6%), more so than from business operations (6.0%). In other words, only approximately 6% of deposits were from iCAP's business operations. Taken by itself, this could have an innocent explanation; for example, the business could be in an investment mode where investments were not yet paying off. A look at the disbursements of cash (below), however, shows this is not the case.

30. As another check, I remove the intercompany transfer amounts and compare the investments from subscribers and money received from iCAP's business operations, as these are the deposits that iCAP received from external sources. The results indicate that iCAP received 76.0% of its funds from subscribers, 14.8% from third party lenders, and 9.2% from business operations. *See* **Exhibit 2**. That is, even when excluding intercompany transfers, the majority of funds received by iCAP were from subscribers and external lenders rather than business operations.

31. The Sources and Uses analyses described thus far incorporate cash flows from both funds that subscribers were directly investing in as well as special purpose entities created for specific projects that iCAP invested in. As a further check on iCAP's Sources and Uses, and to better determine how iCAP was using cash received directly from subscribers, I isolate the funds that subscribers invested in and develop a consolidated Sources and Uses for these funds. I understand that these entities are Funds 1 through 5, iCAP Funding, iCAP Investments, and iCAP Vault. The consolidated Sources and Uses for these funds is shown in **Exhibit 3**. The results indicate that 65.6% of deposits to these funds were investments from subscribers, 29.4%

were intercompany transfers, and 4.1% were from business operations. Thus, 95.0% of the cash deposited to these funds were either from subscribers or other iCAP entities.

32. Again, the relatively low amount of deposits from business activity could be reasonable if iCAP was in a real estate investment phase and was using the cash from subscribers to invest in the possibility of future cash flows from operations. The disbursements discussed below, however, indicate this is not the case, which in turn indicates that the deposits being mainly comprised of cash from subscribers and intercompany transfers are indicative of a Ponzi scheme.

2. Disbursements and Withdrawals

33. If iCAP's disbursements and withdrawals were to fund its investments, then perhaps its operations might make sense. But they were not. The majority of disbursements and withdrawals from iCAP entities were returns to subscribers and intercompany transfers. *See* **Exhibit 1.1**.

34. In total, the Sources and Uses Analysis indicates that $584.8 million was withdrawn from iCAP accounts from October 2018 to September 2023. Of this, $236.1 million, or 40.4%, was returned to subscribers and $205.2 million, or 35.1%, was intercompany transfers. That is, transactions related to returns to subscribers and intercompany transfers comprised 75.5% of total withdrawals.

35. Certain withdrawals from iCAP were related to real estate acquisition, development, and investment. These withdrawals totaled just $78.9 million, or 13.5% of the total. Other transactions, while not specifically related to real estate, involved withdrawals for iCAP's general, operating, and administrative expenses. These withdrawals totaled $45.0

million, or 7.7% of the total. Combining the two, withdrawal transactions related to real estate or the operation of iCAP comprised just 21.2% of total withdrawals.

36. Thus, similar to deposits, withdrawals from iCAP entities were largely comprised of money paid to subscribers (40.4%) and intercompany transfers (35.1%), more so than for real estate investment activities (13.5%) and business operations (7.7%).

37. Alternatively, I once again excluded intercompany transfers and compared the remaining withdrawal amounts. Returns to subscribers comprise 62.2% of total withdrawals, with real estate acquisition, development, and investment (20.8%), and general, operating, and administrative (11.8%), totaling 32.6% combined. *See* **Exhibit 2**. Thus, after removing intercompany transfers, more than half of withdrawals were returns to subscribers, with approximately one-third of withdrawals related to the real estate and business operations side of iCAP.

38. Combining the results of the Sources and Uses analysis, with intercompany transfers excluded, I find that 76.0% of sources were from investors, and only 9.2% were from business operations. Similarly, 62.2% of the funds were used to repay investors, while only 20.8% were used to make real estate investments (other amounts were used to pay for business operations, commissions, etc.). Combined, this is highly indicative of a Ponzi scheme.

39. In addition to these analyses, I once again consider the Sources and Uses for only the funds that subscribers invested in, Funds 1-5, iCAP Funding, iCAP Investments, and iCAP Vault. *See* **Exhibit 3**. The results indicate that 51.3% of withdrawals were returns to subscribers, 35.3% were intercompany transfers, 5.3% were related to real estate acquisition, development, and investment, and 4.1% were related to general, operating, and administrative expenses. Thus, 86.6% of withdrawals were returns to subscribers or intercompany transfers while only 5.3%

were related to real estate activity. Taken together with the deposit activity in **Exhibit 3**, this is again indicative of a Ponzi scheme.

3. Analysis of Individual Fund Sources & Uses

40. The analysis above is based on the Sources and Uses of funds for the consolidated iCAP entity and certain aggregated iCAP entities. Similar analyses can be conducted at the individual fund level. To do this, the Accounting Seed Data can be filtered for the individual fund name in the field "Entity (GLAV1)." The resulting transactions can be used to prepare a fund-level Sources and Uses schedule for iCAP funds 1 through 5, iCAP Funding, iCAP Investments, and iCAP Vault. *See* **Exhibits 4.1-4.8** for the results.

41. The iCAP Equity (Fund 3) Sources and Uses analysis, for example, indicates almost no real estate activity. *See* **Exhibit 4.3**. Deposits total $81.6 million, of which $36.3 million, or 44.4%, are investments from subscribers and $44.5 million, or 54.5%, are intercompany transfers received from other iCAP entities. Only $0.9 million, or 1.1%, is money received from business operations.

42. Withdrawals from iCAP Equity total $85.3 million. Returns to subscribers total $18.8 million, or 22.0%, with intercompany transfers to other iCAP entities totaling $58.6 million, or 68.6%. General, operating, and administrative expenses total $3.5 million, or 4.1%, while real estate acquisition, development, and investment total only $229 thousand, or 0.3% of total withdrawals. Thus, for both deposits and withdrawals, iCAP Equity (Fund 3) has almost no real estate related activity and the deposits and withdrawals are mostly money from and to subscribers, along with intercompany transfers. These data are highly indicative of a Ponzi scheme.

43. The iCAP Pacific Northwest Opportunity & Income Fund (Fund 1) tells a similar story. *See* **Exhibit 4.1**. Total deposits to the fund were $17.5 million. As this fund was raised in 2014, there were almost no investments received from subscribers during the Accounting Seed Data period (October 2018 to September 2023). Instead, the fund received $16.0 million, or 91.0%, of its cash inflows via intercompany transfers from other iCAP entities. Only $1.5 million, or 8.7%, was received from business operations. Again, these data are highly indicative of a Ponzi scheme.

44. Total withdrawals from iCAP Pacific Northwest Opportunity & Income Fund (Fund 1) were $19.8 million. Of this, returns to subscribers were $18.1 million, or 91.4%. Another $1.3 million, or 6.6%, was for general, operating, and administrative expenses, while only $65 thousand, or 0.3%, of withdrawals were for real estate acquisition, development, and investment. Thus, for both deposits and withdrawals, Fund 1 had almost no real estate related activity. In fact, the analysis indicates that Fund 1 primarily received funds from other entities (91.0% of sources) and used that money to pay Fund 1 subscribers (91.4% of uses). These data are highly indicative of a Ponzi scheme.

45. iCAP Vault 1 is similar to Fund 1. *See* **Exhibit 4.8**. Deposits totaled $208.7 million, of which $193.1 million, or 92.5%, were investments from subscribers. Another $12.7 million, or 6.1%, was transferred from other iCAP entities. Thus, approximately 98.6% of iCAP Vault 1's funds were from subscribers or other iCAP entities. Withdrawals from iCAP Vault 1 totaled $204.2 million. Of this, $142.3 million, or 69.7%, was returned to subscribers and $39.6 million, or 19.4%, was transferred to other iCAP entities. Only $16.4 million, or 8.1%, was used for real estate acquisition, development, and investment.

46. iCAP Funding tells more of the same story. *See* **Exhibit 4.6**. Total deposits to the fund were $12.4 million, of which $11.5 million, or 92.8%, were investments from subscribers and $0.6 million (5.1%) were intercompany transfers from other iCAP entities. Withdrawals from iCAP Funding total $12.4 million. Returns to subscribers totaled $5.5 million, or 44.4%, with intercompany transfers to other iCAP entities totaling $4.7 million, or 37.9%. Another $1.7 million, or 13.8%, was for commissions. There was no real estate activity. These data are highly indicative of a Ponzi scheme.

47. Lastly, iCAP Investments had $38.3 million in total deposits. *See* **Exhibit 4.7**. Of this amount, $20.6 million, or 54.0%, was investments from subscribers, with another $12.6 million or, 33.0%, in intercompany transfers. This is compared to the $4.3 million, or 11.1%, in deposits from business operations.

48. iCAP Investments had $38.2 million in total withdrawals. This was mostly comprised of returns to subscribers, $7.5 million or 19.7% and intercompany transfers, $21.5 million or 56.3%. This fund also had $2.0 million or 5.3% in general, operating, and administrative expenses and $1.9 million or 5.0% in commissions, with only $0.9 million or 2.3% in real estate disbursements. These data are highly indicative of a Ponzi scheme.

49. To summarize, taken both at the consolidated level and the individual fund level, from October 2018 to September 2023, iCAP's sources of funds were primarily investments from subscribers and intercompany transfers and its uses of funds were returns to subscribers and intercompany transfers, with relatively little cash generated or invested in real estate activity. *See*

Exhibits 1, 3 and 4.1-4.8. This pattern follows the characteristics discussed in **Section IV** and is highly indicative of a Ponzi scheme.[22]

B. Analysis of iCAP's Real Estate Business

50. I next turn to a review of the performance of iCAP's real estate business.

51. There are two primary ways iCAP can generate revenue from its real estate business: (1) selling owned properties and (2) earning rental revenue and other revenue on a property while it is owned. As to selling properties, a schedule has been produced that provides detail on all properties invested in by iCAP from September 2013 through December 2020.[23] The schedule indicates that iCAP invested $103.4 million in total across these properties. The schedule also provides an exit date when iCAP sold the property or otherwise exited its investment and the net gain or loss on the exit. The schedule indicates that iCAP generated a cumulative net gain of $1.4 million from sales on its $103.4 million in real estate investments.[24] This relatively low cumulative net gain of 1.3% across an over seven-year investment period indicates that iCAP would not be able to rely on its real estate investments appreciating in value in order to make its required payments to subscribers.

52. To evaluate rental revenue and other revenue earned while iCAP owned properties, I reviewed the revenue detail as reported in Accounting Seed for October 2018 to September 2023. I understand based on my review of the data and discussions with iCAP

[22] I note that Chris Christensen himself, in an email to Jim Christensen on October 9, 2019, included a bullet point in an agenda that stated, "Address Ponzi idea." *See* Attached hereto as **Exhibit 13** is a copy of an October 2019 email with the title, "Delegation List."

[23] Project Divestitures.xlsx, tab "Completed Project Investments." Attached hereto as **Exhibit 14** is a copy of this document.

[24] Project Divestitures.xlsx, tab "Completed Project Investments."

personnel that a majority of the revenue booked by iCAP was revenue earned by one iCAP entity for services performed for another iCAP entity. That is, the revenue earned was not from external sources, but rather intercompany revenue and expenses. As such, I exclude these revenue categories from my calculation.[25]

53. To determine whether iCAP was generating enough revenue to meet its obligations to its subscribers, I combined the revenue earned by iCAP while owning its properties and the net gain or loss upon exiting its properties. I then compare this amount to the payments made to subscribers during the same year. The results are as follows:

Table 2: Comparison of iCAP Annual Revenue and Net Gains/Losses on Property Sales to Payments Made to Subscribers, 2018 to 2023

	2018 (Oct.-Dec.)	2019	2020	2021	2022	2023 (Jan.-Sep.)	Total	
Rental Revenue and Net Gain/Loss on Property Sales	($6,303,071)	($3,417,638)	$340,492	$1,056,418	($2,284,304)	$251,106	**($10,356,996)**	**A= B+C+D**
Rental Revenue	*$97,035*	*$55,480*	*$198,411*	*$596,774*	*$1,745,312*	*$251,106*	***$2,944,118***	**B**
Other Revenue	–	–	–	*$146,000*	*$90,667*	–	***$236,667***	**C**
Net Gain/Loss on Property Sales	*($6,400,106)*	*($3,473,118)*	*$142,081*	*$313,644*	*($4,120,282)*	–	***($13,537,780)***	**D**
Returns to Subscribers	($2,766,135)	($24,480,866)	($19,264,741)	($54,630,918)	($112,580,636)	($22,404,658)	**($236,127,953)**	**E**
Net Amount Required from Other Sources	**($9,069,206)**	**($27,898,504)**	**($18,924,248)**	**($53,574,500)**	**($114,864,940)**	**($22,153,551)**	**($246,484,944)**	**F=A+E**

54. As shown in Table 2 above, from October 2018 through September 2023, iCAP earned $3.2 million in rental and other revenue from external sources and lost $13.5 million on the sale of properties, while returning $236.1 million to subscribers. This indicates that iCAP's business operations were insufficient to make its payments to subscribers. iCAP's only other sources of funds according to the Accounting Seed Data were third party loans, approximately

[25] I understand that Rental Income and certain Interest Income amounts are the only revenue sources that iCAP earned from external sources. Excluded revenue categories include Professional Service Fee Income, Management Fee Income, Construction Income, Commissions Income, and Miscellaneous Income. Discussion with Nickisha Haine, internal accountant for iCAP.

$55.8 million (*see* **Exhibit 1.1**), and subscribers' money used to pay other subscribers—in other words, a Ponzi scheme.

55. iCAP's internal communications call into question whether the purported investments were being recorded correctly. In an email from October 6, 2022, Jim Christensen, iCAP President, circulated a spreadsheet for an upcoming "Finance Leadership Meeting" containing information on iCAP's real estate investments. Neil Peritz, iCAP's Vice President of Finance, responded saying that certain numbers were "not even in the ball park" of what iCAP was showing on its consolidated balance sheet. Mr. Peritz then added, "UW and 725 Broadway numbers make no sense to me. UW hasn't started development and 725 Broadway is a parking garage we are demolishing soon to develop so how [do] you get $19.3 [million] in equity on that one?"[26]

56. In addition to internal numbers not matching, iCAP's subscribers also questioned iCAP's investment choices. In an email dated June 26, 2018, Michael Norvet of Evolution Real Estate communicated to Chris Christensen and others at iCAP that (1) they were not properly informed of pending real estate transactions and (2) if they were, they would not have accepted the sales price that Mr. Christensen agreed to. Mr. Norvet then noted that the estimated loss of $500 thousand on the transaction was "completely unacceptable" and that "we reserve the right to take the necessary steps to cancel the sales contracts." Mr. Norvet then requested certain documents and a plan to return investor money, further stating "this affair has shaken our trust in ICAP."[27]

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[26] Attached hereto as **Exhibit 15** is a copy of an October 2022 email chain with the title, "iCap Summary Spreadsheet – Finance Leadership Meeting."

[27] Attached hereto as **Exhibit 16** is a copy of a June and July 2018 email chain with the title, "Lakeview and Brislawn."

57. Thus, the data indicates that, at least as early as October 2018, iCAP's real estate business did not generate sufficient returns, while internal communications and communications from subscribers call into question the reporting of the state of the business and the business decisions being made.

C. Analysis of Intercompany Transfers and Evidence of Commingling

58. Two common characteristics of a Ponzi scheme are (1) lack of profits from the purported business operations and (2) transfer of funds from later investors to early investors. This implies that in the absence of profits generated from the purported businesses, investors are paid through an infusion of additional cash from new investors. Because of these transfers of funds from one set of investors to another, investors' funds cannot be traced to specific business operations. Therefore, in a typical Ponzi scheme, one would expect large transfers of funds among businesses, often unrelated to business-related operations or investments, to sustain the scheme. Evidence from the iCAP Sources and Uses analysis indicates that intercompany transfers made up a large share of the overall cash activity, and that there was commingling of funds. Commingling of investor funds is evidence of a Ponzi scheme because the funds are pooled in one common fund, thereby making it impossible to trace. When a company commingles funds and operates at a loss while continuing to pay the old investors, the money to pay the old investors necessarily comes from new investments.[28]

59. As discussed in **Section VI.A**, the analysis of Sources and Uses of iCAP's funds shows that intercompany transfers accounted for 34.9% of deposits and 35.1% of withdrawals.

[28] *Miller v. Wulf*, 84 F. Supp. 3d 1266, 1273–74 (D. Utah), aff'd, 632 F. App'x 937 (10th Cir. 2015); *see also In re Hedged–Invs. Assocs., Inc.*, 48 F.3d 470, 474 (10th Cir. 1995).

See **Exhibit 1.1**. The relatively large amount of intercompany transfers is confirmed by iCAP internal communications. Neil Peritz, Vice President of Finance at iCAP, stated in an email from October 24, 2022, that "there are still intercompany entries going all over the place and nobody seems to know what's up… The [balance sheet] has intercompany balances that don't eliminate and not sure why, but the debt makes sense at over $200 [million]."[29]

60. An analysis of these intercompany transfers provides further evidence for commingling of funds. For example, **Exhibit 4.1** shows the Sources and Uses analysis for iCAP Pacific Northwest Opportunity and Income Fund (Fund 1). As discussed above, from October 2018 through September 2023, Fund 1 obtained 91.0% of its deposits via intercompany transfers. The majority of these funds were received from iCAP Equity, LLC. While it is theoretically possible that some of these funds may have had a business purpose, the accounting records show otherwise. iCAP's accounting records show these transfers as intercompany loans without any indication of the purpose for such transfers. Further, during the same period, 91.4% percent of Fund 1's withdrawals were used to pay subscribers. In this instance, all or most of the transfers from iCAP Equity, LLC were used to pay off investors of Fund 1. This is highly indicative of both the commingling of funds among iCAP's entities and a Ponzi scheme.

61. iCAP Northwest Fund (Fund 2) is another example of a fund that was infused with cash from iCAP Equity, LLC, primarily to pay off investors. *See* **Exhibit 4.2**. Fund 2's Sources and Uses analysis indicates that $22.9 million, or 68.8% of deposits, were from intercompany transfers, with $10.4 million, or 31.1%, of deposits from business operations. Fund 2's withdrawals were then comprised of $20.2 million, or 55.2%, in returns to subscribers and

[29] Attached hereto as **Exhibit 17** is a copy of an October 2022 email chain titled, "Combined F/S."

$11.8 million, or 32.3%, in intercompany transfers. Again, this is highly indicative of commingling and the use of other funds' subscriber investments to make payments to Fund 2's subscribers.

62. The Sources and Uses analysis of iCAP Pacific Income Fund 4 (Fund 4) raises similar concerns. **Exhibit 4.4** shows that the fund received $23.9 million in deposits, of which 51.9%, or $12.4 million, was from subscribers and 47.9% percent, or $11.4 million, was from intercompany transfers. Meanwhile, Fund 4 generated only $41 thousand in deposits from business operations. A total of $22.6 million was withdrawn from the fund's account. $9.5 million, or 42.1%, was transferred to other iCAP entities while $2.2 million, or 9.7%, was used for "Real Estate Acquisition, Development, and Investment" as well as $3.0 million, or 13.1%, to pay "General, Operating, and Admin Expenses." Approximately $4.9 million, or 21.6%, was returned to investors. Thus, this fund barely generated any net revenue, but paid almost $5 million to subscribers, expensed over $3.0 million in general, operating, and admin expenses, while also redistributing $9.5 million to other entities within the organization.

63. To further illustrate, certain internal email communications provide evidence of requests for fund transfers between iCAP entities and indicate that those transfers were necessary to return money to subscribers of the fund receiving the transfer.

64. As a first example, below is an email from Chris Christensen dated April 14, 2022. In the email, Mr. Christensen indicates that transfers are made between funds "two times each month" and that "The 15th of the month is the big one for the interest payments." The email then goes on to state that "iCAP Equity is covering a big portion of the expenses from funds we have raised" and that Senza Kenmore was transferring $285 thousand "to Fund 4 to cover Fund 4 investor payoffs." The schedule included in the email then indicates that iCAP Investment was

transferring $885 thousand to iCAP Equity, which was then transferring that money to several funds, including Fund 1, Fund 2, and Fund 5.[30]

Cash Follow Up

Chris Christensen <chris@icapequity.com>

Thu 4/14/2022 7:47 AM

To:Cindy Fang <cindy@icapequity.com>;Jim Christensen <jim@icapequity.com>

1 attachments (43 KB)

220415 - Semi-monthly Expense Projections.xlsx;

Hi Cindy and Jim,

Since we are going to be working together on the operating cash needs, I wanted to share with you the proposed plan for today's transfers. As we discussed, we do transfers two times each month. The 15th of the month is the big one for the interest payments. Below are the proposed cash transfers. Here are the highlights:

1. iCap Equity is covering a big portion of the expenses from funds we have raised.
2. Senza Kenmore is transferring $285K to Fund 4 to cover Fund 4 investor payoffs (these funds belong to Fund 4, but we have not distributed them out of Senza Kenmore yet)
3. iCap Investments would need to transfer $885K. There is currently $1.5M in the account for iCap Investments.

We are planning to raise more funds in iCap Equity over the next few weeks. Let me know if you have any questions.

	Proposed Transfers				
	From	To		Amount	
1	iCap Investment	Equity	$	885,000.00	
2	iCap Funding	Equity	$	-	
3	Equity	Fund 1	$	265,000.00	
4	Equity	Fund 2	$	277,000.00	
5	Senza Kenmore	Fund 4	$	285,000.00	
6	Equity	Fund 5	$	35,000.00	
7	Equity	iCap 134th Street	$	8,000.00	
8	Equity	iCap PNWM	$	52,000.00	
9	Equity	iCap Enterprises	$	-	Done trnf on 4/13
10	Fund 5	Campbell	$	4,200.00	

65. In another email dated December 22, 2022, Vera Rohlfing, Accounting Manager at iCAP, emailed a proposed list of transfers to Chris Christensen. The email indicated that in order for iCAP International to make a disbursement to a subscriber, money needed to be transferred from other iCAP entities. In this case, the proposed transfer included $500 thousand from iCAP Investments. iCAP Investments, however, first received this $500 thousand from 725

[30] Attached hereto as **Exhibit 18** is a copy of an April 2022 email titled, "Cash Follow Up."

Broadway as an intercompany loan. 725 Broadway in turn received this money from iCAP Vault in the form of an intercompany loan repayment.[31]

RE: Jinan wiring instruction -transfers and wire are ready for approval in Umpqua.

Chris Christensen <chris@icapequity.com>
Thu 12/22/2022 12:57 PM
To:Vera Rohlfing <vera@icapequity.com>
Cc:Jian Lu <kristyjian@icapequity.com>;Jane Li <Jane@icapequity.com>
Excellent. I will work on that now.

From: Vera Rohlfing <vera@icapequity.com>
Sent: Thursday, December 22, 2022 12:04 PM
To: Chris Christensen <chris@icapequity.com>
Cc: Jian Lu <kristyjian@icapequity.com>; Jane Li <Jane@icapequity.com>; Vera Rohlfing <vera@icapequity.com>
Subject: FW: Jinan wiring instruction -transfers and wire are ready for approval in Umpqua.

Hi Chris,

To pay from the iCap International Investments bank account we need cash there. I added #1 and modified #3.
Please see below the transfers that were setup in the bank and approve in order, then approve the wire out of iCap International investments LLC.

1. **Repayment of intercompany balance of $500K, from Vault to 725 Broadway -** ready
2. Intercompany loan of $500K, from 725 Broadway to iCap Investments- ready
3. Intercompany loan of $500K from iCap Investments to iCap International Investments- will do transfer between the companies
4. Vault Withdrawal of $1,500,075 by iCap International Investments – **Sub S-001867 balance is $ 1,584,763.93. $1,500,075 from it to iCap International investments company-ready. Need a withdrawal form**
5. Wire from iCap International Investments to the recipient below-**ready**

66. Cindy Fang, iCAP Director of International Markets, emailed Chris Christensen on February 9, 2023, "we will have 1.6 [million] in Vault today or tomorrow that you can leverage to pay back [a subscriber.]" Mr. Christensen responded the same day, "if you can somehow bring in $2 [million] more by Tuesday, we could pay a special amount. It would only need to stay for about 1-month." Ms. Fang responded by stating that two subscribers had

[31] Attached hereto as **Exhibit 19** is a copy of a December 2022 email chain with the title, "Jinan wiring instruction – transfers and wire are ready for approval in Umpqua."

resumed making investments, and that they could potentially obtain "a couple million" from another subscriber."[32]

67. In another email from March 27, 2023, Cindy Fang, now with a title of Project Consultant, updated Chris Christensen on the status of several transfers, including an indication that one subscriber's withdrawal request for $940 thousand would be paid from newly received funds from other subscribers.[33] The next month, on April 21, 2023, Chris Christensen sent an email to Cindy Fang and others at iCAP providing a proposed payment schedule to the subscriber. Cindy Fang responded three days later indicating that they were expecting $600 thousand in subscriber deposits that week, and that $100 thousand could go to this subscriber's request. The other $500 thousand would go to one of two other subscribers, depending on whether they were able to "negotiate a deal" with one of the subscribers.[34]

68. As another example, a series of emails in March 2023 show Cindy Fang communicating with other iCAP employees that $200 thousand was expected from the subscriber Yulan Ren. Once the $200 thousand was received, it would then be combined with money from two other subscribers to pay $900 thousand back to a different subscriber.[35]

69. In an internal email chain on May 17, 2019, a Senior Accountant at iCAP questioned why $200 thousand was transferred to Fund 1, to which the Chief Financial Officer, TD Croshaw, responded "I transferred it to cover the interest payment."[36]

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[32] Attached hereto as **Exhibit 20** is a copy of a February 2023 email chain titled, "Steve's mom's payback."

[33] Attached hereto as **Exhibit 21** is a copy of a March 2023 email chain with the title, "This week's withdrawal requests."

[34] Attached hereto as **Exhibit 22** is a copy of an April 2023 email chain titled, "Evergreen."

[35] Attached hereto as **Exhibit 23** is a copy of a March 2023 email chain titled, "Incoming wire."

[36] Attached hereto as **Exhibit 24** is a copy of a May 2019 email chain titled, "$200K Transfer into Fund 1 on 5/13."

70. In another internal email chain in July 2022, Jian Lu, accountant at iCAP, provided Chris Christensen with a schedule of forecasted payments to investors. The email includes the question "Please review and advise on where we can transfer money to cover the month end pay run." The email chain then indicates that $210 thousand would be transferred from iCAP Investments to iCAP Equity to iCAP Enterprise, along with a "short-term" loan from iCAP @ UW to cover the required payments. The final email from Tatiana Pantchenko, iCAP's Director of Accounting, states that iCAP Equity received $182 thousand in checks and that this "should help" cover the payments.[37]

71. Taken together, the Sources and Uses analyses of these funds, along with internal iCAP communications, provide a strong indication that, at least as early as October 2018, iCAP was sustaining a Ponzi scheme through these intercompany transfers and commingling of funds. Further, there is a strong indication that these intercompany transfers were largely made to repay subscribers in the fund receiving the transfer.

D. Analysis of the Unrealistic Returns Required for iCAP to Make its Promised Payments to Subscribers

72. Another characteristic of a Ponzi scheme is the promise of consistent unrealistically high returns to investors. These consistent high returns are key to attracting new investors that eventually help sustain a Ponzi Scheme.[38] These returns are unrealistic because the returns promised are not commensurate with the business operations underlying the investments.

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[37] Attached hereto as **Exhibit 25** is a copy of a July 2022 email chain titled, "7/15/2022 Cash Forecast for review."

[38] "Ponzi Scheme," Investor.gov, U.S. Securities and Exchange Commission, accessed on January 12, 2024, available at: https://www.investor.gov/protect-your-investments/fraud/types-fraud/ponzi-scheme; "Investor Protection Guide: Ponzi Scheme," Legal Information Institute, Cornell Law School, accessed on January 12, 2024, available at: https://www.law.cornell.edu/wex/investor_protection_guide_ponzi_scheme; "Ponzi Schemes," Michigan Consumer Protection," accessed on January 12, 2024, available at: https://www.michigan.gov/consumerprotection/protect-yourself/consumer-alerts/invest/ponzi.

In Ponzi schemes, Debtors either do not operate legitimate business operations or do not generate profits high enough to pay back the investors and are reliant on attracting new investors to pay off older investors. A review of iCAP's financial records shows that its funds promised consistent high returns to its subscribers while failing to generate enough profits to service such payments.

73. The entities under iCAP's Portfolio Business primarily raised capital through Debentures or Promissory Note offerings that offered to pay subscribers between 6 percent and 15 percent in annual interest.[39] A review of Private Placement Memorandums ("PPM") of the Portfolio Business's various debentures and promissory note-offerings shows that majority of the offerings promised between 9 and 12 percent annual interest rates that were payable monthly immediately after the closing of the loan. Certain offerings also included a "payoff premium," a one-time additional payment (i.e., 5% of the subscriber's investment) on the date of principal repayment.[40] The primary investment strategy for Portfolio Businesses, including Fund 1, Fund 2, and Fund 3, as stated in the PPMs, was to invest these funds to acquire preferred equity in the form of joint ventures with qualified builders and developers, and required payoffs within 12 to 18 months from the time of original investment.[41] These funds were invested with the objective

[39] I understand the Portfolio Business to include iCAP Equity, LLC and all of its subsidiaries. *See* Miller First Day Declaration, ¶¶ 8, 17.

[40] *See e.g.* Private Placement Memorandum for iCAP Equity, LLC's $50 million offering of Senior Promissory Notes, July 1, 2020, p. 2, Exhibit B, Section 3(c)(ii); Private Placement Memorandum for iCAP Northwest Opportunity Fund, LLC's $30 million offering of 10% Senior Secured Debentures, April 20, 2015, p. 1; Private Placement Memorandum for iCAP Northwest Opportunity and Income Fund, LLC.'s $30 million offering of 12% Senior Secured Debentures, December 19, 2013, p. 1; Private Placement Memorandum for iCAP Pacific Income Fund 4, LLC's $50 million offering of 10% Secured Promissory Notes, October 1, 2018, p. 2; Private Placement Memorandum for iCAP Pacific Income Fund 5, LLC's $50 million offering of 9% Secured Promissory Notes, September 5, 2019, p. 2. Attached hereto as **Exhibit 26, Exhibit 27, Exhibit 28, Exhibit 29**, and **Exhibit 30**, respectively, are copies of the five PPMs.

[41] Private Placement Memorandum for iCAP Equity, LLC.'s $50 million offering of Senior Promissory Notes, July 1, 2020, pp. 8-9.

of generating approximately a 12 percent rate of return, in addition to an exit fee which ranged from 3 percent to 5 percent.[42]

74. A review of term sheets on a handful of real estate investments (preferred equity) made from Fund 1 confirmed that investments were made with a 12% annual return plus closing fees of 3% as well as an exit fee determined by the overall proceeds of the project and dependent upon the borrower's successful divestiture of the underlying property. Turning these investments quickly and deploying capital just as quickly was critical in order for the iCAP funds to generate sufficient returns to cover subscriber interest and principal.

75. I reviewed a schedule prepared by iCAP in November 2016 reflecting data on the 42 investments made by Fund 1 & Fund 2 up to that date.[43] This schedule reflects that 22 investments had been realized (sold) by the fund. Of these exited investments, three were repaid within six months of loan origination, with another six properties exiting within one year of loan origination. The average loan period for these 22 exited properties was 443 days. This schedule also included data on twenty additional investments made (totaling $19.5M) that were still outstanding at the time. At the date of this schedule (November 2016), the average outstanding period for these twenty investments was 708 days. This schedule alone shows that iCAP's investments as a whole never generated sufficient returns to service the indenture interest and ultimate principal, indicating that iCAP would need to obtain funding for its returns to investors from other sources.

[42] Private Placement Memorandum for iCAP Equity, LLC.'s $50 million offering of Senior Promissory Notes, July 1, 2020, pp. 8-9.

[43] Fund Buyout Projection 2017 – Fund 1 & 2.xlsx. Attached hereto as **Exhibit 31** is a copy of this document.

76. To this end, iCAP's investment strategy for iCAP's various Portfolio Businesses did not align with the terms of the debt instruments they issued to raise capital from subscribers. First, almost all of the debentures and promissory notes issued by iCAP's Portfolio Businesses offered the option of monthly interest payments to subscribers immediately after the closing of the loan.[44] Considering the fund primarily invested in new real estate developments, iCAP's representation that it could begin generating near-immediate returns on such real estate was unrealistic and misleading.

77. Even assuming that all their investments would be fully paid off within 12 to 18 months, it is unclear how the funds would service the monthly interest payments promised to the subscribers without generating any ongoing revenue from such investments. iCAP could have addressed this concern by setting up interest reserve accounts; the PPMs of iCAP's debt offerings even state that some of the capital may be deposited into interest reserve accounts or that the funds "will maintain cash reserves to meet interest payments []."[45] I understand that there is no indication that any such cash and interest reserves were ever utilized.[46] Even if they were, establishing such reserves would decrease the net capital available for iCAP to invest in

[44] *See e.g.* Private Placement Memorandum for iCAP Equity, LLC.'s $50 million offering of Senior Promissory Notes, July 1, 2020, p. 2, Exhibit B Section2(c)(ii); Private Placement Memorandum for iCAP Northwest Opportunity Fund, LLC.'s $30 million offering of 10% Senior Secured Debentures, April 20, 2015, p. 1; Private Placement Memorandum for iCAP Northwest Opportunity and Income Fund, LLC.'s $30 million offering of 12% Senior Secured Debentures, December 19, 2013, p. 1; Private Placement Memorandum for iCAP Pacific Income Fund 4, LLC.'s $50 million offering of Secured Promissory Notes, October 1, 2018, p. 2; Private Placement Memorandum for iCAP Pacific Income Fund 5, LLC.'s $50 million offering of 9% Secured Promissory Notes, September 5, 2019, p. 1.

[45] *See e.g.* Private Placement Memorandum for iCAP Equity, LLC.'s $50 million offering of Senior Promissory Notes, July 1, 2020, p. 14.

[46] I have reviewed the balance sheets of the various funds and see no indication of any interest reserves. *See, e.g.,* 2019 – Balance Sheet by Entity by Period-2023-12-19-16-03-13.xlsx. Attached hereto as **Exhibit 32** is a copy of this document.

real estate projects, thereby requiring the remaining investable funds to generate even higher returns to pay off the loan.

78. iCAP internal projections as early as January 2017 shed light on the company's cash flow concerns. TD Croshaw, iCAP Controller, provided a management budget to Chris Christensen on January 24, 2017, and stated "we are going to be in a significant deficit at the end of February and the first of March… January was a bad month for us."[47] Later than year, Mr. Croshaw provided another management budget to Mr. Christensen in an email dated November 10, 2017. In the email, Mr. Croshaw stated "as you can see we are significantly in the Red for [November and December 2017]." Mr. Croshaw went on to state that iCAP would "need to come up with" $320 thousand in order to make its November and December 2017 payroll payments.[48]

79. Mr. Christensen failed to acknowledge these concerns publicly. In a call with Fund 2 investors in November 2018, in response to a question about the sources of funds that iCAP relies on to pay the investors, Mr. Christensen represented that interest payments were carved out of payoffs from real estate projects and that such payments were not serviced using funds received from other investors.[49] However, based on the Sources and Uses analyses of iCAP's funds, Mr. Christensen's statement was false. For example, **Exhibit 4.2** shows that between October 2018 and September 2023, Fund 2 paid out a sum of $20.2 million to its subscribers. However, during the same period, the fund generated only $10.4 million in funds from business operations including rent and project payoff, which, even before accounting for $1.7 million in general, operating, and administrative expenses during the same period, is

[47] Attached hereto as **Exhibit 33** is a copy of a January 2017 email titled, "2017 Budget."

[48] Attached hereto as **Exhibit 34** is a copy of a November 2017 email titled, "Budget."

[49] Investor Call Audio Clip, November 21, 2018. As this document is an audio clip, it is not attached as an exhibit to this Declaration.

approximately half of what was paid out to subscribers. The fund also received $22.9 million in intercompany transfers and transferred $11.8 million to other entities.

80. Even assuming the funds' investments in real estate development projects happened to be unique in generating ongoing returns immediately upon closing, the funds would need to generate very high annual returns to service the interest payments as well as make the final principal payment. For example, iCAP Pacific Northwest Opportunity and Income Fund, LLC (Fund 1) raised capital in December 2013 through a private placement of senior debentures that matured in December 2016.[50] The terms of the offering stated that investors were entitled to 12% annual simple interest paid monthly.[51] As part of the offering, the fund expected to incur 13% in commissions and administrative fees related to the offering, which brought down the overall proceeds from investors that would be available for investment to about 87% of the total proceeds.[52] In addition, Fund 1 owed a 2% management fee annually and an up to 3% origination fee on every investment made.[53] Assuming a 36-month term on the loan, the fund would need a 17.6% annual return on their overall investment to service the interest payments and pay the principal at maturity. *See* **Exhibit 5.1**. A review of Fund 1's project divestitures shows that the fund did not generate nearly as much as the 17.6% in annual returns it needed to pay its investors. In fact, Fund 1 made a total net gain of only $1.3 million on the total $44.1

[50] Private Placement Memorandum for iCAP Pacific Northwest Opportunity and Income Fund, LLC.'s $30 million offering of 12% Senior Secured Debentures, December 19, 2013, p. 1.

[51] Private Placement Memorandum for iCAP Pacific Northwest Opportunity and Income Fund, LLC.'s $30 million offering of 12% Senior Secured Debentures, December 19, 2013, pp. 1, 30.

[52] Private Placement Memorandum for iCAP Pacific Northwest Opportunity and Income Fund, LLC.'s $30 million offering of 12% Senior Secured Debentures, December 19, 2013, p. 5.

[53] Private Placement Memorandum for iCAP Pacific Northwest Opportunity and Income Fund, LLC.'s $30 million offering of 12% Senior Secured Debentures, December 19, 2013, p. 4.

million that the fund invested in various real estate projects from March 2014 (date of first investment) to January 2022 (date of most recent exit), or an average return of 0.4% per year.[54]

81. Similarly, iCAP Northwest Opportunity Fund, LLC (Fund 2) raised capital through a private placement of Senior Secured Debentures at 10 percent annual interest rate, paid monthly.[55] Given the terms of this offering, the fund would need to generate 16.4% annual returns to pay its investors. *See* **Exhibit 5.2**. A review of the real estate project divestitures for this fund shows that the fund invested $40.4 million in real estate projects from May 2015 through December 2018, and generated a total return of $2.7 million upon exiting these properties from October 2015 to July 2022, or an average return of 0.9% per year.[56]

82. In total, iCAP invested $103 million in real estate projects from 2013 to 2022 across its Portfolio Businesses and received approximately $104.4 million in total upon exiting the projects, an astonishingly low total net return of only $1.4 million. This extremely low return implies that iCAP would not have been able to pay off the investors from the appreciation in its real estate investments, but had to use funds raised from others. This is highly indicative of a Ponzi scheme.

83. iCAP's internal communications indicate the unrealistic nature of its required returns. In an analysis of a potential Fund 6, Andy Willett, iCAP Director of Capital Markets, concluded that in order to meet the repayment demand of raising between $310 million and $470 million, iCAP would have to invest in between 959 projects and 1,056 projects. This is in stark contrast to produced data indicating that iCAP only made 87 investments from September 2013

[54] (($1.3 million + $44.1 million)/$44.1 million)^(1/7.75 years)-1 = 0.4%. Project Divestitures.xlsx.

[55] Private Placement Memorandum for iCAP Northwest Opportunity Fund, LLC.'s $30 million offering of 10% Senior Secured Debentures, April 20, 2015, p. 1.

[56] (($2.7 million + $40.4 million)/$40.4 million)^(1/7 years)-1 = 0.9%. Project Divestitures.xlsx.

through December 2020, which it then exited from January 2014 through December 2022.[57] Mr. Willett concluded that "the numbers look daunting to me" and that iCAP would need to have most or all of the Fund 1 and Fund 2 investors roll over to Fund 6, while agreeing to not receive a monthly interest payment.[58]

E. Analysis of Other Ponzi Scheme Factors

1. Organizer failed to invest (all of) the investors' funds in promised investments

84. In a Ponzi Scheme, the organizer often fails to invest the investors' funds in promised investments. This is particularly true for the investments from later investors, whose funds are either transferred to earlier investors or are used to cover costs of the purported underlying business operations. This appears to have been the case for iCAP's later funds.

85. A review of PPMs of iCAP's offerings and the Sources and Uses analyses of its funds reveals that the capital invested in some of iCAP's funds – especially the latter funds such as iCAP Pacific Income Fund 4 (Fund 4) – was not invested in accordance with the representations in the PPMs. For example, Fund 4 sought to raise $50 million in capital through an offering of Secured Promissory Notes in October 2018.[59] The promissory notes had a maturity of 20 years but allowed the subscribers to redeem their investments in full after 3 years. The PPM for this offering states that "the primary purpose of the Company is to acquire real

[57] This includes multiple iCAP funds investing in the same property, so the number of "unique" projects invested in and exited during this period is less than 87. *See* Project Divestitures.xlsx.

[58] Attached hereto as **Exhibit 35** is a copy of a May 2020 email chain titled, "Fund 6 Financial Model."

[59] Private Placement Memorandum for iCAP Pacific Income Fund 4, LLC.'s $50 million offering of Secured Promissory Notes, October 1, 2018, p. 1.

estate investments in the United States and provide a rate of return to its investors."[60] The PPM also makes representations about the potential use of the funds. In particular, the PPM states that the "proceeds [] will be used to pay expenses related to its formation and operations and for this Offering, and to purchase and manage preferred equity real estate positions through Portfolio SPEs. The proceeds will be used to cover costs associated with this process[]."[61] The PPM also made provisions for organizational expenses approximating $250,000 as well as additional expenses of approximately $200,000 in addition to commission charges for placement agents.[62]

86. A comparison of these representations with the actual allocation of funds as shown by the Sources and Uses analysis for this fund reveals that the funds received from subscribers were not allocated in accordance with the PPM. **Exhibit 4.4** shows that, for Fund 4, a total of $23.9 million was deposited into the fund's account between October 2018 and September 2023. Of these deposits, $12.4 million were funds from subscribers and $11.4 million were intercompany transfers, with almost no funds from other sources. Fund 4 then disbursed $4.9 million to subscribers and transferred $9.5 million to other iCAP entities, while only using $2.2 million for real estate acquisition, development, and investment. This means only 9.7% of Fund 4's withdrawals were for investments in real estate projects even though raising capital for new real estate investments was the primary objective of this fund. Furthermore, while the PPM does make provisions for expenses and commissions, the fund allocated more money to expenses and commissions than to investments in real estate projects.

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[60] Private Placement Memorandum for iCAP Pacific Income Fund 4, LLC.'s $50 million offering of Secured Promissory Notes, October 1, 2018, p. 1.

[61] Private Placement Memorandum for iCAP Pacific Income Fund 4, LLC.'s $50 million offering of Secured Promissory Notes, October 1, 2018, p. 11.

[62] Private Placement Memorandum for iCAP Pacific Income Fund 4, LLC.'s $50 million offering of Secured Promissory Notes, October 1, 2018, p. 11.

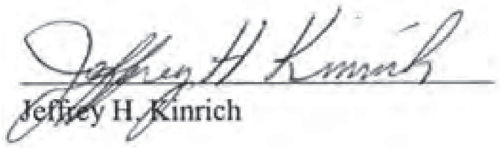
2. Later investors received lower returns than earlier investors.

87. In a Ponzi Scheme, companies typically are incapable of generating adequate revenue to fulfill the promised returns to their investors. Consequently, they resort to using funds from later investors to pay off earlier investors. Thus, one of the characteristics of Ponzi schemes is that later investors tend to receive lower returns compared to their earlier counterparts.

88. This is exactly what happened to iCAP subscribers, as only subscribers who invested in Fund 1 received distributions in excess of their investments on average, while subsequent fund subscribers on average received less than they invested. *See* **Exhibit 6**. That is, Fund 1 on average managed to achieve 12% distributions in excess of investments, while Funds 2 through 5, iCAP Vault, iCAP Investments, and iCAP Funding all returned less than the original investment. These amounts returned for Funds 2 through 5, iCAP Vault, iCAP Investments, and iCAP Funding ranged from 8% to 81% less than the original investment amount. This pattern aligns with the characteristic commonly associated with Ponzi schemes, where later investors typically receive lower returns compared to the earlier investors.

* * *

Signed on the 6th day of September, 2024, at Los Angeles, CA.



Jeffrey H. Kinrich

NOTES

Chapter 6

Judges Panel

The Honorable Mary Jo Heston
U.S. Bankruptcy Court, Western District of Washington
Tacoma, Washington

The Honorable Whitman Holt
U.S. Bankruptcy Court, Eastern District of Washington
Yakima, Washington

The Honorable Peter McKittrick
U.S. Bankruptcy Court, Oregon District
Portland, Oregon

The Honorable Thomas Renn
U.S. Bankruptcy Court, Oregon District
Eugene, Oregon

There are no course materials for this session.

NOTES

Chapter 7

Navigating SBA Bankruptcy Issues After COVID-19

Matthew Koos
Office of General Counsel
U.S. Small Business Administration
Denver, Colorado

There are no course materials for this session.

NOTES

Chapter 8

Untangling the Web of Our Homestead Laws

Matthew Anderton
Chapter 7 Panel Trustee
Yakima, Washington

Ann Chapman
Sussman Shank LLP
Portland, Oregon

Russell Garrett
Jordan Ramis PC
Portland, Oregon

Christina Henry
Seattle Consumer Justice
Seattle, Washington

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NOTES

WASHINGTON STATE HOMESTEAD EXEMPTION

Northwest Bankruptcy Institute, 2025

Washington Homestead Exemption Statute

- RCW 6.13.030

Homestead exemption amount.

- (1) The homestead exemption amount is the greater of:
- (a) $125,000;
- (b) The county median sale price of a single-family home in the preceding calendar year; or
- (c) Where the homestead is subject to execution, attachment, or seizure by or under any legal process whatever to satisfy a judgment in favor of any state for failure to pay that state's income tax on benefits received while a resident of the state of Washington from a pension or other retirement plan, no dollar limit.
- (2) In determining the county median sale price of a single-family home in the preceding year, a court shall use data from the Washington center for real estate research or, if the Washington center no longer provides the data, a successor entity designated by the office of financial management.

- New Statute fixed the language in the prior statute that only protected "equity" in a home up to $125,000 and "equity" in personal property used as a home of up to $15,000 based on the "lesser of" the "net value" as determined at a state sheriff's sale
- The homestead statute was amended in 2021 because it was incompatible with the goals and purposes of the state homestead and bankruptcy law

Washington Homestead Exemption Statute (cont'd)

- **RCW 6.13.010**
- **Homestead, what constitutes—Terms defined.**
  - (1) The homestead consists of real or personal property that the owner or a dependent of the owner uses as a residence. In the case of a dwelling house or mobile home, the homestead consists of the dwelling house or the mobile home in which the owner resides or intends to reside, with appurtenant buildings, and the land on which the same are situated and by which the same are surrounded, or improved or unimproved land, regardless of area, owned with the intention of placing a house or mobile home thereon and residing thereon. A mobile home may be exempted under this chapter whether or not it is permanently affixed to the underlying land and whether or not the mobile home is placed upon a lot owned by the mobile home owner or a dependent of the owner. Property included in the homestead must be actually intended or used as the principal home for the owner.
  - (2) As used in this chapter:
  - (a) "Owner" includes but is not limited to a purchaser under a deed of trust, mortgage, or real estate contract.
  - (b) "Net value" means market value less all liens and encumbrances senior to the judgment being executed upon and not including the judgment being executed upon.
  - (c) "Forced sale" includes any sale of homestead property in a bankruptcy proceeding under Title 11 of the United States Code. The reinvestment provisions of RCW **6.13.070** do not apply to the proceeds.
  - (d) "Dependent" has the meaning given in Title 11 U.S.C. Sec. 522(a)(1).

New Statute codified *In re Good*, 588 B.R. 573 (Bankr. W.D. Wash. 2018) and included the definition from 11 U.S.C. Sec. 522(a)(1) that included dependents.

Washington Homestead Exemption Statute (cont'd)

- **RCW 6.13.070**
- **Homestead exempt from execution, when—Presumed valid.**
  - (1) Except as provided in RCW **6.13.080**, the homestead is exempt from attachment and from execution or forced sale for the debts of the owner up to the amount specified in RCW **6.13.030**.
  - (2) In a bankruptcy case, the debtor's exemption shall be determined on the date the bankruptcy petition is filed. If the value of the debtor's interest in homestead property on the petition date is less than or equal to the amount that can be exempted under RCW **6.13.030**, then the debtor's entire interest in the property, including the debtor's right to possession and interests of no monetary value, is exempt. Any appreciation in the value of the debtor's exempt interest in the property during the bankruptcy case is also exempt, even if in excess of the amounts in RCW **6.13.030**(1).
  - (3) The proceeds of the voluntary sale of the homestead in good faith for the purpose of acquiring a new homestead, and proceeds from insurance covering destruction of homestead property held for use in restoring or replacing the homestead property, up to the amount specified in RCW **6.13.030**, shall likewise be exempt for one year from receipt, and also such new homestead acquired with such proceeds.
  - (4) Every homestead created under this chapter is presumed to be valid to the extent of all the property claimed exempt, until the validity thereof is contested in a court of general jurisdiction in the county or district in which the homestead is situated.

New Statute included bankruptcy only provisions specifically to modernize the law and to address the case of *Wilson v. Rigby*, 909 F.3d 306 (2018).

The Allowance of Exemptions

- A debtor may use either state or federal exemptions.
  - States have virtually unbridled authority to determine what exemptions are available and to establish their metes and bounds. See *Sticka v. Applebaum (In re Applebaum)*, 422 B.R. 684, 689 (B.A.P. 9th Cir. 2009).
  - The Code also allows States to *opt out* of the default federal scheme, making only the state-law exemptions available to debtors (subject to several narrow exceptions). 11 U.S.C. 522(b)(1).
    - Additionally, "a separate bankruptcy-only exemption schedule is not in and of itself pre-empted by the Supremacy Clause." Applebaum, 422 B.R. at 690.

Siegel v. Fitzgerald and Homestead Exemption

- *Siegel v. Fitzgerald*, No. 21-441, 2022 WL 1914098, at *7 (U.S. June 6, 2022)
  - The Bankruptcy Clauses uniformity principle does not require Congress to eliminate existing state exemptions in bankruptcy laws, explicitly including homestead and wage exemption laws. *Id.*, at 188, 22 S.Ct. 857.
  - Citing to *Moyses* v. *Hanover Nat'l Bank*, 186 U.S. 181,190 (1902), the "general operation of the law is uniform although it may result in certain particulars differently in different states.

Exemptions – 11 U.S.C. Sec. 522

- A homestead exemption maintains the status it has on the day a bankruptcy is filed
  - *Owen v. Owen*, 500 U.S. 305, 308 (1991)
    - The effect of an exemption is that when an interest in property is valued below the exemption limit at the time of the bankruptcy filing the debtor's interest in the property is withdrawn from the estate (and hence from the creditors) for the benefit of the debtor.
  - *Schwab v Reilly*, 560 US 770
    - When an exemption in an interesting property is valued above the exemption limit, the debtor's interest in the property is limited to the dollar amount exempted and the property remains in the bankruptcy estate until administered or abandoned.
      - Noting 100% of FMV or full FMV may exempt an entire asset as opposed to just the dollar value interest.
  - *Law v. Siegel*, 134 S. Ct. 1188, 1197 (2014).
    - Federal law provides no authority for bankruptcy courts to deny an exemption on a ground not specified in the Code.

Issues regarding Post-Petition Appreciation

- Does the language of the state statute indicate that equity belongs to the Debtor or the Bankruptcy Estate?
- Is there an objection to the Exemption? If not, the exemption is assumed valid.
- Was the exemption taken in "equity" as opposed to an exemption in the whole property?
  - *See In re Ayobami*, 15-35488, 2016 WL 3854052, at *9 (Bankr. S.D. Tex. June 9, 2016), certified question answered sub nom. *In matter of Ayobami*, 879 F.3d 152 (5th Cir. 2018).

Issues regarding Post-Petition Appreciation (cont'd)

- Is a homestead exemption protected in conversion under 11 USC 348?
  - *In re Castleman*, 631 B.R. 914, 917 (Bankr. W.D. Wash. 2021) – Interpreting 11 USC 348(f)(1)(A), a Washington State bankruptcy court followed the minority view to find that post petition appreciation should not be treated separately from pre-petition property and inures to the bankruptcy estate, not the debtor. Thus, upon conversion from Chapter 13 to Chapter 7, any post petition appreciation can be captured by the bankruptcy estate. *See In re Reed,* 940 F.2d 1317 (9th Cir. 1991).
    - Court made distinction between "value" and "valuation" and found that valuations made prior to conversion were not binding on the Chapter 7 Trustee.
    - *Cf. In re Cofer,* 625 B.R. 194 (Bankr. D. Idaho 2021).

Problems with Washington's Homestead Act in Bankruptcy Court

- All assets of the Debtor become Property of the Bankruptcy Estate upon the filing of a petition – 11 USC 541(a) .
- Omnibus Objections to Homestead Exemptions
  - Prevents property from vesting in the debtor when exemptions are filed
- The 9th Circuit holds that Post-petition Appreciation in Ch 7's under 11 USC 541(a)(6) inures to the estate
  - "[p]roceeds, product, offspring, rents, or profits of or from the property of the estate…"
  - This holding may be in conflict with recent US Supreme Court Decisions

The Snapshot Rule and Chapter 7

- **The Partial Snapshot Rule**
  - 11 U.S.C. § 522(a)(3) Noting the well-settled holding in this circuit "that what is frozen as of the date of filing the petition is the value of the debtor's exemption, not the fair market value of the property claimed as exempt." *Gebhart v. Gaughan* (*In re Gebhart*), 621 F.3d 1206, 1211 (9th Cir. 2010).
  - Under *In re Jacobson*, 676 F.3d 1193, 1199 (9th Cir. 2012), the Ninth Circuit has embraced a "partial" snapshot rule, finding that the entire homestead act of a state, including the "reinvestment" provisions after a sale allow a debtor to *lose* the exempt status of an exemption postpetition if homestead assets are not reinvested under the applicable provision of the state exemption scheme.
    - *Gebhardt* and *Wilson v Rigby* are an exception to the general rule that exempt property revests in the debtor.

- ***In re Anderson*, 988 F.3d 1210 (9th Cir. 2021)**
  - Distinguished *In re Jacobson* and limited *In re Golden*, 789 F.2d 698 (9th Cir. 1986) to its facts.
  - Found that Supreme Court precedent not clearly irreconcilable.
- ***In re Guevarra*, BAP No. EC-21-1141-SFL (9th Cir. B.A.P. March 25, 2022).**
  - Debtor may amend schedule to claim exemption in sale proceeds after interest sold by the Bankruptcy Trustee

The Snapshot Rule and Chapter 7

- **The Complete Snapshot Rule (1st Circuit)**
  - The First Circuit *in Rockwell*, relying on *White v. Stump*, 266 U.S. 310, 313 (1924), found that exemptions are fixed as of the bankruptcy petition date in what is known as the "snapshot rule." *In re Rockwell,* 968 F.3d 12, 21 (1st Cir. 2020), *cert. denied sub nom. Hull v. Rockwell,* No. 20-499, 2021 WL 666390 (U.S. Feb. 22, 2021).
  - The *Rockwell* court recognized that the snapshot rule may be either "complete"—meaning that a debtor's exemptions are fixed at the time he files his petition notwithstanding changing circumstances post-petition—or "partial"—meaning that later events may change the status of property claimed as exempt.
    - The court found that a "partial" snapshot is only found where under 11 USC 522(c).
  - The Complete Snapshot applies to a debtor's homestead exemption – rendering it unchanged by post-petition circumstances.
  - The Bankruptcy Policy of a "fresh start" supports the complete snapshot rule.

The Snapshot Rule and Chapter 13

- *In re Wells,* No. 20-35984, 2021 WL 5755086, at *1 (9th Cir. Dec. 3, 2021)
  - Holding – Debtor with homestead exemption who sells homestead while the bankruptcy is pending must reinvest sale proceeds in New Homestead. Case holding adopted holding in *In re Jacobson*, 676 F.3d 1193 (9th Cir. 2012) but found debtors only have a "contingent" homestead exemption, i.e. *fewer rights than debtors in other jurisdictions.*
  - Issue – Is the issue different in Chapter 13 as opposed to Chapter 7?
  - This case is the subject of a U.S. Supreme Court Petition for Certiorari.

Recent US Supreme Court Cases Question 9th Circuit Partial Snapshot Rule

- *Law v Siegel,* 571 U.S. 415 (2014)
  - Under *Law v Siegel*, the US Supreme Court held that a Debtor should not be deprived of her exemptions and cannot be considered conditional and subject to postpetition divestiture.
  - Federal law provides no authority for bankruptcy courts to deny an exemption on a ground not specified in the Code.
- *Harris v. Viegelahn,* 135 S. Ct. 1829 (2015)
  - A Chapter 7 estate allows a debtor to make a "fresh start" by not including the debtor's "postpetition earnings and acquisitions." *Harris,*135 S. Ct. at 1835.
  - The debtor is allowed a "clean break from his financial past," rendering his transactions off-limits "after the bankruptcy filing." *Ibid.* (citing 11 U.S.C. 541(a)).
- If a homestead is exempt on that date, then Chapter 7 debtors have the right to use any exempt property for their fresh start—just as they are entitled to retain future wages or profits from any other postpetition transactions. *Harris v. Viegelahn,* 135 S. Ct. 1829 (2015)

Munding v. Masingale (9th Cir. 2024) – How To Take a Valid 100% FMV Exemption

Munding v. Masingale (In re Masingale), 108 F.4th 1195 (9th Cir. 2024).

- Debtors claimed "100% of FMV" homestead exemption in Chapter 11.
- No objection was filed within the 30-day window under Fed. R. Bankr. P. 4003(b).
- Case later converted to Chapter 7 after plan confirmation.
- Debtor sought full proceeds from postpetition sale of home (~$422K).
- Trustee argued exemption capped at statutory limit ($45,950).

Key Issues

- Does "100% of FMV" on Schedule C override statutory cap if no timely objection?
- Must parties object to facially excessive claims within 30 days?
- What role do contradictory plan statements play in evaluating the claimed exemption?

Holding

- Ninth Circuit reversed the Ninth Circuit BAP.
- Exemption limited to statutory cap, despite no timely objection.
- *Taylor v. Freeland & Kronz* and *Schwab v. Reilly* do not require objection where:
- The case originated in Chapter 11, and
- Debtors made contradictory representations (e.g., disclosure that exemptions did not exceed the statutory limit).

Key Quote

"Even if '100% of FMV' on Schedule C can be sufficient standing alone… the Masingales said more than this."
— *Masingale*, 108 F.4th at 1206

Takeaway

- "100% of FMV" claims must be read in context—especially in Chapter 11.
- Trustees may rely on debtor representations elsewhere in the record.
- No free pass for overreaching debtors; statutory cap still controls absent a clear and consistent claim.

After Masingale - "100% of FMV" Still a Viable Homestead Exemption Strategy

Confirmed by Supreme Court Guidance

- *Schwab v. Reilly*, 560 U.S. 770 (2010):

"Where... it is important to the debtor to exempt the full market value of the asset… [they should] list the exempt value as 'full fair market value (FMV)' or '100% of FMV.'"

Use with Caution

- Still effective if the debtor's intent is clear and no contradictory disclosures are made.
- Best practices:
  - Check the "100% of FMV, up to any applicable statutory limit" box on Official Form 106C.
  - Avoid inconsistent representations (e.g., Disclosure Statements or Plans implying lesser values).
  - Consider attaching clarifying language in Plan or Disclosure Statement for Chapter 11s.

Post-*Masingale* Clarification

- *Masingale* does not invalidate "100% of FMV" claims.
- Court distinguished based on contradictory plan statements and fiduciary duties in Chapter 11.
- In a typical Chapter 7 with no conflicting disclosures, "100% of FMV" remains a powerful tool—but only up to statutory limits unless properly supported.

Practice Tip

Clear, consistent intent + no contradictory filings = valid "100% FMV" exemption claim.

Why Use "100% of FMV" on Schedule C?

1. To Be Certain Postpetition Appreciation is Exempt
•If the debtor claims a dollar amount, the trustee may argue that any appreciation beyond that amount belongs to the estate.
•By contrast, claiming "100% of FMV" suggests the debtor intends to exempt the entire
•value of the asset, including future appreciation.
Goal: Protect *all equity*, not just equity on the petition date.

2. To Trigger the "Taylor Rule"
•Under *Taylor v. Freeland & Kronz*, 503 U.S. 638 (1992):
If a debtor claims an over-limit exemption and no one objects in 30 days, the exemption may stand—even if improper.
•Listing "100% of FMV" can force the trustee to object or risk waiving the cap.
Strategy: Put the burden on the trustee—create finality through silence.

3. To Preserve Optionality

- If "100% of FMV" is accepted (or unchallenged), the debtor may retain:
  - Entire sale proceeds
  - Surplus value from appreciation
  - Flexibility during plan negotiations (in Ch. 11/13)

In re Castleman (9th Cir. 2023): Post-Petition Appreciation in Converted Cases

Castleman v. Burman (In re Castleman), 75 F.4th 1052 (9th Cir. 2023).

"Post-petition, pre-conversion appreciation belongs to the estate upon Chapter 13 → 7 conversion."

•Citing §§ 348(f)(1)(A) and 541(a)(6).
•Increase in equity deemed *"product or proceeds"* of the original asset.
•Applies even if debtors converted in good faith.
•Reaffirmed *Wilson v. Rigby* and *In re Reed* on estate scope.

Key Consequence:
Converted Chapter 7 estate can capture appreciation in debtor's home—even if exempt equity was initially zero. Best practice is to dismiss and refile as a Chapter 13.

In re Castleman (9th Cir. 2023): Post-Petition Appreciation in Converted Cases (Cont'd)

Judge Tallman's Dissent
"This ruling punishes debtors who tried to do the right thing under Chapter 13."

•Argued that *vested property post-confirmation* should belong to debtor, not estate.
•Cited § 1327(b): plan confirmation vests property back in debtor.
•Emphasized Washington's 2021 legislative fix allowing exemption of post-petition
•appreciation under RCW 6.13.070(2).
•Warned of disincentives to Chapter 13 filings—undermining fresh start.

Washington's Legislative Response (2021):
RCW 6.13.070(2): "Any appreciation in the value of the debtor's exempt interest in the property during the bankruptcy case is also exempt."
— Now codified debtor-friendly rule post-Wilson and *Castleman* dissent.

Takeaway for Washington Attorneys

- In post-2021 cases, Washington's homestead law shields appreciation, limiting *Castleman*'s impact.
- But in pre-2021 cases or federal exemption cases, trustees may still argue that appreciation belongs to the estate.

Challenges to Washington's New Homestead Bill

- *In re Tangonan*, Case No. 21-11288
  - Chapter 7 Trustee brought an objection to homestead exemption
  - Court ruled that entire homestead passes out of the estate under the "non-monetary" language of the statute
- *Wood v Wolf*, Adv Case No. 21-11757
  - Chapter 7 Trustee brought adversary proceeding to avoid tax claims under 11 U.S.C. 724(a).
  - Issue of whether the property is still "property of the estate" to allow the avoidance under 11 U.S.C. 550 and 551 despite the homestead amendments under RCW 6.13 et seq.

In re Tillman – Majority Holding: Exempt Property Is Off-Limits to Lien Preservation

United States v. Warfield (In re Tillman), 53 F.4th 1160 (9th Cir. 2022).

- Debtor claimed the Arizona homestead exemption in full.
- IRS had recorded a penalty lien (26 U.S.C. § 6702).
- Trustee sought to avoid the penalty lien under § 724(a) and preserve it under § 551 to benefit unsecured creditors.
- No objection made to Exemption by Creditor or Trustee

Holding

- Once property is validly exempted, it is no longer part of the bankruptcy estate. Trustees cannot preserve avoided penalty liens on exempt property.

Key Legal Principles

- § 724(a) allows trustees to avoid certain liens (e.g., penalty portions of tax liens).
- But § 551 only preserves avoided liens "for the benefit of the estate."
- Exempt property is no longer part of the estate once exemptions are allowed. Therefore, no preservation possible.

Core Holding

- "Preservation under § 551 requires that the property remain in the estate. Exempt property is not property of the estate." — *Tillman*, 53 F.4th at 1172

In re Tillman – Judge Bumatay's Dissent: Trustee Power Should Reach Exempt Property

Dissenting View – Judge Bumatay

> "Our duty is to follow the text of the Bankruptcy Code no matter how the pie gets sliced."
> — *Tillman*, 53 F.4th at 1175

Trustee's Power Should Extend to Exempt Property:

- The Bankruptcy Code does not carve out exempt property from the trustee's lien avoidance authority under §§ 724(a) and 551.
- Exempt property is initially part of the estate under § 541(a) and only later carved out.

Challenges to Washington's New Homestead Bill (cont'd)

- *In re Stephen Lee Ates*, Case No. 21-41090-MJH
  - Objection based on
    - Unlawful delegation to the Washington Center for Real Estate Research to determine annual county median property values
    - Violation of the Administrative Procedures Act
    - Emergency Enactment was Unlawful
    - Equal Protection violation under the Washington State Constitution – Article I, Section 12

    (Objection withdrawn)

Challenges to Washington's New Homestead Bill (cont'd)

- *In re Cotton*, Case No. 21-40847-MJH
  - Case regarding whether homestead was limited due to 11 USC 522(p)(1)(A) and (D) due to a prior felony conviction
  - Question whether the homestead is limited to $170,350

  (issues still pending)

Questions and Answers

NOTES

S5406, Washington's New Homestead Law[1]
Marc S. Stern and Christina Latta Henry

On April 19, 2021 the Washington Legislature passed S5406 dealing with the Homestead law in the State of Washington. This article will deal with four (4) aspects of the law that practitioners need to know when the law becomes effective. The effective date is not yet known but the legislation contains an emergency clause that makes it effective upon signing by Governor Inslee.

1. The amount of the homestead is dramatically increased and is different in each county.

The Homestead amount is the greater of $125,000 or the previous year's median value of a single-family residence. The amount is tied to the "Annual Median Price by County" records kept and published by the University of Washington Center for Real Estate Research - https://wcrer.be.uw.edu/archived-reports/which is found on the last tab.

The Bankruptcy Court Clerk's Office will provide a link to that number or on its court website. The actual relevant document can be found here: https://wcrer.be.uw.edu/wp-content/uploads/sites/41/2021/02/2020Q4WSHMR.pdf Page 23

Claiming the exemption on Schedule C presents a dilemma. In *Taylor v. Freeland & Kronz,* 503 U.S. 638 (1992), the Supreme Court held that listing the property with no value or unknown value put the trustee on notice and the property exited the estate if the trustee did not object to exemptions. In *Schwab v. Reilly (In re Reilly),* —— U.S. ——, 130 S.Ct. 2652, 177 L.Ed.2d 234 (2010), the debtor scheduled some kitchen equipment at $ and claimed the equipment exempt with a value of $10,718. Justice Thomas, writing for the majority said that was not sufficient. The Court ruled that the debtor must claim "100% of Fair Market Value."

Subsequent cases have opined that the debtor must allocate the exemption so that the trustee can determine how much is being claimed exempt. *In re Salazar*, 449 B.R. 890, 901 (2011); *In re Massey*, 465 B.R. 720, 730 (2012); *In re Luckham*, 464 B.R. 67 76-77 (2012). Most software publishers do not allow this allocation and the attorney needs to think carefully before just allowing the software to choose a number.

The authors agree that the intent of the legislature was to make the entire property exempt. However, *In re Mwangi*, 764 F.3d 1168, 1175 (9th Cir. 2014), the court held:

> We applied *Schwab 's* holding in *In re Gebhart*. There, we considered two statutes that allow a debtor to exempt an interest in real property, the value of which may not exceed a certain dollar amount. *In re Gebhart*, 621 F.3d at 1210. Relying on *Schwab*, we held that "the fact that the value of the claimed exemption [was] ... equal to the market value of the residence at the time of filing the

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> petition did not remove the entire asset from the estate." Id. "Instead, what [was] removed from the estate [was] an interest in the property equal to the value of the exemption." Id. (internal quotation marks omitted). As a result, the asset would remain estate property until it was administered in bankruptcy, the trustee abandoned the asset, or the bankruptcy case closed. *Id*. at 1210, 1212, 621 F.3d 1206; *see also Schwab*, 560 U.S. at 792, 130 S.Ct. 2652 ("Where a debtor intends to exempt nothing more than an interest ... [and] an interested party does not object to the claimed interest ..., title to the asset will remain with the estate pursuant to § 541, and the debtor will be guaranteed a payment in the dollar amount of the exemption.").

Mwangi is a case for the wary. It might be that just claiming the exemption is sufficient. However, it might not be. The proper practice of law requires an attorney to know what is being filed and how exemptions are being claimed. Properly planning and claiming exemptions is one of the most important roles of the bankruptcy attorney. It is best not left to a computer programmer.

One case has clearly addressed what is necessary:

> **A debtor must to do two things to exempt a 100% interest in an asset from the estate. First, she must check the box in the third column of Schedule C that corresponds with the text "100% of fair market value, up to any applicable statutory limit." Second, she must assign a dollar value to her interest**. Ms. Ayobami accomplished the second requirement by indicating the value of her interest in the assets in the fourth column of Schedule C.
>
> The trustee may object to a debtor's claimed exemption. If the trustee lodges an objection, the court will hold an evidentiary hearing to determine the value of the claimed exemption of a 100% interest in the asset. Perhaps because the debtor's sworn schedules attest to the value of the interest, Fed. R. Bankr.P. 4003(c) imposes the burden of proof on the trustee to challenge the debtor's value. If the objection is overruled, the debtor's interest will be removed from the estate, and the estate retains only bare title to the asset. Any postpetition appreciation of the asset will go to the debtor. If the objection is sustained, the debtor will be required to amend his exemptions to comply with § 522. *See In re Moore*, 442 B.R. at 868. [Emphasis supplied.]

In re Ayobami, 15-35488, 2016 WL 3854052, at *9 (Bankr. S.D. Tex. June 9, 2016), certified question answered sub nom. *In matter of Ayobami*, 879 F.3d 152 (5th Cir. 2018).

2. Post-petition appreciation is now exempt under state law.

In addition to providing a homestead exemption of the median price of a single-family house in the county, the legislature also specifically rejected the Ninth Circuit Ruling in *Wilson v. Rigby*, 909 F.3d 306, 309 (9th Cir. 2018). State law now provides that the exemption is determined on the date of filing and that appreciation after that date belongs to the debtor.

There are issues of what that means and whether there is a federal supremacy issue. We believe that Congress left the issues of exemption to the states and this provision is not subject to attack. The Homestead Exemption Bill (ESSB 5408) brings Washington State's exemption statute more in line with the legislature's intentions than the Ninth Circuit's interpretation of the statute in *Wilson v. Rigby*. While it is true that in *Wilson v. Rigby*, 909 F.3d 306, 309 (9th Cir. 2018), the court relied on 11 USC § 541(a) and 11 USC § 541(a)(1) to review RCW 6.13.070, the amendments to the homestead bill are intended to align with those specific statutes. Remember, however, that choosing a number instead of an asset may create unforeseen problems.

When it comes to exemptions, the bankruptcy code specifically allows states to opt out of the federal exemption scheme to implement their own exemptions under 11 USC 552(b). The US Supreme Court has also opined that the exemption delegation to states is broad, not limited in scope, and even allows a state not to enact any exemption scheme at all. *Owen v. Owen*, 500 U.S. 305, 308 (1991). Additionally, once a bankruptcy petition is filed, the transfer of rights to the estate is limited by the exemptions claimed. *Wilson*, 909 F.3d at 309. And it is widely accepted that property deemed exempt from a debtor's bankruptcy estate revests in the debtor. *In re Smith*, 235 F.3d 472, 478 (9th Cir. 2000); *see also* 11 U.S.C. § 522(l). Simply put, and as the Ninth Circuit has explained, "Congress has not occupied the field of bankruptcy regulation to the point of preempting state exemption statutes." *Sticka v. Applebaum (In re Applebaum)*, 422 B.R. 684, 689 (B.A.P. 9th Cir. 2009).

3. A sale in Title 11 is a "forced sale" under the homestead statute.

The statute codifies Judge Barreca's ruling in *In re Good*, 588 B.R. 573 (Bankr. W,D. Wash. 2018). Any sale in bankruptcy is now classified as a forced sale. This means that the one-year reinvestment provision does not apply. RCW 6.13.070.

The law now is that the homestead may be voluntarily sold, and the proceeds are exempt for one year to allow the homesteader to purchase a new property. When the new property is purchased, that property becomes the homestead.

Other courts have held that the homestead proceeds resulting from the trustee's sale of property are only exempt for one year and must be reinvested. This was not the result in *Good, supra,* and the legislature has now codified that result. The proceeds of a sale under Title 11 remain exempt with no time limits.

4. Moving or getting a new homestead can be problematical.

Section 522(o) and (p) place limits on the homestead, currently $170,360. But note §522(p)(2)(B) provides a safe harbor if moving within the state:

> (B) For purposes of paragraph (1), any amount of such interest does not include any interest transferred from a debtor's previous principal residence (which was acquired prior to the beginning of such 1215-day period) into the debtor's current principal residence, if the debtor's previous and current residences are located in the same State.

Additionally, the limitation does not apply to an exemption claimed on a principal residence by a family farmer.

There is an ambiguity in the phrase "interest that was acquired by the debtor" under section 522(p). The issue is what leads to "acquiring" an interest in a principal residence. Some courts argue that the homestead should not apply to an interest attributable simply to an increase in the market value of the debtor's homestead during the 1215-day period, because that is not an interest "acquired" by the debtor, but rather an increase in the value of the debtor's existing interest. *See, In re Greene*, 583 F.3d 614, 623 (9th Cir. 2009).

In the same vein, paying down the mortgage, or home improvements, do not increase the property interest that the debtor holds. *See. In re Elia*, 198 B.R. 588, 596 (Bankr. D. Ariz. 1996). However, care must be taken. If not done properly, defense of a dischargeability issue may ensue.

> Generally, a Debtor's conversion of non-exempt property into exempt property on the eve of bankruptcy is not fraudulent per se. *In re Daniel*, 771 F.2d 1352 (9th Cir.1985); In re Love, 341 F.2d 680 (9th Cir.1965); *In re Summers*, 85 B.R. 121, 126 (Bankr. Or. 1988). Extrinsic evidence of fraud must be present to invalidate the exemption.

In re Luthje, 107 B.R. 292, 295 (Bankr. D. Mont. 1989).

RCW 6.13.010

Homestead, what constitutes—Terms defined.

(1) The homestead consists of real or personal property that the owner or a dependent of the owner uses as a residence. In the case of a dwelling house or mobile home, the homestead consists of the dwelling house or the mobile home in which the owner resides or intends to reside, with appurtenant buildings, and the land on which the same are situated and by which the same are surrounded, or improved or unimproved land, regardless of area, owned with the intention of placing a house or mobile home thereon and residing thereon. A mobile home may be exempted under this chapter whether or not it is permanently affixed to the underlying land and whether or not the mobile home is placed upon a lot owned by the mobile home owner or a dependent of the owner. Property included in the homestead must be actually intended or used as the principal home for the owner.

(2) As used in this chapter:

(a) "Owner" includes but is not limited to a purchaser under a deed of trust, mortgage, or real estate contract.

(b) "Net value" means market value less all liens and encumbrances senior to the judgment being executed upon and not including the judgment being executed upon.

(c) "Forced sale" includes any sale of homestead property in a bankruptcy proceeding under Title 11 of the United States Code. The reinvestment provisions of RCW **6.13.070** do not apply to the proceeds.

(d) "Dependent" has the meaning given in Title 11 U.S.C. Sec. 522(a)(1).

[**2021 c 290 s 2**; **1999 c 403 s 1**; **1993 c 200 s 1**; **1987 c 442 s 201**; **1981 c 329 s 7**; **1945 c 196 s 1**; **1931 c 88 s 1**; **1927 c 193 s 1**; **1895 c 64 s 1**; Rem. Supp. 1945 s 528. Formerly RCW **6.12.010**.]

NOTES:

Findings—2021 c 290: "The legislature finds that the homestead exemption is intended to protect the homeowner's equity in a home against unsecured creditors. The legislature finds that changes to the homestead exemption are necessary to modernize the law and to address the case of Wilson v. Rigby, 909 F.3d 306 (2018) and to adopt the reasoning in In re Good, 588 B.R. 573 (Bankr. W.D. Wash. 2018)." [**2021 c 290 s 1**.]

Effective date—2021 c 290: "This act is necessary for the immediate preservation of the public peace, health, or safety, or support of the state government and its existing public institutions, and takes effect immediately [May 12, 2021]." [**2021 c 290 s 8**.]

Severability—1981 c 329: See note following RCW **6.21.020**.

RCW 6.13.020

Homestead—What may constitute.

If the owner is married or in a state registered domestic partnership, the homestead may consist of the community or jointly owned property of the spouses or the domestic partners or the separate property of either spouse or either domestic partner: PROVIDED, That the same premises may not be claimed separately by the spouses or domestic partners with the effect of increasing the net value of the homestead available to the marital community or state registered domestic partnership beyond the amount specified in RCW **6.13.030** as now or hereafter amended. When the owner is not married or not in a state registered domestic partnership, the homestead may consist of any of his or her property.

[**2008 c 6 s 633**; **1987 c 442 s 202**; **1981 c 329 s 8**; **1977 ex.s. c 98 s 1**; **1973 1st ex.s. c 154 s 6**; **1895 c 64 s 2**; RRS s 530. Formerly RCW **6.12.020**.]

NOTES:

Part headings not law—Severability—2008 c 6: See RCW **26.60.900** and **26.60.901**.

Severability—1981 c 329: See note following RCW **6.21.020**.

Severability—1973 1st ex.s. c 154: See note following RCW **2.12.030**.

RCW 6.13.030

Homestead exemption amount.

(1) The homestead exemption amount is the greater of:

(a) $125,000;

(b) The county median sale price of a single-family home in the preceding calendar year; or

(c) Where the homestead is subject to execution, attachment, or seizure by or under any legal process whatever to satisfy a judgment in favor of any state for failure to pay that state's income tax on benefits received while a resident of the state of Washington from a pension or other retirement plan, no dollar limit.

(2) In determining the county median sale price of a single-family home in the preceding year, a court shall use data from the Washington center for real estate research or, if the Washington center no longer provides the data, a successor entity designated by the office of financial management.

[**2021 c 290 s 3**; **2007 c 429 s 1**; **1999 c 403 s 4**; **1993 c 200 s 2**; **1991 c 123 s 2**; **1987 c 442 s 203**; **1983 1st ex.s. c 45 s 4**; **1981 c 329 s 10**; **1977 ex.s. c 98 s 3**; **1971 ex.s. c 12 s 1**; **1955 c 29 s 1**; **1945 c 196 s 3**; **1895 c 64 s 24**; Rem. Supp. 1945 s 552. Formerly RCW **6.12.050**.]

NOTES:

Findings—Effective date—2021 c 290: See notes following RCW **6.13.010**.

Purpose—1991 c 123: "The legislature recognizes that retired persons generally are financially dependent on fixed pension or retirement benefits and passive income from investment property. Because of this dependency, retired persons are more vulnerable than others to inflation and depletion of their assets. It is the purpose of this act to increase the protection of income of retired persons residing in the state of Washington from collection of income taxes imposed by other states." [**1991 c 123 s 1**.]

Severability—1981 c 329: See note following RCW **6.21.020**.

Severability—1971 ex.s. c 12: "If any provision of this 1971 amendatory act, or its application to any person or circumstance is held invalid, the remainder of the act, or the application of the provision to other persons or circumstances is not affected." [**1971 ex.s. c 12 s 5**.]

RCW 6.13.040

Automatic homestead exemption—Conditions—Declaration of homestead—Declaration of abandonment.

(1) Property described in RCW 6.13.010 constitutes a homestead and is automatically protected by the exemption described in RCW 6.13.070 from and after the time the real or personal property is occupied as a principal residence by the owner or, if the homestead is unimproved or improved land that is not yet occupied as a homestead, from and after the declaration or declarations required by the following subsections are filed for record or, if the homestead is a mobile home not yet occupied as a homestead and located on land not owned by the owner of the mobile home, from and after delivery of a declaration as prescribed in RCW 6.15.060(3)(c) or, if the homestead is any other personal property, from and after the delivery of a declaration as prescribed in RCW 6.15.060(3)(d).

(2) An owner who selects a homestead from unimproved or improved land that is not yet occupied as a homestead must execute a declaration of homestead and file the same for record in the office of the recording officer in the county in which the land is located. However, if the owner also owns another parcel of property on which the owner presently resides or in which the owner claims a homestead, the owner must also execute a declaration of abandonment of homestead on that other property and file the same for record with the recording officer in the county in which the land is located.

(3) The declaration of homestead must contain:

(a) A statement that the person making it is residing on the premises or intends to reside thereon and claims them as a homestead;

(b) A legal description of the premises; and

(c) An estimate of their actual cash value.

(4) The declaration of abandonment must contain:

(a) A statement that premises occupied as a residence or claimed as a homestead no longer constitute the owner's homestead;

(b) A legal description of the premises; and

(c) A statement of the date of abandonment.

(5) The declaration of homestead and declaration of abandonment of homestead must be acknowledged in the same manner as a grant of real property is acknowledged.

[1993 c 200 s 3; 1987 c 442 s 204; 1981 c 329 s 9. Formerly RCW 6.12.045.]

NOTES:

Severability—1981 c 329: See note following RCW 6.21.020.

RCW 6.13.050

Homestead presumed abandoned, when—Declaration of nonabandonment.

A homestead is presumed abandoned if the owner vacates the property for a continuous period of at least six months. However, if an owner is going to be absent from the homestead for more than six months but does not intend to abandon the homestead, and has no other principal residence, the owner may execute and acknowledge, in the same manner as a grant of real property is acknowledged, a declaration of nonabandonment of homestead and file the declaration for record in the office of the recording officer of the county in which the property is situated.

The declaration of nonabandonment of homestead must contain:

(1) A statement that the owner claims the property as a homestead, that the owner intends to occupy the property in the future, and that the owner claims no other property as a homestead;

(2) A statement of where the owner will be residing while absent from the homestead property, the estimated duration of the owner's absence, and the reason for the absence; and

(3) A legal description of the homestead property.

[**1987 c 442 s 205**; **1981 c 329 s 14**; **1895 c 64 s 7**; RRS s 535. Formerly RCW **6.12.120**.]

NOTES:

Severability—1981 c 329: See note following RCW **6.21.020**.

RCW 6.13.060

Conveyance or encumbrance by spouses or domestic partners.

The homestead of a spouse or domestic partner cannot be conveyed or encumbered unless the instrument by which it is conveyed or encumbered is executed and acknowledged by both spouses or both domestic partners, except that either spouse or both or either domestic partner or both jointly may make and execute powers of attorney for the conveyance or encumbrance of the homestead. The conveyance or encumbrance of the homestead does not require that any dependent of the owner who is not a spouse or domestic partner execute and acknowledge the instrument by which it is conveyed or encumbered.

[**2021 c 290 s 4**; **2008 c 6 s 634**; **1987 c 442 s 206**; **1983 c 251 s 1**; **1895 c 64 s 6**; RRS s 534. Formerly RCW **6.12.110**.]

NOTES:

Findings—Effective date—2021 c 290: See notes following RCW **6.13.010**.

Part headings not law—Severability—2008 c 6: See RCW **26.60.900** and **26.60.901**.

*Married persons and domestic partners, property: Chapter **26.16** RCW.*

RCW 6.13.070

Homestead exempt from execution, when—Presumed valid.

(1) Except as provided in RCW **6.13.080**, the homestead is exempt from attachment and from execution or forced sale for the debts of the owner up to the amount specified in RCW **6.13.030**.

(2) In a bankruptcy case, the debtor's exemption shall be determined on the date the bankruptcy petition is filed. If the value of the debtor's interest in homestead property on the petition date is less than or equal to the amount that can be exempted under RCW **6.13.030**, then the debtor's entire interest in the property, including the debtor's right to possession and interests of no monetary value, is exempt. Any appreciation in the value of the debtor's exempt interest in the property during the bankruptcy case is also exempt, even if in excess of the amounts in RCW **6.13.030**(1).

(3) The proceeds of the voluntary sale of the homestead in good faith for the purpose of acquiring a new homestead, and proceeds from insurance covering destruction of homestead property held for use in restoring or replacing the homestead property, up to the amount specified in RCW **6.13.030**, shall likewise be exempt for one year from receipt, and also such new homestead acquired with such proceeds.

(4) Every homestead created under this chapter is presumed to be valid to the extent of all the property claimed exempt, until the validity thereof is contested in a court of general jurisdiction in the county or district in which the homestead is situated.

[**2021 c 290 s 5**; **1987 c 442 s 207**; **1981 c 329 s 13**; **1945 c 196 s 2**; **1927 c 193 s 2**; **1895 c 64 s 4**; Rem. Supp. 1945 s 532. Formerly RCW **6.12.090**.]

NOTES:

Findings—Effective date—2021 c 290: See notes following RCW **6.13.010**.

Severability—1981 c 329: See note following RCW **6.21.020**.

RCW 6.13.080

Homestead exemption, when not available.

The homestead exemption is not available against an execution or forced sale in satisfaction of judgments obtained:

(1) On debts secured by mechanic's, laborer's, construction, maritime, automobile repair, material supplier's, or vendor's liens arising out of and against the particular property claimed as a homestead;

(2) On debts secured:

(a) By security agreements describing as collateral the property that is claimed as a homestead; or

(b) By mortgages or deeds of trust on the premises that have been executed and acknowledged by both spouses or both domestic partners or by any claimant not married or in a state registered domestic partnership. The execution and acknowledgment of a mortgage or deed of trust by a dependent who is not a spouse or domestic partner is not required;

(3) On one spouse's or one domestic partner's or the community's debts existing at the time of that spouse's or that domestic partner's bankruptcy filing where (a) bankruptcy is filed by both spouses or both domestic partners within a six-month period, other than in a joint case or a case in which their assets are jointly administered, and (b) the other spouse or other domestic partner exempts property from property of the estate under the bankruptcy exemption provisions of 11 U.S.C. Sec. 522(d);

(4) On debts arising from a lawful court order or decree or administrative order establishing a child support obligation or obligation to pay maintenance;

(5) On debts owing to the state of Washington for recovery of medical assistance correctly paid on behalf of an individual consistent with 42 U.S.C. Sec. 1396p;

(6) On debts secured by a condominium, homeowners', or common interest community association's lien; or

(7) On debts owed for taxes collected under chapters **82.08**, 82.12, and **82.14** RCW but not remitted to the department of revenue.

[**2021 c 290 s 6**; **2019 c 238 s 215**; **2018 c 277 s 501**; **2013 c 23 s 2**; **2008 c 6 s 635**; **2007 c 429 s 2**; **2005 c 292 s 4**; **1993 c 200 s 4**. Prior: **1988 c 231 s 3**; **1988 c 192 s 1**; **1987 c 442 s 208**; **1984 c 260 s 16**; **1982 c 10 s 1**; prior: **1981 c 304 s 17**; **1981 c 149 s 1**; **1909 c 44 s 1**; **1895 c 64 s 5**; RRS s 533. Formerly RCW **6.12.100**.]

NOTES:

Findings—Effective date—2021 c 290: See notes following RCW **6.13.010**.

Effective date—2018 c 277: See RCW **64.90.910**.

Part headings not law—Severability—2008 c 6: See RCW **26.60.900** and **26.60.901**.

Severability—1988 c 231: See note following RCW **6.01.050**.

Severability—1982 c 10: "If any provision of this act or its application to any person or circumstance is held invalid, the remainder of the act or the application of the provision to other persons or circumstances is not affected." [**1982 c 10 s 19**.]

RCW 6.13.090

Judgment against homestead owner—Lien on excess value of homestead property.

A judgment against the owner of a homestead shall become a lien on the value of the homestead property in excess of the homestead exemption from the time the judgment creditor records the judgment with the recording officer of the county where the property is located. However, if a judgment of a district court of this state has been transferred to a superior court, the judgment becomes a lien from the time of recording with such recording officer a duly certified abstract of the record of such judgment as it appears in the office of the clerk in which the transfer was originally filed. A department of revenue tax warrant filed pursuant to RCW **82.32.210** shall become a lien on the value of the homestead property in excess of the homestead exemption from the time of filing in superior court.

[**2007 c 429 s 3**; **1988 c 231 s 4**; **1987 c 442 s 209**; **1984 c 260 s 30**. Formerly RCW **6.12.105**.]

NOTES:

Severability—1988 c 231: See note following RCW **6.01.050**.

RCW 6.13.100

Execution against homestead—Application for appointment of appraiser.

When execution for the enforcement of a judgment obtained in a case not within the classes enumerated in RCW **6.13.080** is levied upon the homestead, the judgment creditor shall apply to the superior court of the county in which the homestead is situated for the appointment of a person to appraise the value thereof.

[**1987 c 442 s 210**; **1895 c 64 s 9**; RRS s 537. Formerly RCW **6.12.140**.]

RCW 6.13.110

Application under RCW 6.13.100 must be made by verified petition—Contents.

The application under RCW **6.13.100** must be made by filing a verified petition, showing:
(1) The fact that an execution has been levied upon the homestead.
(2) The name of the owner of the homestead property.
(3) That the net value of the homestead exceeds the amount of the homestead exemption.

[**1987 c 442 s 211**; **1981 c 329 s 15**; **1895 c 64 s 10**; RRS s 538. Formerly RCW **6.12.150**.]

NOTES:

Severability—1981 c 329: See note following RCW **6.21.020**.

RCW 6.13.120

Notice.

A copy of the petition, with a notice of the time and place of hearing, must be served upon the owner and the owner's attorney of record, if any, at least ten days before the hearing.

[**1987 c 442 s 212**; **1981 c 329 s 16**; **1895 c 64 s 12**; RRS s 540. Formerly RCW **6.12.170**.]

NOTES:

Severability—1981 c 329: See note following RCW **6.21.020**.

RCW 6.13.130

Hearing—Appointment of appraiser.

At the hearing, the judge may, upon the proof of the service of a copy of the petition and notice and of the facts stated in the petition, appoint a disinterested qualified person of the county to appraise the value of the homestead.

[**1987 c 442 s 213**; **1984 c 118 s 1**; **1895 c 64 s 13**; RRS s 541. Formerly RCW **6.12.180**.]

NOTES:

*Compensation of appraiser: RCW **6.13.190**.*

RCW 6.13.140

Appraiser—Oath—Duties.

The person appointed, before entering upon the performance of duties, must take an oath to faithfully perform the same. The appraiser must view the premises and appraise the market value thereof and, if the appraised value, less all liens and encumbrances, exceeds the homestead exemption, must determine whether the land claimed can be divided without material injury. Within fifteen days after appointment, the appraiser must make to the court a report in writing, which report must show the appraised value, less liens and encumbrances, and, if necessary, the determination whether or not the land can be divided without material injury and without violation of any governmental restriction.

[**1987 c 442 s 214**; **1895 c 64 s 14**; RRS s 542. Formerly RCW **6.12.190**.]

RCW 6.13.150

Division of homestead.

If, from the report, it appears to the court that the value of the homestead, less liens and encumbrances senior to the judgment being executed upon and not including the judgment being executed upon, exceeds the homestead exemption and the property can be divided without material injury and without violation of any governmental restriction, the court may, by an order, direct the appraiser to set off to the owner so much of the land, including the residence, as will amount in net value to the homestead exemption, and the execution may be enforced against the remainder of the land.

[**1999 c 403 s 2**; **1987 c 442 s 215**; **1981 c 329 s 17**; **1895 c 64 s 17**; RRS s 545. Formerly RCW **6.12.220**.]

NOTES:

Severability—1981 c 329: See note following RCW **6.21.020**.

RCW 6.13.160

Sale, if not divisible.

If, from the report, it appears to the court that the appraised value of the homestead property, less liens and encumbrances senior to the judgment being executed upon and not including the judgment being executed upon, exceeds the amount of the homestead exemption and the property is not divided, the court must make an order directing its sale under the execution. The order shall direct that at such sale no bid may be received unless it exceeds the amount of the homestead exemption.

[**1999 c 403 s 3**; **1987 c 442 s 216**; **1981 c 329 s 18**; **1895 c 64 s 18**; RRS s 546. Formerly RCW **6.12.230**.]

NOTES:

Severability—1981 c 329: See note following RCW **6.21.020**.

RCW 6.13.170

Application of proceeds.

If the sale is made, the proceeds must be applied in the following order: First, to the amount of the homestead exemption, to be paid to the judgment debtor; second, up to the amount of the execution, to be applied to the satisfaction of the execution; third, the balance to be paid to the judgment debtor.

[**1987 c 442 s 217**; **1981 c 329 s 19**; **1895 c 64 s 20**; RRS s 548. Formerly RCW **6.12.250**.]

NOTES:

Severability—1981 c 329: See note following RCW **6.21.020**.

RCW 6.13.180

Money from sale protected.

The money paid to the owner is entitled to the same protection against legal process and the voluntary disposition of the other spouse or other domestic partner which the law gives to the homestead.

[**2008 c 6 s 636**; **1987 c 442 s 218**; **1981 c 329 s 20**; **1973 1st ex.s. c 154 s 10**; **1895 c 64 s 21**; RRS s 549. Formerly RCW **6.12.260**.]

NOTES:

Part headings not law—Severability—2008 c 6: See RCW **26.60.900** and **26.60.901**.

Severability—1981 c 329: See note following RCW **6.21.020**.

Severability—1973 1st ex.s. c 154: See note following RCW **2.12.030**.

RCW 6.13.190

Appraiser—Compensation.

The court shall determine a reasonable compensation for the appraiser.

[**1987 c 442 s 219**; **1984 c 118 s 2**; **1895 c 64 s 22**; RRS s 550. Formerly RCW **6.12.270**.]

RCW 6.13.200

Costs.

The execution creditor must pay the costs of these proceedings in the first instance; but in the cases provided for in RCW **6.13.150** and **6.13.160** the amount so paid must be added as costs on execution, and collected accordingly.

[**1987 c 442 s 220**; **1895 c 64 s 23**; RRS s 551. Formerly RCW **6.12.280**.]

RCW 6.13.210

Alienation in case of incompetency or disability of either spouse or either domestic partner.

In case of a homestead, if either spouse or either domestic partner shall be or become incompetent or disabled to such a degree that he or she is unable to assist in the management of his or her interest in the property of the marriage or domestic partnership and no guardian has been appointed, upon application of the other spouse or other domestic partner to the superior court of the county in which the homestead is situated, and upon due proof of such incompetency or disability in the severity required above, the court may make an order permitting the spouse or the domestic partner applying to the court to sell and convey or mortgage such homestead.

[**2008 c 6 s 637**; **1987 c 442 s 221**; **1977 ex.s. c 80 s 4**; **1895 c 64 s 26**; RRS s 554. Formerly RCW **6.12.300**.]

NOTES:

Part headings not law—Severability—2008 c 6: See RCW **26.60.900** and **26.60.901**.

Purpose—Intent—Severability—1977 ex.s. c 80: See notes following RCW **4.16.190**.

RCW 6.13.220

Notice of application for order.

Notice of the application for such order shall be given by publication of the same in a newspaper published in the county in which such homestead is situated, if there be a newspaper published therein, once each week for three successive weeks prior to the hearing of such application, and a copy of such notice shall be served upon the alleged incompetent spouse or domestic partner personally, and upon the nearest relative of such incompetent or disabled spouse or domestic partner other than the applicant, resident in this state, at least three weeks prior to such application being heard, and in case there be no such relative known to the applicant, a copy of such notice shall be served upon the prosecuting attorney of the county in which such homestead is situated; and it is hereby made the duty of such prosecuting attorney, upon being served with a copy of such notice, to appear in court and see that such application is made in good faith, and that the proceedings thereon are fairly conducted.

[**2008 c 6 s 638**; **1987 c 442 s 222**; **1977 ex.s. c 80 s 5**; **1895 c 64 s 27**; RRS s 555. Formerly RCW **6.12.310**.]

NOTES:

Part headings not law—Severability—2008 c 6: See RCW **26.60.900** and **26.60.901**.

Purpose—Intent—Severability—1977 ex.s. c 80: See notes following RCW **4.16.190**.

RCW 6.13.230

Petition.

Thirty days before the hearing of any application under the provisions of this chapter, the applicant shall present and file in the court in which such application is to be heard a petition for the order mentioned, subscribed and sworn to by the applicant, setting forth the name and age of the alleged incompetent or disabled spouse or domestic partner; a description of the premises constituting the homestead; the value of the same; the county in which it is situated; such facts necessary to show that the nonpetitioning spouse or domestic partner is incompetent or disabled to the degree required under RCW **6.13.210**; and such additional facts relating to the circumstances and necessities of the applicant and his or her family as he or she may rely upon in support of the petition.

[**2008 c 6 s 639**; **1987 c 442 s 223**; **1977 ex.s. c 80 s 6**; **1895 c 64 s 28**; RRS s 556. Formerly RCW **6.12.320**.]

NOTES:

Part headings not law—Severability—2008 c 6: See RCW **26.60.900** and **26.60.901**.

Purpose—Intent—Severability—1977 ex.s. c 80: See notes following RCW **4.16.190**.

RCW 6.13.240

Order—Effect.

If the court shall make the order provided for in RCW 6.13.210, the same shall be entered upon the minutes of the court, and thereafter any sale, conveyance, or mortgage made in pursuance of such order shall be as valid and effectual as if the property affected thereby was the absolute property of the person making such sale, conveyance, or mortgage in fee simple.

[1987 c 442 s 224; 1895 c 64 s 29; RRS s 557. Formerly RCW 6.12.330.]

Honorable Mary Jo Heston
Chapter 7

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE WESTERN DISTRICT OF WASHINGTON

In Re Stephen Lee Ates, Debtor	NO: 21-41090-MJH NOTICE OF OBJECTION TO CLAIM OF EXEMPTION DECLARATION OF SERVICE

TO: Clerk of the Court; and

TO: Debtor Stephen Lee Ates

TO: Debtor's counsel, Brett L. Wittner

TO: Trustee Kathryn A. Ellis, Bankruptcy Trustee

TO: U.S. TRUSTEE, by and through his/her attorney of record;

TO: All other Interested Parties

PLEASE TAKE NOTICE THAT William C. Gibson and Laurel Gibson, Creditors herein, hereby object to debtor's claim of exemption for the real property located at 60 NE Lake Drive, Tahuya, Washington 98588. Creditors object to the claim of exemption on the following grounds.

1. Property Value. Debtor has claimed that the current value of the property is $450,000, and therefore claims that the entire property is exempt. However, creditors maintain

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that the property is valued at $850,000, and therefore the entire property is not exempt; only the amount of any allowed exemption claim.

2. Unenforceability of Amendments to RCW 6.13.030. Under RCW 6.13.030, the homestead exemption was previously limited to $125,000. Under a recent change to the law, in 2021, Chapter 290, Laws of 2021, effective May 12, 2021, the amount of the homestead amount is now "the greater of (a) $125,000; [or] (b) the county median sale price of a single family home in the preceding calendar year …". The new enactment further provides that "(2) In determining the county median sale price for a single-family home in the preceding year, a court shall use data from the Washington Center for Real Estate Research or, if the Washington Center no longer provides the data, a successor entity designated by the office of financial management." This alteration of the law is unenforceable on the following grounds:

(A) Unlawful Delegation. The legislature may delegate administrative power to determine facts on which the law is made to operate only when the law enunciates standards by which those officers will be guided. Diversified Investment v. DSHS, 113 Wn.2d 19, 775 P.2d 947 (1989). The legislature may delegate administrative power to fill in the interstices of the law only when procedural safeguards are in effect to control arbitrary administrative action. Hi-Starr, Inc. v. Liquor Control Bd., 106 Wn.2d 455, 722 P.2d 808(1986). The Washington Center for Real Estate Research is not an administrative agency, the standards of the statute for the fixing of property values are not adequately enunciated, and the statute provides no procedural safeguards to control arbitrary administrative action.

(B) Administrative Procedures Act. To the extent that the Washington Center for Real Estate Research is an administrative agency, its rule making determinations are subject to the Administrative Procedure Act, RCW 34.05. The act in turns requires advanced notice before the rule-making hearing, and publication of proposed rules with the code reviser's office, and publication in the state register concerning the proposed rule adoption. RCW 34.05.320.

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The Act further requires an opportunity for public comment. RCW 34.05.325. None of these measures have been followed by the Washington Center for Real Estate Research.

(c) Emergency Enactment. Under Article II, Section 31 of the Washington State Constitution, enactments shall take effect within ninety days after the adjournment of the session at which the law was enacted, in the absence of an emergency. The legislation purports to take effect immediately, in spite of the fact that there was no extant emergency related to the homestead laws.

(d) Equal Protection. Article I, Section 12 of the Washington State Constitution provides that no law passed granting to any citizen, class or classes of citizens privileges or immunities which upon the same terms shall not equally belong to all citizens." The above statute determines different homestead amounts to different individuals based solely on the county in which the real estate is located, in violation of the above clause.

Based on the foregoing, the changes to Washington law are illegal and unenforceable, and the Debtor is entitled to a homestead exemption of $125,000.

DATED: 8/25/21

BAUMAN & WOLF, PLLC

By: *s/Bradley S. Wolf*

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CERTIFICATE OF SERVICE

I, Bradley S. Wolf do hereby declare under penalty of perjury under the Laws of the State of Washington that the above document has been served on the following parties, via PACER/ECR System, and transmitted by First Class Mail to the following:

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DATED 8/25/21, Tacoma WA

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Entered on Docket November 16, 2021

Below is the Order of the Court.

Mary Jo Heston
U.S. Bankruptcy Judge
(Dated as of Entered on Docket date above)

UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT OF WASHINGTON AT TACOMA

In re: ROBERT DANIEL COTTON, JR. TINA MARIE COTTON, Debtors.	Case No. 21-40847-MJH **Order Granting Partial Summary Judgment on Debtors' Motion to Avoid Lien**

This matter came before the Court on October 12, 2021 on Robert Daniel Cotton and Tina Marie Cotton's ("Debtors") motion to avoid the judicial lien held by Suzanne Moore against Debtors' residence located at 4128 South J Street, Tacoma, Washington (the "Real Property"). Ms. Moore objected to the motion. The Court considered the parties' arguments and took the matter under advisement. On November 4, 2021, the Court held a status conference, at which time the Court identified for the parties four discrete issues raised by Debtors' motion.[1] At the status conference, the parties requested the Court bifurcate and enter partial summary judgment on the following issues: (1) whether the Real Property is the type of property described in subparagraph (A), (B), (C), or (D) of 11 U.S.C. § 522(p)(1);[2] and, (2) whether Mr.

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[1] *See* discussion *infra* Section II.B.1.

[2] Unless otherwise indicated, all chapter, section and rule references are to the Federal Bankruptcy Code, 11 U.S.C. §§ 101-1532, and to the Federal Rules of Bankruptcy Procedure, Rules 1001-9037.

Cotton has been convicted of a felony as defined in 18 U.S.C. § 3156. Based on the pleadings in the record and the arguments of counsel, the order of the Court is as follows.

I. BACKGROUND

The facts relied upon for the purpose of this order are undisputed. In 1997 and 1998, Debtor Robert Daniel Cotton ("Mr. Cotton") sexually abused Ms. Moore when she was ten and eleven years old. In 1999, Mr. Cotton was convicted of two counts of child molestation in the first degree under RCW 9A.44.083, a class A felony. In 2016, Debtors purchased the Real Property for $160,000 and have resided there at all times since its purchase.[3] On October 13, 2019, Ms. Moore commenced an action against Mr. Cotton in Pierce County Superior Court for damages caused by the sexual abuse. On October 12, 2020, Ms. Moore obtained a civil judgment against Mr. Cotton in the amount of $358,775 (the "Judgment"). Ms. Moore recorded the Judgment against Mr. Cotton's interest in the community property on November 19, 2020.

On May 12, 2021, amendments to the Homestead Act became effective, increasing the maximum allowed homestead exemption from $125,000 to "the greater of: (a) $125,000; [or] (b) The county median sale price of a single-family home in the preceding calendar year." RCW 6.13.030. On May 17, 2021, five days after the increased homestead exemption became effective, Debtors filed their Chapter 7 bankruptcy case.

Debtors' schedules reflect that the Real Property had a value of $400,614 as of the petition date. Schedule A, ECF No. 1. At the time of the petition, the Real Property was encumbered by a deed of trust in the amount of $145,831.40. Debtors claimed a homestead exemption in the Real Property in the amount of $254,782.60. Schedule C, ECF No. 1. On June 15, 2021, a meeting of the creditors was held under § 341. On June 30, 2021, Ms. Moore timely filed a proof of claim asserting that, as of the petition date, she was owed $389,442.89. At the time of filing the claim, Ms. Moore indicated that the claim was not secured by a lien on property. On

[3] The Real Property is community property.

August 16, 2021, Debtors moved under § 522(f) to avoid Ms. Moore's judicial lien. On the same day, Ms. Moore amended her claim, increasing the total amount claimed to $395,104.65 and indicating that the claim is secured by a lien on the Real Property.

On October 6, 2021 Ms. Moore responded to Debtors' motion to avoid the judicial lien, arguing that § 522(q)(1)(A) does not permit Debtors to exempt an interest in the Real Property exceeding $170,350.[4] Ms. Moore did not concede that the Real Property has a fair market value of $400,614 but failed to provide any evidence contradicting Debtors' valuation. On October 12, 2021, the Court held a hearing and the parties presented arguments on the applicability of § 522(q)(1) to Debtors' claimed exemption.

II. DISCUSSION

To avoid a lien under § 522(f), Debtors must prove the following: "(1) there was a fixing of a lien on an interest of the debtor in property; (2) such lien impairs an exemption to which the debtor would have been entitled; and (3) such lien is a judicial lien." *Culver, LLC v. Chiu (In re Chiu)*, 304 F.3d 905, 908 (9th Cir. 2002). Neither party disputes that the lien securing the Judgment was fixed on Debtors' property or that such lien is a judicial lien, therefore, these questions need not be addressed. Thus, to avoid Ms. Moore's judicial lien, Debtors must prove that it impairs their homestead exemption.

Judicial liens impair an exemption to the extent that the sum of all liens on the property, together with the value that the debtor could claim as exempt in the absence of the liens, exceed the value of the debtor's interest in the property if it were totally unencumbered. *See Owen v. Owen*, 500 U.S. 305 (1991).

In this case, the parties dispute the amount that the Debtors can claim as exempt. Both parties agree that RCW 6.13.030 allows Debtors to claim a maximum homestead exemption

[4] In her objection, Ms. Moore argued that the homestead exemption should be capped at $125,000 under § 522(q)(1)(A). However, the amount of the cap in § 522(q)(1) was adjusted under 11 U.S.C. § 104, effective April 1, 2019, to $170,350. Accordingly, the Court applies the current statutory cap amount to this order.

of $424,300.[5] Debtors argue that they may exempt their claimed equity of $254,782.60. Ms. Moore argues that Debtors' exemption must be capped at $170,350 under § 522(q)(1)(A). If Debtors are correct, Ms. Moore's judicial lien would impair their homestead exemption and therefore could be avoided. If Ms. Moore is correct, the lien may only be partially avoided to the extent that it impairs the applicable exemption.

A. Procedure

As an initial matter, the Court addresses the procedural appropriateness of Ms. Moore's objection.

1. *Ms. Moore's objection is timely and proper under Rule 4003.*

Exemptions are governed by Rule 4003. This rule provides that "[a]n objection to a claim of exemption based on § 522(q) shall be filed before the closing of the case." Fed. R. Bankr. P. 4003(b)(3). Ms. Moore objected to Debtors' exemption under § 522(q)(1)(A) before the close of the case. Thus, her objection is timely.

Unlike some other bankruptcy rules, Rule 4003(b) prescribes no particular form for objections to exemption claims. However, the lack of entitlement to an exemption may be raised as a defense to a lien avoidance action, even if no timely objection was made. *See* Fed. R. Bankr. P. 4003(d); *Heintz v. Carey* (*In re Heintz)*, 198 B.R. 581 (9th Cir. BAP 1996). Although Ms. Moore did not raise an independent objection to Debtors' claim of exemption, she has raised her objection as a defense to Debtors' lien avoidance action. As such, Ms. Moore's objection is proper under Rule 4003(d).

2. *Ms. Moore has the burden of proof.*

Generally, a debtor's claimed exemption is presumptively valid, and the party objecting to a debtor's exemption has the burden of proving that the exemption is improper. *Carter v.*

[5] Ms. Moore does not contest that the median sale price of a single-family home in Pierce County in 2020 was $424,300.

Anderson (In re Carter), 182 F.3d 1027, 1029 n.3 (9th Cir.1999); Fed. R. Bankr. P. 4003(c). If the objecting party can produce evidence sufficient to rebut the presumption of validity, then the burden shifts to the debtor to provide unequivocal evidence to demonstrate that the exemption is proper. *Carter*, 182 F.3d at 1029 n.3. Accordingly, Ms. Moore has the burden of establishing by a preponderance of the evidence that Debtors' claimed exemption of $254,782.60 is improper.

B. Arguments

1. *Introduction and Background*

Ms. Moore challenges the validity of Debtors' claimed exemption under § 522(q)(1)(A) arguing that Debtors' exemption cannot exceed $170,350. In relevant part, § 522(q) provides:

> (q)(1) As a result of electing under subsection (b)(3)(A) to exempt property under State or local law, a debtor may not exempt any amount of an interest in property described in subparagraphs (A), (B), (C), and (D) of subsection (p)(1) which exceeds in the aggregate $170,350 if—
>
> (A) the court determines, after notice and a hearing, that the debtor has been convicted of a felony (as defined in section 3156 of title 18), which under the circumstances, demonstrates that the filing of the case was an abuse of the provisions of this title[.] 11 U.S.C. § 522(q).

To meet her burden, Ms. Moore must establish by a preponderance of the evidence that:

> (1) The Real Property is the type of property described in subparagraph (A), (B), (C), or (D) of subsection (p)(1);
>
> (2) Mr. Cotton exempted an interest in the Real Property which exceeds in the aggregate $170,350;
>
> (3) Mr. Cotton has been convicted of a felony as defined in Section 3156 of Title 18; and,
>
> (4) The felony conviction demonstrates that the filing of the case was an abuse of the Bankruptcy Code.

At the November 4, 2021 status conference, the Court noted that: (1) the facts surrounding the first and third issues are undisputed, and the Court could decide these issues as a matter

of law; and (2) the second[6] and fourth[7] issues require further factual development in the record for final resolution. At the status conference, the parties requested that the Court decide the two legal issues under partial summary judgment and leave the factual issues for future resolution following the December 2, 2021 continued status conference.

2. *Legal Issues*

a. *The Real Property is the type of property described in § 522(p)(1)(A) and (D).*

For the exemption cap imposed under § 522(q)(1)(A) to apply, Debtors must have exempted an interest in property described in subparagraphs (A), (B), (C), or (D) of subsection (p)(1). In relevant part, subsection (p)(1) provides:

> [A] debtor may not exempt any amount of interest that was acquired by the debtor during the 1215-day period preceding the date of the filing of the petition that exceeds in the aggregate $170,350 in value in--
>
> (A) real or personal property that the debtor or a dependent of the debtor uses as a residence;
>
> . . . . [or]
>
> (D) real or personal property that the debtor or dependent of the debtor claims as a homestead.

11 U.S.C. § 522(p)(1).

The parties do not dispute that Debtors acquired the Real Property more than 1215 days before filing their petition or that it is used as a residence and claimed as a homestead. The parties only dispute the extent that (q)(1) incorporates (p)(1). At the heart of this dispute is whether the phrase "property described in subparagraphs [(A) and (D)] of subsection (p)(1)" imports the 1215-day time limitation of (p)(1) into (q)(1), or whether the cross-reference to the

---

[6] Because the Judgment is only against Mr. Cotton's interest in the community property, the second issue can be further divided into the following two sub-issues: (1) Whether the parties dispute the value of the Real Property; and (2) What is Mr. Cotton's interest in the community property? On November 9,2021, Debtors filed a declaration stating that each Debtor owns a 50% interest in the community property. Currently, it is not clear if Ms. Moore plans to dispute Mr. Cotton's claimed interest in the community property.

[7] The issue of whether the felony conviction demonstrates that the filing of the case was an abuse of the Bankruptcy Code is a disputed factual issue that may require further hearing.

subparagraphs of (p)(1) incorporates only the types of property described without importing the time limitation.[8]

Debtors argue that (p)(1) only applies to property acquired during the 1215-day period preceding the date the petition was filed, and therefore, subparagraphs (A) and (D), as incorporated in to § 522(q), also contain this 1215-day temporal requirement. Debtors argue that because they acquired the Real Property more than 1215 days before filing their petition, the Real Property is not the type of property described in the subparagraphs of (p)(1) and therefore, the exemption cap imposed by (q)(1) is inapplicable. Conversely, Ms. Moore argues that (q)(1) specifically references the subparagraphs of (p)(1)—not the entire subsection. Because the subparagraphs of (p)(1) list types of property, (q)(1)'s cross-reference is intended to incorporate these types of property without importing the 1215-day temporal requirement of the greater subsection.

In interpreting the meaning of a statute, a court must start "with the language of the statute itself." *United States v. Ron Pair Enterprises, Inc.*, 489 U.S. 235 (1989). If the language is clear, the court's inquiry ends, and the court will enforce the statute according to its terms. *See Ron Pair*, 489 U.S. at 241. A statute is ambiguous if it "gives rise to more than one reasonable interpretation." *Woods v. Carey*, 722 F.3d 1177, 1181 (9th Cir. 2013) (internal quotations omitted). If the term is ambiguous, the court "may use canons of construction, legislative history, and the statute's overall purpose to illuminate Congress's intent." *Woods*, 722 F.3d at 1181 (internal quotations omitted). A fundamental principle of statutory construction is that "[i]nterpretive constructions [of statutes] which would render some words surplusage . . . are to be avoided." *In re Kun*, 868 F.2d 1069, 1071 (9th Cir. 1989).

[8] On November 15, 2021, Debtors filed a supplemental memorandum and provided the Court with excerpts of a secondary source and cases interpreting this issue for the purposes of § 522(q)(1)(B)(ii). The Court has taken these sources into consideration in deciding the issues addressed in this order.

The language in dispute specifically states, "property described in *subparagraphs* (A) [through] (D) of subsection (p)(1)." 11 U.S.C. § 522(q) (emphasis added). This language is neither vague nor ambiguous and must be enforced according to its terms. This language refers only to the subparagraph and does not incorporate the 1215-day temporal requirement of the greater subsection. *See* Lawrence R Ahern, III, *Homestead and Other Exemptions Under the Bankruptcy Abuse Prevention and Consumer Protection Act: Observations on 'Asset Protection' After 2005*, 13 AM. BANKR. INST.L. REV. 585, 597 (2005) (explaining that section 522(q) applies "regardless of when the property was acquired").

However, even if the language were ambiguous, interpreting § 522(q) as incorporating the entirety of (p)(1) would run afoul of the fundamental principles of statutory construction and Congress's intent. Congress enacted § 522(p) and (q) as part of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ("BAPCPA"). Section 522(p) attempts to close the "mansion loophole" by capping the amount of a homestead exemption. *See Greene v. Savage (In re Greene)*, 583 F.3d 614, 619 (9th Cir. 2009). "Section 522(q) *further limits* the exemption permitted by Section 522(p) for a debtor who is convicted of certain felonies or if the debtor has a debt arising from certain types of wrongful conduct*." In re Tarkanian*, 562 B.R. 424, 451 (Bankr. D. Nev. 2014) (emphasis added).

If Congress intended to incorporate the 1215-day time limitation of (p)(1) into (q)(1), it could have simply stated "property described in subsection 522(p)(1)." Instead, Congress chose to specifically reference only the subparagraphs of (p)(1). This indicates that Congress did not intend to incorporate the 1215-day period of the great (p)(1) subsection. *See* Leigh J. Francis, *Calling All Debtors, Want to Defraud Your Creditors? Here Is How: The Tenancy by the Entirety Loophole and the Nullification of Section 522(o), (p), and (q) of the 2005 Bankruptcy Amendments*, 18 U. MIAMI BUS. L. REV., Winter 2010, at 1, n.204. Additionally, interpreting § 522(q)'s cross-reference to the subparagraphs of (p)(1) as importing the entirety of (p)(1)

would render the language "subparagraphs (A), (B), (C), and (D)" superfluous. Under such an interpretation, (q)(1) effectively serves as a restatement of (p)(1), not as a further limitation on the permitted exemption. Conversely, interpretating the cross-reference as incorporating only the types of property listed in the subparagraphs, without importing the time limitation, would not create any redundancies. Such an interpretation is consistent with the view that § 522(q) is a further limitation on the permitted exemption. Therefore, the Court rejects Debtors' arguments. Because the Real Property is used as a residence and claimed as a homestead, the Court concludes that it is the type of property described in subparagraphs (A) and (D) of subsection (p)(1). Accordingly, this element of § 522(q)(1) is satisfied.

b. *Mr. Cotton has been convicted of a felony as defined in Section 3156 of Title 18.*

For § 522(q)(1)(A) to apply, Ms. Moore must show that "the debtor has been convicted of a felony (*as defined in section 3156 of title 18*)[.]" 11 U.S.C. § 522(q)(1)(A) (emphasis added). The parties do not dispute that Mr. Cotton has been convicted of a felony under RCW 9A.44.083. The issue here is whether a felony under state law is a "felony" as defined in Section 3156 of Title 18, for the purposes of § 522(q)(1)(A). The parties have not provided, and the Court is not aware of, any caselaw addressing this issue.

Section 3156 provides:

> the term "felony" means an offense punishable by a maximum term of imprisonment of more than one year. 18 U.S.C. § 3156(a)(3).

Debtors argue that this definition of "felony" is limited to violations of federal law—not violations of state law. Debtors argue that the definition of "felony" in § 3156(a)(3) includes the word "offense," which is defined in § 3156(a)(2).

Section 3156 (a)(2) provides:

> the term "offense" means any criminal offense, other than [certain military offenses], which is in violation of an Act of Congress and is triable in any court established by an Act of Congress. 18 U.S.C. § 3156(a)(2).

Debtors argue that because "offense" is defined in subsection (a)(2), the subsequent use in subsection (a)(3) has the same meaning. In sum, Debtors argue that Mr. Cotton's state law conviction is not a violation of an "Act of Congress" and therefore, is not a "felony" as defined by 18 U.S.C. § 3156. Ms. Moore argues that "felony (as defined in section 3156 of title 18)" incorporates only the definition of "felony" provided in § 3156(a)(3). She argues that this definition of felony is not limited to violations of federal law and that the term "offense" in § 3156(a)(3) should be read according to its dictionary definition, not the limited definition provided in § 3156(a)(2). Thus, whether Mr. Cotton's felony conviction falls within the definition of the statute turns on whether the definition of felony in § 3156(a)(3) uses the dictionary definition of "offense" or uses "offense" as a term of art.

When considering a disputed term, the court should first consider it in the context of the statute, or identify any ambiguity or absurdity, before looking to secondary sources. Whether a statutory term is unambiguous does not turn solely on dictionary definitions. *Yates v. United States*, 135 S. Ct. 1074, 1081 (2015). "Rather, [t]he plainness or ambiguity of statutory language is determined [not only] by reference to the language itself, [but as well by] the specific context in which that language is used, and the broader context of the statute as a whole.'" *Yates*, 135 S. Ct. at 1081–82 (quoting *Robinson v. Shell Oil Co.*, 519 U.S. 337, 341 (1997)). While a word's usage ordinarily accords with its dictionary definition, in law, "the same words, placed in different contexts, sometimes mean different things." *Yates*, 135 S. Ct. at 182.

First turning to the statute as a whole, the term "offense" is defined twice and is given separate definitions each time.[9] Further, both definitions of "offense" use the word "offense"

[9] Section 3156(a)(2) provides "the term 'offense' means any criminal offense, other than [certain military offenses], which is in violation of an Act of Congress and is triable in any court established by an Act of Congress." 11 U.S.C. § 3156(a)(2).

Section 3156(b)(2) provides "the term 'offense' means any Federal criminal offense which is in violation of any Act of Congress and is triable by any court established by Act of Congress (other than a Class B or C misdemeanor or an infraction, or an offense triable by court-martial, military commission, provost court, or other military tribunal). 11 U.S.C. § 3156(b)(2).

within the definition. This indicates that the statute uses the word “offense” as its ordinary definition, as well as two separate terms of art. Nonetheless, this seeming ambiguity subsides when viewed in the specific context in which it is used.

When viewed in the specific context of § 3156(a)(3), only the ordinary definition of “offense” is consistent with the statute as a whole. Applying either of the term of art definitions to “offense”, as used in § 3156(a)(3), would create internal inconsistencies. First, § 3156 specifically limits the definitions of subsection (a) to “sections 3141–3150 of this chapter” and the definitions of subsection (b) to “sections 3152–3155 of this chapter.” Because the application of the term of art definitions is limited to §§ 3141–55, neither definition applies to the word “offense” within § 3156(a)(3). Second, even if the term of art definitions were applicable, both § 3156(a)(2) and (b)(2) use the ordinary definition of “offense” within their definitions. Therefore, the use of the ordinary definition of “offense” within the definition of § 3156(a)(3) would be internally consistent with how it is used within the definition of other defined terms in the statute. Conversely, applying a term of art definition only within the definition § 3156(a)(3) would be internally inconsistent with the rest of the statue. Thus, the context of § 3156 as a whole tugs strongly in favor of giving “offense” its dictionary definition. Accordingly, the Court concludes that the word “offense” within § 3156(a)(3) must be read in accord with its ordinary meaning. Black's Law Dictionary defines the term “offense” as “a violation of the law.” *Black's Law Dictionary* 885 (9th ed.2009).

In defining “felony” for the purpose of § 522(q)(1)(A), the Court adopts the definition “a violation of the law punishable by a maximum term of imprisonment of more than one year.” A conviction under RCW 9A.44.083 is a violation of the law punishable by a maximum term of imprisonment of more than one year. Accordingly, for the purpose of § 522(q)(1)(A), Mr. Cotton has been convicted of a felony as defined in Section 3156 of Title 18.

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III. CONCLUSION

Based on the foregoing, the Court concludes that Debtors' residence located at 4128 South J Street, Tacoma, Washington is property as described in § 522(p)(1)(A) and (D); and Mr. Cotton has been convicted of a felony as defined in 18 U.S.C. § 3156.

Until the facts on the record are further developed, the Court makes no determination on whether Mr. Cotton has exempted an interest in the Real Property that exceeds in the aggregate $170,350 or whether Mr. Cotton's felony conviction demonstrates that the filing of the case was an abuse of the Bankruptcy Code. These remaining issues will be continued to the status conference scheduled for December 2, 2021.

Accordingly, for the reasons stated herein, it is hereby

ORDERED that partial summary judgment on Debtors' Motion to avoid lien is granted.

/ / / End of Order / / /

Entered on Docket January 19, 2022

Below is the Order of the Court.

Christopher M. Alston
U.S. Bankruptcy Judge
(Dated as of Entered on Docket date above)

UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT OF WASHINGTON AT SEATTLE

IN RE	)	**CASE NO: 21-11288**
	)	
ALBERTO TANGONAN TANGONAN JR,	)	**ORDER OVERRRULING TRUSTEE'S OBJECTION TO DEBTOR'S HOMESTEAD EXEMPTION**
	)	
Debtor(s).	)	

THIS MATTER having come on regularly for hearing upon the Trustees Motion for an Order Determining Debtors Exemption, filed in connection with the Trustee's objection to debtors Homestead exemption regarding debtor's property located at 3461 NE Partridge Hollow Road, Bremerton, WA 98310 (Tax Parcel #4724-000-009-0008); the trustee, EDMUND J. WOOD, appearing by and through his attorney RORY C. LIVESEY, Debtor appearing by and through his attorney , DAVID CARL HILL; the Court having reviewed the records on file herein and considered argument of counsel; the Court having made Findings of Fact and Conclusions of Law on the record which are incorporated herein by this reference pursuant to Fed. R. Civ. P. 52(c), made applicable to these proceedings pursuant to Fed. R. Bank. P. 7052; and being otherwise fully

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apprised in the premises; now, therefore, it is hereby

ORDERED, ADJUDGED AND DECREED that the Trustee's Objection to Debtors Homestead Exemption under RCW 6.13.010 and 070 be and it hereby is overruled and that the debtor's homestead claim over the property property located at 3461 NE Partridge Hollow Road, Bremerton, WA 98310 (Tax Parcel #4724-000-009-0008) is hereby allowed.

///End of Order///

Presented by:

/s/David Carl Hill
DAVID CARL HILL, WSBA #9560
Attorney for Debtor

Approved for entry:

/s/Rory C. Livesey
RORY C. LIVESEY, WSBA #17601
Attorney for Edmund J. Wood, Trustee

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The Honorable Christopher M. Alston
Chapter 7

UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT OF WASHINGTON AT SEATTLE

In re MARK CONRAD WOLF, Debtor.	Case No. 21-11757-CMA
EDMUND J. WOOD, solely in his capacity as Chapter 7 Trustee for MARK CONRAD WOLF, Plaintiff. vs. MARK CONRAD WOLF; the STATE OF WASHINGTON; the INTERNAL REVENUE SERVICE; BANK OF AMERICA, N.A.; LARRY A. JOHNSON; WASHINGTON STATE DEBT ACQUISITION LLC, a Washington limited liability company, as successor-in-interest to FD 2011-C1 HOOD RETAIL, LLC, an Oregon limited liability company; and RENTON COLLECTIONS, INC., a Washington corporation, Defendants.	Adversary Proceeding No. _____ COMPLAINT FOR (1) DECLARATORY JUDGMENT, (2) JUDGMENT AVOIDING AND PRESERVING AND RECOVERING IRS LIENS SECURING NON-PECUNIARY TAX PENALTIES AND INTEREST ON PENALTIES, AND (3) RELATED RELIEF

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Plaintiff Edmund J. Wood, solely in his capacity as the Chapter 7 trustee for the bankruptcy estate of Mark Conrad Wolf, on his own knowledge or on information and belief, alleges as follows.

I. INTRODUCTION

This complaint concerns the Debtor's improved real property commonly known as 4032 138th Avenue SE, Bellevue, Washington 98006. The Debtor claims a homestead exemption in the Bellevue Residence (defined in paragraph 9 below) under the recently amended Washington homestead act, RCW 6.13 *et. Seq.* (the "Homestead Act"). Under a recent amendment, RCW 6.13.070(2) provides that in a bankruptcy case, if the requirements are otherwise met, a debtor's "right to possession and interests of no monetary value" in the homestead property are exempt. This complaint asks the court to determine whether the Bellevue Residence is property of the estate under 11 U.S.C. § 541, notwithstanding the amendments to the Homestead Act, particularly where, as here, there are IRS liens that secure significant liens for penalties and interest on penalties that may be avoided pursuant to 11 U.S.C. § 724(a) and recovered and preserved for the estate and its creditors pursuant to 11 U.S.C. §§ 550 and 551. This complaint seeks the resolution of certain related matters, so that if the requested relief is granted, the Trustee can market and sell the Bellevue Residence for the benefit of the unsecured creditors of the estate.

Specifically, the Trustee seeks determination of the following:

1. That the Bellevue Residence is property of the estate under 11 U.S.C. § 541, notwithstanding recent amendments to RCW 6.13 *et seq*.

2. Alternatively, that the Homestead Act as amended is void and unenforceable by reason of Article VI, paragraph 2 of the United States Constitution (the "Supremacy Clause") to the extent it would deprive the Trustee of his rights to administer the Bellevue Residence and to avoid, recover, and preserve the IRS Liens (defined in paragraph 16.4

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below) as to penalties and interest on penalties for the benefit of the estate and the Debtor's unsecured creditors pursuant to 11 U.S.C. § 724(a) and 11 U.S.C. §§ 550 and 551.

3. The nature and amount of the Debtor's homestead exemption.

4. The extent, validity, and priority of liens and interests in the Bellevue Residence, including the priority and amount of the IRS Liens for penalties and interest on penalties.

5. Judgment that the Trustee may avoid the IRS Liens as to penalties and interest on penalties pursuant to 11 U.S.C. § 724(a) with the avoided liens recovered for the benefit of the estate under 11 U.S.C. § 550.

6. Judgment that the Trustee may avoid the IRS Liens as to penalties and interest on penalties pursuant to 11 U.S.C. § 724(a) with the avoided liens preserved for the benefit of the estate under 11 U.S.C. § 551.

7. Judgment that the disbursement of proceeds attributable to the IRS Liens, other than those proceeds from liens avoided under 11 U.S.C. § 724(a) and recovered and preserved under 11 U.S.C. §§ 550 and 551, shall be made pursuant to 11 U.S.C. §724(b).

II. PARTIES

1. Plaintiff. Edmund J. Wood, solely in his capacity as the Chapter 7 trustee for the bankruptcy estate of Mark Conrad Wolf ("Wood" or "Trustee"), is the plaintiff in this adversary proceeding.

2. Defendants.

2.1 Mark Conrad Wolf ("Wolf" or "Debtor") is the debtor in the chapter 7 bankruptcy filed September 20, 2021, in the United States Bankruptcy Court for the Western District of Washington, at Seattle, under case number 21-11757-CMA.

2.2 The State of Washington.

2.3 The Internal Revenue Service ("IRS") is the tax collection agency for the United States of America and administers the Internal Revenue Code enacted by Congress.

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2.4 Bank of America, N.A. ("B of A") is a National Association organized and existing under the laws of the United States of America, with an address of 100 North Tryon Street, Charlotte, North Carolina, 28255.

2.5 Larry A. Johnson, on information and belief, is an individual residing in the State of California.

2.6 Washington State Debt Acquisition, LLC is a Washington limited liability company. It is assignee of a judgment in favor of FD 2011-C1 Hood Retail, LLC, an Oregon limited liability company that was dissolved on January 15, 2019. On February 4, 2013, a General Judgment for Foreclosure of Real and Personal Property and Money Award in favor of FD 2011-C1 Hood Retail, LLC was entered in case number 11C25243 in the Circuit Court of the State of Oregon for Marion County. On May 20, 2013, the Judgment was domesticated in Washington in King County Superior Court under case number 13-2-20260-3 SEA. The Judgment was last assigned to Washington State Debt Acquisition, LLC on June 25, 2021, and the Assignment of Judgment was filed with King County Superior Court on July 1, 2021 and recorded in King County on July 23, 2021.

2.7 Renton Collections, Inc., is a Washington for-profit corporation located in Renton, Washington.

III. JURISDICTION; VENUE

3. Jurisdiction to consider this complaint arises under 28 U.S.C. §§ 157(a) and (b), 1334(a) and (b). This is a core matter under 28 U.S.C. § 157(b)(2)(A), (B), (K) and (O).

4. This matter has been referred to the Bankruptcy Judges of this District pursuant to General Rule 7 of the Rules for the United States District Court for the Western District of Washington.

5. Venue is proper in this district under 28 U.S.C. § 1409(a).

6. This adversary proceeding is commenced pursuant to Federal Rule of Bankruptcy Procedure 7001(2), (7) and (9)

7. Plaintiff consents to entry of final orders or judgment by the bankruptcy court.

IV. FACTUAL BACKGROUND

8. The underlying case (the "Bankruptcy") was commenced when Wolf filed his voluntary Chapter 7 bankruptcy petition on September 20, 2021 (the "Petition Date"). Wood

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was appointed as the Chapter 7 trustee for Wolf on the Petition Date and has acted in that capacity since then.

9. Among the assets of the estate is a parcel of improved real property legally described as

> A PORTION OF THE NORTHEAST QUARTER OF THE NORTHWEST QUARTER OF SECTION 15, TOWNSHIP 24 NORTH, RANGE 5 EAST, W.M., IN KING COUNTY, WASHINGTON, DESCRIBED AS FOLLOWS:
>
> COMMENCING AT THE NORTHWEST CORNER OF LOT 14 OF EAST VIEW HOMES ADDITION, ACCORDING TO PLAT RECORDED IN VOLUME 53 OF PLATS, AT PAGE(S) 39, IN KING COUNTY, WASHINGTON;
>
> THENCE SOUTH 00°26'00" WEST ALONG THE WEST LINE OF SAID PLAT 150 FEET;
>
> THENCE NORTH 88°47'53" WEST 130.33 FEET;
>
> THENCE SOUTH 00°24'18" WEST 146 FEET TO THE TRUE POINT OF BEGINNING;
>
> THENCE NORTH 88°47'53" WEST 160.28 FEET, MORE OR LESS, TO THE EASTERLY MARGIN OF 138TH AVENUE SOUTHEAST;
>
> THENCE SOUTHERLY ALONG SAID EASTERLY MARGIN 74.23 FEET;
>
> THENCE SOUTH 89°37'25" EAST 160.24 FEET, MORE OR LESS, TO A POINT WHICH BEARS SOUTH 0°24'18" WEST AND DISTANT 72.40 FEET FROM THE TRUE POINT OF BEGINNING;
>
> THENCE NORTH 0°24'18" WEST AND DISTANT 72.40 FEET FROM THE TRUE POINT OF BEGINNING;
>
> THENCE NORTH 0°24'18" EAST 72.40 FEET TO THE TRUE POINT OF BEGINNING.
>
> SITUATE IN THE COUNTY OF KING, STATE OF WASHINGTON.

and commonly known as 4032 138th Avenue SE, Bellevue, Washington 98006 (the "Bellevue Residence").

10. As of October 1, 2021, title to the Bellevue Residence was vested in Mark C. Wolf, as his separate estate.

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11. The Debtor scheduled the value of the Bellevue Residence as $800,000. Bankruptcy Dkt. # 1, at 11. For the tax year 2022, King County appraised the value of the Bellevue Residence as $784,000, comprised of $645,000 for the land and $139,000 for the improvements. Wood's real estate agent, Chad Tharp, viewed the Bellevue Residence and estimated its fair market value as $1,395,000. Declaration of Chad Tharp, ¶ 3.

12. Debtor claimed $729,600 of his interest in the Bellevue Residence as exempt under RCW 6.13.010, 6.13.020, and 6.13.030. Bankruptcy Dkt. # 1, at 17.

13. In 2021, the state of Washington made changes to its Homestead Act, RCW 6.13 *et seq.*, finding that the changes "are necessary to modernize the law and to address the case of *Wilson v. Rigby*, 909 F.3d 306 (2018) and to adopt the reasoning in *In re Good*, 588 B.R. 573 (Bankr. W.D. Wash 2018)." RCW 6.13.010, Notes: Findings-2021 c 290.

14. Under RCW 6.13.030, as amended, the homestead exemption amount is the greater of $125,000 or the county's median sale price of a single-family home in the preceding calendar year, using data from the Washington Center for Real Estate Research. In King County, the annual median home price for 2020 was $729,600 [https://wcrer.be.uw.edu/archived-reports/].

15. RCW 6.13.070(2) now provides as follows:

> In a bankruptcy case, the debtor's exemption shall be determined on the date the bankruptcy petition is filed. If the value of the debtor's interest in homestead property on the petition date is less than or equal to the amount that can be exempted under RCW 6.13.030, then the debtor's entire interest in the property, including the debtor's right to possession and interests of no monetary value, is exempt. Any appreciation in the value of the debtor's exempt interest in the property during the bankruptcy case is also exempt, even if in excess of the amounts in RCW 6.13.030(1).

16. The Bellevue Residence is encumbered by various liens, approximately as follows, with the total of stated lien amounts greatly exceeding the estimated fair market value, as more particularly described in the Title Commitment:

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16.1 Lien of Real Estate Excise Tax and other taxes upon sale of said premises, or transfer of a controlling interest, if unpaid;

16.2 Deed of Trust in the principal amount of $207,433, granted by Mark C. Wolf, as his sole and separate property, to Bank of America, N.A., dated October 20, 2010, and recorded October 27, 2010, under King County Recording Number 20101027000717 (the "B of A DOT");

16.3 Deed of Trust in the principal amount of $106,000, granted by Mark C. Wolf to Larry A. Johnson, dated March 18, 2011, and recorded March 25, 2011, under King County Recording Number 20110325000511 (the "Johnson DOT");

16.4 Tax liens securing obligations to the IRS in the total amount of $1,433,444.16, including liens for non-pecuniary penalties and interest on penalties in the total amount of $440,966.53, as of the Petition Date (collectively, the "IRS Liens"), as follows:

16.4.1 Tax lien in favor of the United States of America in the original amount of $99,363.50[1], dated December 19, 2014, and recorded December 29, 2014, under King County Recording Number 20141229000570 (the "2014 IRS Lien");

16.4.2 Tax lien in favor of the United States of America in the original amount of $29,015.97[2], dated February 28, 2019, and recorded March 12, 2019, under King County Recording Number 20190312000844; ("2019 IRS Lien");

16.4.3 Tax lien in favor of the United States of America in the original amount of $1,196,932.52[3], dated December 24, 2019, and recorded January 7, 2020, under King County Recording Number 20200107000610 ("2020 IRS Lien"); and

16.4.4 Tax lien in favor of the United States of America in the original amount of $46,457.35[4], dated March 9, 2021, and recorded March 19, 2021, under King County Recording Number 20210319000694 (the "IRS 2021 Lien").

---

[1] As of the Petition Date, the 2014 IRS Lien secured a claim in the total amount of $68,379.85, of which $27,856.02 was for penalties and interest on penalties within the definition of 11 U.S.C. §§ 724(a) and 726(a)(4).

[2] As of the Petition Date, the 2019 IRS Lien secured a claim in the total amount of $37,775.07, of which $11,104.88 was for penalties and interest on penalties within the definition of 11 U.S.C. §§ 724(a) and 726(a)(4).

[3] As of the Petition Date, the 2020 IRS Lien secured a claim in the total amount of $1,279,513.49, of which approximately $387,367.63 was for penalties and interest on penalties within the definition of 11 U.S.C. §§ 724(a) and 726(a)(4).

[4] As of the Petition Date, the IRS 2021 Lien secured a claim in the total amount of $47,775.75 of which $14,638.00 was for penalties and interest on penalties within the definition of 11 U.S.C. §§ 724(a) and 726(a)(4).

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16.5 Judgment against Mark C. Wolf and Ryan D. Lentz, jointly and severally, originally entered in the Circuit County of the State of Oregon for Marion County, under case number 11C25243, in the total amount of $3,396,667.95 plus attorneys' fees and costs, and domesticated May 20, 2013, in King County Superior Court under case number 13-2-20260-3 SEA, in favor of FD 2011-C1 Hood Retail, LLC, last assigned to Washington State Debt Acquisition LLC and recorded July 23, 2021, under King County Recording Number 20210723002395.and 20200218001586; and

16.6 Judgment against Mark Wolf individually and in favor of Renton Collections, Inc., in the original amount of $2,401.40, entered in King County District Court on May 6, 2014, and transcribed to King County Superior Court under case number 15-2-15743-4 SEA on June 30, 2015, in the total amount of $2,774.40.

V. LEGAL AUTHORITY

17. 11 U.S.C. § 541(a) provides that

> The commencement of a case under section 301 302, or 303 of this title creates an estate. Such estate is comprised of all the following property, wherever located and by whomever held:
>
> (1) Except as provided in subsections (b) and (c)(2) of this section, all legal or equitable interests of the debtor in property as of the commencement of the case.
>
> …
>
> (3) Any interest in property that the trustee recovers under 329(b), 363(n), 543, 550, 553, or 723 of this title.
>
> (4) Any interest in property preserved for the benefit of or ordered transferred to the estate under section 510(c) or 551 of this title.
>
> …
>
> (7) Any interest in property that the estate acquires after the commencement of the case.

18. 11 U.S.C. § 724(a) provides that "[t]he trustee may avoid a lien that secures a claim of a kind specified in section 726(a)(4) of this title."

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19. 11 U.S.C. § 726(a)(4) provides that:

> Except as provided in section 510 of this title, property of the estate shall be distributed—
>
> …
>
> (4) fourth, in payment of any allowed claim, whether secured or unsecured, for any fine, penalty, or forfeiture, or for multiple, exemplary, or punitive damages, arising before the earlier of the order for relief or the appointment of a trustee, to the extent that such fine, penalty, forfeiture, or damages are not compensation for actual pecuniary loss suffered by the holder of such claim;

20. 11 U.S.C. § 550(a) provides that

> Except as otherwise provided in this section, to the extent that a transfer is avoided under section … 724(a) of this title, the trustee may recover, for the benefit of the estate, the property transferred, or, if the court so orders, the value of such property, from—
>
> (1) the initial transferee of such transfer or the entity for whose benefit such transfer was made; or
>
> (2) any immediate or mediate transferee of such initial transferee.

21. 11 U.S.C. § 551 provides that "[a]ny transfer avoided under section … 724(a) of this title … is preserved for the benefit of the estate but only with respect to property of the estate."

22. 11 U.S.C. § 724(b) governs the order of distribution of property and the proceeds of property subject to a lien that secures an allowed claim for a tax that is not avoidable "under this title" and in which the estate has an interest.

23. 11 U.S.C. § 522(c)(2)(B) provides that a debtor may not avoid a properly filed tax lien.

24. Article VI, Paragraph 2 of the United States Constitution, commonly referred to as the "Supremacy Clause," provides that

> This Constitution, and the Laws of the United States which shall be made in Pursuance thereof; and all Treaties made, or which shall be made, under the Authority of the United States, shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding.

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25. Article I, Section 8, of the United States Constitution, commonly referred to as the "Uniformity Clause," states in part that "[t]he Congress shall have Power … To establish … uniform Laws on the subject of Bankruptcies throughout the United States."

VI. FIRST CAUSE OF ACTION

A. For declaratory judgment determining that the Bellevue Residence is an asset of the estate under 11 U.S.C. § 541

26. Plaintiff repeats and realleges paragraphs 1 through 25 above.

27. Under 11 U.S.C. § 541(a)(1), the property of the estate includes all legal or equitable interest of the Debtor in property as of the Petition Date.

28. Under 11 U.S.C. § 541(a)(3), property of the estate includes any interest in property that the Trustee recovers under section 550.

29. Under 11 U.S.C. § 541(a)(4), property of the estate also includes "[a]ny interest in property preserved for the benefit of or ordered transferred to the estate under section…551 of this title."

30. The IRS Liens described in paragraph 16 above may be avoided to the extent they are liens for tax penalties and interest on penalties. 11 U.S.C. § 724(a) and 11 U.S.C. 726(a)(4). Such avoided liens are automatically preserved for the benefit of the estate under 11 U.S.C. § 551 and may further be recovered by the trustee under 11 U.S.C. § 550.

31 The Homestead Act, as amended, including RCW 6.13.070(2), as amended, does not change the application of 11 U.S.C. § 541(a) to the Bellevue Residence. The Bellevue Residence is property of the estate.

32. Alternatively, property of the estate includes the liens described in paragraph 16 above that are avoided under 11 U.S.C. § 724(a) and recovered under 11 U.S.C. § 550, as provided by 11 U.S.C. § 541(a)(3).

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33. Alternatively, property of the estate includes the liens described in paragraph 16 above that are avoided under 11 U.S.C. § 724(a) and preserved under 11 U.S.C. § 551, as provided by 11 U.S.C. § 541(a)(4).

VII. SECOND CAUSE OF ACTION

A. For declaratory judgment determining that to the extent RCW 6.13.070, as amended, violates the Supremacy Clause, it is void to that extent

34. Plaintiff repeats and realleges paragraphs 1 through 33 above.

35. 11 U.S.C. § 724(a) and 11 U.S.C. §§ 550 and 551 together embody the latest iteration of a clear and long-standing federal policy that creditors should not suffer from non-pecuniary tax penalties or interest on tax penalties in a debtor's bankruptcy.

36. To the extent that RCW 6.13.070(2), as amended, would prevent the Trustee from using 11 U.S.C. §§ 724 and 551 for the benefit of the estate and its creditors, it violates that long-standing federal policy, and is void and unenforceable by reason of the Supremacy Clause. *See United States v. Rodgers*, 461 U.S. 677, 701 (1983) (the Supremacy Clause of the Constitution renders state homestead exemptions ineffective against a federal tax lien).

VIII. THIRD CAUSE OF ACTION

A. For declaratory judgment determining that to the extent RCW 6.13.070, as amended, prevents the Bellevue Residence from being an asset of the estate it violates the Uniformity Clause and is void to that extent

37. Plaintiff repeats and realleges paragraphs 1 through 36 above.

38. To the extent that the amendments to the Washington Homestead Act, including RCW 6.13.070(2), as amended, would prevent the Trustee from using 11 U.S.C. §§ 724(a), 550 and 551 for the benefit of the estate and its creditors, it violates the Uniformity Clause because it would result in disuniform applications of federal policy among the several states, and is void and unenforceable.

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IX. FOURTH CAUSE OF ACTION

A. For declaratory judgment determining the extent, validity, and priority of liens against the Bellevue Residence

39. Plaintiff repeats and realleges paragraphs 1 through 38 above.

40. Plaintiff requests that the court determine the extent, validity and priority of liens against the Bellevue Residence.

X. FIFTH CAUSE OF ACTION

A. For judgment avoiding the IRS Liens for tax penalties and interest on tax penalties under 11 U.S.C. § 724(a) and recovering the avoided IRS Liens or their value for the benefit of the estate under 11 U.S.C. § 550

41. Plaintiff repeats and realleges paragraphs 1 through 40 above.

42. Plaintiff is entitled to an order avoiding the IRS Liens to the extent they secure nonpecuniary penalties and interest on penalties under 11 U.S.C. § 724(a).

43. To the extent the IRS Liens against the Bellevue Residence are avoided pursuant to 11 U.S.C. § 724(a), Plaintiff is entitled to an order recovering the avoided IRS Liens or their value for the benefit of the estate and its creditors pursuant to 11 U.S.C § 550 and 11 U.S.C. § 541(a)(3).

XI. SIXTH CAUSE OF ACTION

A. For judgment avoiding the IRS Liens for tax penalties and interest on tax penalties under 11 U.S.C. § 724(a) and preserving the avoided IRS Liens for the benefit of the estate under 11 U.S.C § 551

44. Plaintiff repeats and realleges paragraphs 1 through 43 above.

45. Plaintiff is entitled to an order avoiding the IRS Liens to the extent they secure nonpecuniary penalties and interest on penalties under 11 U.S.C. § 724(a).

46. To the extent the IRS Liens against the Bellevue Residence are avoided pursuant to 11 U.S.C. § 724(a), the avoided IRS Liens should be preserved for the benefit of the estate and its creditors pursuant to 11 U.S.C. §§ 551 and 541(a)(4).

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XII. SEVENTH CAUSE OF ACTION

A. For judgment that on sale of the Bellevue Residence, the proceeds of sale subject to the non-avoidable portions of the IRS Liens should be disbursed pursuant to 11 U.S.C. § 724(b)

47. Plaintiff repeats and realleges paragraph 1 through 46 above.

48. On the Trustee's sale of the Bellevue Residence, the proceeds of sale subject to the non-avoidable portions of the IRS Liens should be disbursed pursuant to 11 U.S.C. § 724(b).

XIII. RELIEF REQUESTED

WHEREFORE, Plaintiff prays for judgment against Defendants, as follows:

1. Determining that the Bellevue Residence is an asset of the estate under 11 U.S.C. §§ 541(a)(1), (3), and (4).

2. Determining that to the extent the Washington Homestead Act, as amended, including but not limited to RCW 6.13.070(2), as amended, would prevent the Bellevue Residence from being an asset of the estate so that the Trustee could avoid, recover, and preserve the IRS Liens for non-pecuniary penalties and interest on penalties for the benefit of the estate and its creditors, it violates the Supremacy Clause of the United States Constitution, Article VI, paragraph 2, and is void and unenforceable to that extent.

3 Determining that to the extent the Washington Homestead Act, as amended, including but not limited to RCW 6.13.070(2), as amended, would prevent the Bellevue Residence from being an asset of the estate so that the Trustee could avoid, recover, and preserve the IRS Liens for non-pecuniary penalties and interest on penalties for the benefit of the estate and its creditors, it violates the Uniformity Clause of the United States Constitution, Article I, Section 8, and is void and unenforceable to that extent.

4. Determining the extent, validity and priority of liens against the Bellevue Residence.

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5. Avoiding the IRS Liens for non-pecuniary tax penalties and interest on penalties under 11 U.S.C. § 724(a) and allowing the Plaintiff to recover the avoided liens or their value from the IRS for the benefit of the estate and its creditors pursuant to 11 U.S.C. §§ 550 and 541(a)(3).

6. Avoiding the IRS Liens for non-pecuniary tax penalties and interest on penalties under 11 U.S.C.§ 724(a) and automatically preserving the avoided liens pursuant to 11 U.S.C. §§ 551 and 541(a)(4).

7. Ordering that on sale of the Bellevue Residence, disbursement of proceeds attributable to the IRS Liens, other than those proceeds from liens avoided under 11 U.S.C. § 724(a) and recovered and preserved under 11 U.S.C. §§ 550 and 551, shall be made pursuant to 11 U.S.C. §724(b).

DATED this 19th day of February, 2022.

GROSHONG LAW PLLC

/s/ Geoffrey Groshong
Geoffrey Groshong
WSB No. 6124

Attorneys for Edmund J. Wood
Plaintiff / Trustee

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FILED

DEC 3 2021

MOLLY C. DWYER, CLERK
U.S. COURT OF APPEALS

NOT FOR PUBLICATION

UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

In re: DUSTIN JADE WELLS, Debtor, KATHLEEN A MCCALLISTER, Plaintiff-Appellee, v. DUSTIN JADE WELLS, Defendant-Appellant.	No. 20-35984 D.C. No. 4:20-cv-00086-BLW MEMORANDUM*

Appeal from the United States District Court
for the District of Idaho
B. Lynn Winmill, Chief District Judge, Presiding

Argued and Submitted November 9, 2021
Portland, Oregon

Before: GRABER and CHRISTEN, Circuit Judges, and R. COLLINS,** District Judge.

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* This disposition is not appropriate for publication and is not precedent except as provided by Ninth Circuit Rule 36-3.

** The Honorable Raner C. Collins, United States District Judge for the District of Arizona, sitting by designation.

Debtor Dustin Jade Wells timely appeals the district court's order holding that the bankruptcy court erred by permitting Debtor to keep the proceeds from a voluntary sale of his homestead. We review de novo the district court's decision. Phillips v. Gilman (In re Gilman), 887 F.3d 956, 963 (9th Cir. 2018). We review de novo the bankruptcy court's legal conclusions and for clear error its factual findings. Id. Because the district court correctly applied binding precedent, we affirm.

Debtors in Idaho must use Idaho's exemptions. Idaho Code § 11-609; see Owen v. Owen, 500 U.S. 305, 308 (1991) (noting that States may constrain debtors to a State-created list of exemptions). Idaho permits a homestead exemption up to $100,000 for an owner-occupied residence. Idaho Code §§ 55-1003, 55-1004(1), 55-1008(1).[1] Idaho also grants a time-limited homestead exemption on proceeds from the sale of a homestead: "The proceeds of the voluntary sale of the homestead in good faith for the purpose of acquiring a new homestead, . . . up to the amount specified in section 55-1003, Idaho Code, shall likewise be exempt for one (1) year from receipt, and also such new homestead acquired with such

[1] All citations are to the 2019 version of the Idaho Code. Effective this year, Idaho amended its provisions to allow a homestead exemption of up to $175,000. Idaho Code § 55-1003 (2021). But no statutory amendment affects the analysis of this case, which concerns an amount less than $100,000.

proceeds." Id. § 55-1008(1). Debtor filed for bankruptcy and, while his case was pending, moved to sell his homestead. The bankruptcy court approved the sale, but Debtor failed to purchase a new homestead within the year required by statute.

1. The district court correctly held that our decisions in Wolfe v. Jacobson (In re Jacobson), 676 F.3d 1193 (9th Cir. 2012), and England v. Golden (In re Golden), 789 F.2d 698 (9th Cir. 1986), control. In In re Jacobson, 676 F.3d at 1197, as here, a debtor owned a homestead, filed for bankruptcy in a State that imposes a time-limited exemption on proceeds from a sale, and then sold the homestead during bankruptcy. We held that, in order to retain the homestead exemption, the debtor must comply with the State's time limit for reinvesting the sales proceeds in a new homestead. Id. at 1198–1200; see also In re Golden, 789 F.2d at 699–701 (holding that a debtor who filed for bankruptcy after selling a homestead but during the State's period for reinvesting the sales proceeds lost the homestead exemption by failing to reinvest). Although those cases arose in California, California's homestead exemption is materially indistinguishable from Idaho's homestead exemption. Compare Cal. Civ. Proc. Code § 704.720(b) (2012) ("If a homestead is sold under this division . . . , the proceeds of sale . . . are exempt in the amount of the homestead exemption . . . for a period of six months

after the time the proceeds are actually received by the judgment debtor . . . ."), with Idaho Code § 55-1008(1) (quoted above).

2. The district court correctly held that the Trustee's motion, which sought an order declaring that the sales proceeds belonged to the bankruptcy estate, was timely. Throughout the bankruptcy, "the estate held a contingent, reversionary interest" in any eventual proceeds resulting from a sale of the homestead. Gaughan v. Smith (In re Smith), 342 B.R. 801, 808 (B.A.P. 9th Cir. 2006). When Debtor sold the homestead and failed to reinvest the proceeds within the period allowed by statute, "the proceeds, stripped of their exempt status, transformed into nonexempt property, i.e., property of the bankruptcy estate, by operation of law. At that point, there was no need for the trustee to pursue an objection to the claimed exemption because no such exemption existed." Id.; see also Schwab v. Reilly, 560 U.S. 770, 788–91 (2010) (holding that the trustee need not object within the time specified by Bankruptcy Rule 4003 when the trustee seeks an order reclaiming value that has always belonged to the bankruptcy estate). The Trustee's motion was timely and otherwise procedurally proper.

3. The district court correctly held that the rule that we announced in In re Jacobson remains good law. Neither Harris v. Viegelahn, 575 U.S. 510 (2015), nor Law v. Siegel, 571 U.S. 415 (2014), nor any other Supreme Court decision is

"clearly irreconcilable" with our decision. See Miller v. Gammie, 335 F.3d 889, 900 (9th Cir. 2003) (en banc).

Harris ruled that post-petition wages held by the Chapter 13 trustee must be returned to the debtor when the debtor converts the case to Chapter 7, but the decision hinged on the particular statutory provisions applicable to conversion cases, which do not apply here. 575 U.S. at 516–22. The Court also discussed the general "fresh start" principle of bankruptcy law, id. at 513–14, 518, but its discussion is fully consistent with our own discussion of that principle in In re Jacobson, 676 F.3d at 1200.

A similar analysis applies to Siegel, 571 U.S. at 421, in which the Supreme Court held that, whatever inherent powers a bankruptcy court has, "a bankruptcy court may not contravene specific statutory provisions" of the Bankruptcy Code. In particular, the Court rejected the creation of an equitable exception to the Code's list of exemptions: "The Code's meticulous—not to say mind-numbingly detailed—enumeration of exemptions and exceptions to those exemptions confirms that courts are not authorized to create additional exceptions." Id. at 424. But the Court expressly noted that States could create their own regimes of exemptions and exceptions: "It is of course true that when a debtor claims a state-created exemption, the exemption's scope is determined by state law . . . . But federal law

provides no authority for bankruptcy courts to deny an exemption on a ground not specified in the Code." Id. at 425. In re Jacobson neither purported to apply a judicially created exception nor authorized an action otherwise prohibited by the Bankruptcy Code; instead, it applied a state-created exemption. Siegel and In re Jacobson are not clearly irreconcilable.

4. Although our precedents require that we affirm, we recognize, as did the district court, that our decisions have been criticized, questioned, and rejected by many. A pair of bankruptcy judges wrote separately in the wake of In re Golden to question the validity of that court's consideration of post-petition acts. Ford v. Konnoff (In re Konnoff), 356 B.R. 201, 208 (B.A.P. 9th Cir. 2006) (Pappas, Bankr. J., concurring); In re Smith, 342 B.R. at 809 (Klein, Bankr. J., concurring). The Ninth Circuit Bankruptcy Appellate Panel ("BAP") distinguished In re Golden as "based on a peculiar temporal exemption statute" and held that "its holding is thus limited to its facts." Cisneros v. Kim (In re Kim), 257 B.R. 680, 686 (B.A.P. 9th Cir. 2000). The year after we decided In re Jacobson, Bankruptcy Judge Ahart published a point-by-point critique of the decision and explained his view that the decision is both wrong and poor policy. See Hon. Alan M. Ahart, In re Jacobson: The Ninth Circuit Court of Appeals Erred By Holding the Debtor Liable for Her Exempt Homestead Sale Proceeds, 32 Cal. Bankr. J. 409 (2013). A prominent

bankruptcy practice guide calls In re Jacobson's holding "questionable." 3 Norton Bankr. L. & Prac. 3d § 56:9 n.6 (Oct. 2021); see also 13 Collier on Bankruptcy CH. 02.[5] (Richard Levin & Henry J. Sommer eds., 16th ed. 2021) (noting the general rule that post-petition acts are irrelevant and observing that, "despite this principle," we considered post-petition acts in In re Jacobson). The First Circuit recently rejected our rule, expressly disagreeing with our decision and labeling it "unpersuasive." Rockwell v. Hull (In re Rockwell), 968 F.3d 12, 23 (1st Cir. 2020) cert. denied, 141 S. Ct. 1372 (2021). For our part, earlier this year, we distinguished In re Jacobson; characterized that decision as an "outlier"; and agreed with the BAP that In re Golden's holding is "limited to its facts." Klein v. Anderson (In re Anderson), 988 F.3d 1210, 1214 n.4, 1216 (9th Cir. 2021) (per curiam).

The Fifth Circuit has agreed with In re Jacobson—at least nominally—in a case involving Texas's homestead exemption. Viegelahn v. Frost (In re Frost), 744 F.3d 384, 388 n.2 (5th Cir. 2014). But the Fifth Circuit distinguished other cases on the ground that Texas did not exempt an interest or specific amount of the homestead—Texas exempts the full homestead, without limit. Id. at 388–89. California and Idaho, by contrast, exempt only a specific amount of the homestead, so the Fifth Circuit's reasoning appears to contradict our rule in In re Jacobson.

We add only one observation. Applying In re Jacobson's rule in a case like this one leads to arguably peculiar results. The federal government and some States allow a homestead exemption but allow no exemption whatsoever in sales proceeds. 11 U.S.C. § 522(d)(1). In those jurisdictions, a debtor may claim the full homestead exemption and, once the period for objecting to exemptions expires, the debtor may sell the homestead and retain all proceeds. States like California and Idaho grant debtors a more generous exemption by allowing debtors an additional exemption, albeit a time-limited one, in sales proceeds. Yet our ruling in In re Jacobson has the perverse result that debtors in those jurisdictions have only a contingent homestead exemption such that, practically, they have fewer rights during bankruptcy than debtors in other jurisdictions. We see no justification in federal law, state law, or logic for that result.

The primary motivation of our earlier decisions appears to be that, under a contrary rule, bankruptcy debtors would escape the State's time limit and thus have greater rights than those persons in the same state who do not file for bankruptcy. We agree with Judge Pappas' cogent response: "That . . . bankruptcy debtors [receive] additional rights as compared to those not in bankruptcy is nothing new given the remedial purposes of the bankruptcy laws. Bankruptcy is all about the

modification of creditors' state law rights." In re Konnoff, 356 B.R. at 209–10 (Pappas, Bankr. J., concurring).

AFFIRMED.

NOTES

FILED

MAR 25 2022

SUSAN M. SPRAUL, CLERK
U.S. BKCY. APP. PANEL
OF THE NINTH CIRCUIT

ORDERED PUBLISHED

UNITED STATES BANKRUPTCY APPELLATE PANEL
OF THE NINTH CIRCUIT

In re: RIZAL JUCO GUEVARRA, Debtors.	BAP No. EC-21-1141-SFL Bk. No. 2:18-bk-25306
RIZAL JUCO GUEVARRA, Appellant, v. DOUGLAS M. WHATLEY, Appellee.	**OPINION**

Appeal from the United States Bankruptcy Court
for the Eastern District of California
Christopher D. Jaime, Bankruptcy Judge, Presiding

APPEARANCES:
Mark T. O'Toole argued for appellant; Barry H. Spitzer argued for appellee.

Before: SPRAKER, FARIS, and LAFFERTY, Bankruptcy Judges.

SPRAKER, Bankruptcy Judge:

INTRODUCTION

The bankruptcy court held that debtor Rizal Guevarra was equitably estopped from amending his exemption. Guevarra appeals this decision.

The bankruptcy court found that Guevarra induced the chapter 7[1] trustee to sell his joint interest in real property by denying any interest and by failing to exempt the real property in his original schedules. The court based its decision on an unduly narrow understanding of Guevarra's position. The record demonstrates that the trustee was fully apprised of the facts concerning Guevarra's ownership and his argument that he held his interest in a resulting trust for his nephew. As such, the trustee cannot prove all the elements of equitable estoppel. Therefore, we REVERSE.

FACTS[2]

Many of the facts set forth below are drawn from this Panel's prior decision in *Guevarra v. Whatley (In re Guevarra)*, BAP No. EC-20-1165-LBT, 2021 WL 1179619 (9th Cir. BAP Mar. 29, 2021). Guevarra commenced his bankruptcy case in August 2018. Douglas M. Whatley was appointed to serve as the chapter 7 trustee. Guevarra listed in his schedules real property located in North Highlands, California (the "Property"). More specifically, in response to the question in Schedule A/B "Do you own or have any legal or equitable interest in any residence, building, land, or similar property," he answered "yes" and listed the Property by its street

[1] Unless specified otherwise, all chapter and section references are to the Bankruptcy Code, 11 U.S.C. §§ 101–1532, and all "Rule" references are to the Federal Rules of Bankruptcy Procedure.

[2] We exercise our discretion to take judicial notice of the documents filed in Guevarra's bankruptcy case. *See Atwood v. Chase Manhattan Mortg. Co. (In re Atwood)*, 293 B.R. 227, 233 n.9 (9th Cir. BAP 2003).

address. In the space provided in the schedule for describing the nature of his ownership interest, he stated: "[c]o-signed for Nephew; Debtor has no interest in property." He valued the Property at $217,612 but stated that the value of the portion he owned was "0.00." Guevarra also listed the loan secured by the deed of trust encumbering the Property as a secured debt in his Schedule D.

Consistent with his Schedule A/B, Guevarra did not exempt any interest in the Property. He did, however, claim an exemption under California Code of Civil Procedure ("CCP") § 703.140(b)(5)—also known as California's "wild card" exemption—for $310.00 in his bank accounts and $22,306.20 in a 401(k) account.

The deed for the Property listed Guevarra and his nephew Daryl Guevarra as joint tenants. Indeed, Guevarra never denied this. By the time of the § 341(a) hearing held in September 2018, or shortly thereafter, the trustee knew that Guevarra and Daryl held title to the Property as joint tenants. Almost immediately, the trustee disagreed with Guevarra's assertion that he had no interest of value in the Property. On December 13, 2018, the trustee's counsel wrote to Daryl to advise him that the bankruptcy estate asserted an interest in the Property. As counsel explained to Daryl, "[a]ccording to the documents provided by your uncle, you and he are on title to the real property . . . ."

Guevarra's counsel responded to the trustee's counsel roughly a week later committing to provide the trustee with documents showing that

Guevarra did not live at the Property and had not made any payments on the loan. Nonetheless, based on Guevarra's joint tenancy interest, the trustee continuously asserted that 50% of any equity in the Property was property of the bankruptcy estate. And Guevarra continuously countered that while the deed granted him joint title to the Property, he did not hold any interest in the Property.

The trustee sued Daryl to sell the Property under § 363(h) and obtained entry of default. Instead of seeking default judgment in the adversary proceeding, however, the trustee moved to sell Guevarra's interest in the Property.[3] The trustee proposed to sell Guevarra's interest to Global Capital Concepts, Inc. for $32,000 subject to existing liens. The motion identified Guevarra as a joint tenant together with his nephew under the Grant Deed and disclosed a deed of trust against the Property.

Despite Guevarra's titled interest, the motion to sell disclosed that "if a Court of competent jurisdiction determines the bankruptcy estate did not have an interest in the Subject Property, the bankruptcy estate will refund the money paid by the Buyers." Though the trustee did not say why the estate might not have an interest in the Property, the motion discussed the trustee's strong-arm rights under the Bankruptcy Code. Specifically, the trustee argued that his status as a bona fide purchaser for value under

[3] After he succeeded in selling Guevarra's interest, the trustee voluntarily dismissed the adversary proceeding.

§ 544(a)(3) entitled the estate to sell its interest "free of a prior equitable interest or constructive trust interest."[4]

Guevarra's counsel obtained leave to file a late, terse six-sentence opposition to the sale motion without a declaration or other evidence. In it, Guevarra merely restated his position that he only was a co-signer on his nephew's home loan and therefore had no genuine economic interest in the Property. Rather than offer any analysis, the opposition advised that Guevarra would move to convert the case to chapter 13 and asked that the sale motion be continued so that it could be heard with the to-be-filed conversion motion. Guevarra's counsel filed the motion to convert the case to chapter 13 the day before the hearing on the trustee's motion to sell. The motion acknowledged that it was filed to "save his nephew's home."

At the sale hearing, the bankruptcy court noted Guevarra's argument that he did not have any interest in the Property and was merely a co-signer on the loan. The court observed that this argument was consistent with Guevarra's schedules but was otherwise unsupported by any evidence. Based on the deed and deed of trust, the court ruled that Guevarra's joint tenancy interest was estate property.

Though the recently filed motion to convert was not on the calendar, Guevarra's counsel advised the court of it and asked that the sale motion

[4] Counsel for the trustee submitted a fee application after the court approved the sale. His billing entries detail at least 3.3 hours researching Guevarra's interest in the Property and discussing the topic with the trustee. This included 1.8 hours researching constructive and resulting trusts.

be continued to a date when both matters could be heard. The court responded that Guevarra did not have a right to convert his case because he had acted in bad faith by knowingly misstating his interest in the Property on the schedules. Responding to the issue of bad faith, Guevarra's counsel informed the court that "I produced proof to the trustee that he never made a down payment and doesn't live in the house and that the nephew's made every payment." The court replied, "[t]hat doesn't matter, he's on the title." Guevarra's counsel then offered to cite applicable cases on the issue, stating that he had previously provided them to trustee's counsel though they were not included in the opposition. The court did not accept the offer for supplemental briefing. In its findings of fact and conclusions of law approving the sale, the court found that Guevarra believed he was on title and "yet filed the schedules incorrectly stating he was a co-signer."

The bankruptcy court approved the sale of Guevarra's interest in the Property to a competing bidder for $32,500. The court entered its sale order in December 2019, and the trustee closed the sale. Guevarra did not appeal either the sale order or the order denying his motion to convert.

In March 2020, Guevarra amended his schedules. By this time, Guevarra's counsel had been suspended from the practice of law. Guevarra filed his amended schedules pro se. In his amended Schedule A/B, he continued to list the value of his 50% interest in the Property as "$0.00." However, he described the nature of his ownership interest as: "Debtor

interest in said property it [sic] was sold for $32,500 by chapter 7 trustee[.]" In the space provided for additional information, Guevarra put: "Debtor claims said funds under exemption statute CCP 703." In his amended Schedule C, Guevarra claimed $27,915 of these sale proceeds as exempt under California's "wild card" exemption.[5]

The trustee objected to Guevarra's amended exemption. According to the trustee, Guevarra had acted in bad faith and was equitably estopped from asserting the exemption claim. The trustee pointed out that Guevarra had insisted since the commencement of his chapter 7 case that he had no interest of value in the Property. The trustee additionally noted that it had taken Guevarra nineteen months from the commencement of his case to amend his schedules to claim the exemption in the Property (or its proceeds). The trustee explained that had he known Guevarra would claim an interest and an exemption in the proceeds he would not have sold the Property.

In support of the objection, the trustee filed the declaration of his counsel stating that he had spoken to Guevarra's counsel to discuss the ownership issue and requested documents. The trustee submitted his counsel's December 13, 2018 letter to Daryl informing him of the estate's interest in the Property based on the deed and deed of trust. The trustee

[5] Guevarra's amended Schedule C also still claimed a "wild card" exemption in his bank accounts, which he still valued at $310. As for his 401(k) account, he claimed that as exempt in his amended Schedule C under CCP § 703.140(b)(10)(E).

also included the response from Guevarra's counsel dated December 19, 2018, committing to provide documents to establish that Guevarra never paid any money for the Property and never lived there, whereas Daryl paid all the monies owed on the Property including the down payment and lived there.

Guevarra opposed the objection in another terse document. As he explained, he never attempted to hide the Property from the trustee, and he correctly identified it in his original schedules. Guevarra explained that he changed his wild card exemption after the court ruled that he owned 50% of the Property. For the first time, he submitted case law to support his argument, citing *Johnson v. Johnson*, 192 Cal. App. 3d 551, 555-56 (1987), *Siegel v. Boston (In re Sale Guaranty Corp.)*, 220 B.R. 660, 664 (9th Cir. BAP 1998), *aff'd*, 199 F.3d 1375 (9th Cir. 2000), and *Law v. Siegel*, 134 S. Ct. 1188 (2014). The *Johnson* and *Sale Guaranty* cases address California's recognition of resulting trusts. Specifically, these cases hold that a transferee of property who does not pay the purchase price for the real property "is presumed to hold the property in a resulting trust for the party who paid the consideration." *In re Sale Guar. Corp.*, 220 B.R. at 664; *Johnson*, 192 Cal. App. 3d at 555-56.

Guevarra also submitted a declaration from Daryl in support of the opposition. Daryl's declaration was consistent with Guevarra's argument: his uncle only co-signed the home loan and was placed on title so that he (Daryl) could qualify for the loan. Daryl further stated that he and his wife

had always lived in the home situated on the Property, that he always made the loan payments, and that he and Guevarra never intended for Guevarra to hold any interest of value in the Property.

The bankruptcy court denied the amended exemption without a hearing. The court ruled that California law requires exemptions to be claimed in good faith and to benefit the person taking the exemption. The bankruptcy court found that Guevarra claimed his wild card exemption for the improper purpose of protecting Daryl's property. Consequently, the bankruptcy court sustained the trustee's exemption claim objection.

On appeal, we vacated and remanded. We held that California's wild card exemption does not require debtors to harbor an intent to use the exempt property for any particular purpose. Rather, debtors were free to use property in which they claimed a wild card exemption for whatever purpose they saw fit.

Pertinent to the matter currently before us, we noted that California law presumes that a joint tenant who does not pay for real property holds bare legal title subject to a resulting trust. Citing *Johnson* and *Sale Guaranty*, we observed:

> Both cases involved resulting trusts. Under California law, if a transferee of property does not pay the purchase price for the property, the transferee is presumed to hold the property in a resulting trust for the party who paid the consideration for its purchase. Further, if a bankruptcy trustee has constructive notice of the resulting trust, it cannot be avoided under the trustee's strong-arm powers. But Debtor did not indicate on his

> schedules that he held the Property in a resulting trust, nor did he ever request any adjudication of these issues.

In re Guevarra, 2021 WL 1179619, at *2 n.4 (citations omitted).

We remanded the case to the bankruptcy court to consider the trustee's equitable estoppel argument. On remand, the bankruptcy court permitted the parties to file supplemental briefs. Guevarra, represented by new counsel, filed a supplemental brief that argued he was not the legal owner of the Property. As asserted in the supplemental brief, a resulting trust arose because Guevarra did not make any payments towards the purchase and had never lived on the Property. Guevarra filed his declaration to support his argument. Once again, he stated that he had never made any payments towards the purchase of the Property, never lived in it, and had always intended that it would be Daryl's property.

In his supplemental brief, the trustee argued that Guevarra should not be rewarded for his lengthy inaction in light of the trustee's costly administration of the asset. The trustee did not, however, dispute that Daryl lived on the Property, made all the payments on the loan, or that his uncle had merely intended to help him purchase his residence. Nor did he address the discussion of resulting trust cited in our decision remanding the matter and in Guevarra's supplemental briefing.

The bankruptcy court again ruled on the matter without argument. It sustained the objection to the amended exemption based on equitable estoppel. Guevarra timely appealed.

JURISDICTION

The bankruptcy court had jurisdiction under 28 U.S.C. §§ 1334 and 157(b)(2)(B). We have jurisdiction under 28 U.S.C. § 158.

ISSUE

Did the bankruptcy court abuse its discretion when it applied equitable estoppel to sustain the trustee's objection to Guevarra's exemption claim?

STANDARD OF REVIEW

We review the bankruptcy court's decision whether to apply equitable estoppel for an abuse of discretion. *Parker v. Smith (In re Smith)*, BAP No. EC–16–1140–BJuTa, 2017 WL 1457942, at *4 (9th Cir. BAP Apr. 24, 2017) (citing *Leong v. Potter*, 347 F.3d 1117, 1121 (9th Cir. 2003)); *see also In re Guevarra*, 2021 WL 1179619, at *5 (citing California law and stating that the application of equitable estoppel is matter of discretion for the bankruptcy court).

A bankruptcy court abuses its discretion if it applies an incorrect legal standard, or its factual findings are illogical, implausible or without support in the record. *TrafficSchool.com, Inc. v. Edriver Inc.*, 653 F.3d 820, 832 (9th Cir. 2011).

DISCUSSION

A. Law generally governing exemptions.

When a debtor files a chapter 7 petition, the debtor's legal and equitable interests in property as of the petition date become property of

the bankruptcy estate, subject to the debtor's right to exempt certain property of the estate. *Schwab v. Reilly*, 560 U.S. 770, 774 (2010). The Bankruptcy Code includes a list of federal bankruptcy exemptions but also permits states to "opt out" of the federal exemption scheme and offer their own list of exemptions. *Phillips v. Gilman (In re Gilman)*, 887 F.3d 956, 964 (9th Cir. 2018) (citing § 522(b)(2), (b)(3)(A), (d)).

California has opted out of the federal exemption scheme and permits its debtors only those exemptions allowable under state law. CCP § 703.130. As a result, though the bankruptcy court has jurisdiction to decide the merits of Guevarra's exemption claims, the allowance or disallowance of his claims is governed by California law. *In re Gilman*, 887 F.3d at 964 (citing *Diaz v. Kosmala (In re Diaz)*, 547 B.R. 329, 334 (9th Cir. BAP 2016)).

California exemptions are liberally construed in favor of the debtor. *Elliott v. Weil (In re Elliott)*, 523 B.R. 188, 192 (9th Cir. BAP 2014). And we must determine Guevarra's exemption rights as they existed on the date he filed his bankruptcy petition. *Wolfe v. Jacobson (In re Jacobson)*, 676 F.3d 1193, 1199 (9th Cir. 2012).

Debtors in bankruptcy have a general right to amend their schedules, including their exemptions, at any time before the case is closed. Rule 1009(a). Bankruptcy courts have no equitable authority under federal law to restrict this right based on a perception of bad faith or prejudice to creditors. *Gray v. Warfield (In re Gray)*, 523 B.R. 170, 173-75 (9th Cir. BAP

2014) (citing *Law*, 134 S. Ct. at. 1196-97). On the other hand, such equitable power might be derived from state law if state law provides an equitable basis for disallowing the amended exemption. *Id*. at 175 (citing *Law*, 134 S. Ct. at 1196-97).

Here, the bankruptcy court applied California equitable estoppel law to disallow Guevarra's amended wild card exemption. Guevarra challenges this application. Thus, we must consider the elements for applying equitable estoppel under California law and whether the bankruptcy court correctly determined that all the requisite elements were satisfied.

B. Equitable estoppel and exemption claims.

Both the Ninth Circuit and this panel generally have observed that equitable estoppel can be invoked to sustain objections to California exemptions. *In re Gilman*, 887 F.3d at 966; *In re Guevarra*, 2021 WL 1179619, at *5. When equitable estoppel is raised in an objection to an exemption, the objecting party bears the burden of proof to establish the elements of equitable estoppel. *In re Smith*, 2017 WL 1457942, at *5 (citing *Domarad v. Fisher & Burke, Inc.*, 270 Cal. App. 2d 543, 556 (1969)); *see also Transp. Clearings-Bay Area v. Simmonds*, 226 Cal. App. 2d 405, 427–28 (1964) (stating that "[t]he doctrine of estoppel must be applied strictly and established in every particular"). To successfully invoke equitable estoppel under California law, the objecting party must establish:

> "(a) a representation or concealment of material facts; (b) made with knowledge, actual or virtual, of the facts; (c) to a party ignorant, actually and permissibly, of the truth; (d) with the intention, actual or virtual, that the ignorant party act on it; and (e) that party was induced to act on it."

In re Guevarra, 2021 WL 1179619, at *5 (quoting *Simmons v. Ghaderi*, 44 Cal. 4th 570, 584 (2008)).

Bankruptcy courts in California have applied equitable estoppel to deny exemptions in similar situations where a debtor amended exemptions after the bankruptcy estate administered an asset. In *In re Aubry*, 558 B.R. 333 (Bankr. C.D. Cal. 2016), the trustee reopened the debtor's case to administer a previously undisclosed annuity from which the debtor was receiving annual payments. Aubry did not amend her exemptions to exempt the annuity until after the trustee had recovered one of the annual annuity payments. She exempted the annuity nearly two years after she filed her bankruptcy and more than a year after the trustee had reopened her case. When her case was reopened, she had even amended her exemptions but had not exempted the annuity. *Id.* at 341-42.

The court held that Aubry was equitably estopped from claiming an exemption in the annuity. The court found that her failure to exempt the annuity when the trustee reopened and administered the undisclosed asset constituted a representation that she would not amend her exemptions. *Id.* at 346. It also held that her failure to exempt the annuity in a timely manner qualified as a concealment of her intent to exempt the annuity. *Id.* The court

found that Aubry knew, or should have known, that she had the opportunity to exempt the annuity and her failure to do so would constitute knowledge that she was representing she would not exempt the asset. *Id.* at 346-47. It also held that the trustee had proven the remaining elements necessary to estop Aubry from amending her exemptions. *Id.* at 349-50.

A year after *Aubry,* the Ninth Circuit issued its unpublished decision in *Lua v. Miller (In re Lua),* 692 F. App'x 851, 852–53 (9th Cir. 2017), reversing the denial of an amended exemption based on equitable estoppel. In *Lua*, the debtor originally listed an interest in her residence as part of her schedules and exempted the interest under California's homestead exemption. She then amended her schedules to say that she "had no interest in the Property other than 'such community interest as may exist for the purposes of a divorce action.'" *In re Lua*, 529 B.R. 766, 769 (Bankr. C.D. Cal.), *aff'd*, 551 B.R. 448 (C.D. Cal. 2015), *rev'd and remanded*, 692 F. App'x 851 (9th Cir. 2017). The amended schedules stated that the residence was owned by her husband and two other members of his family. *Id.* In keeping with these amendments, Lua also amended her Schedule C to omit her prior homestead exemption. *Id.*

The chapter 7 trustee spent almost three years litigating with Lua and her non-debtor husband to sell the residence. The court ultimately held the entirety of the residence was community property and ordered that it be turned over to the trustee. It was only after the trustee obtained an order

compelling Lua to turn over possession of the residence that she finally vacated the property and permitted the trustee to sell it. *Id.* at 770-71. Roughly a month after Lua vacated the property, she filed her second amended schedules to claim a $100,000 homestead exemption under California law. *Id.* at 771.

The bankruptcy court held that Lua was equitably estopped from amending her exemption, and the district court affirmed. On appeal, the Ninth Circuit reversed. It explained that the debtor's first amended exemption "cannot form the basis of an estoppel because [it] set forth all of the existing facts known to Lua." 692 F. App'x at 852. The Ninth Circuit further found that "nothing in Lua's First Amended Schedules can be deemed a representation by Lua that she would not amend her exemptions again if circumstances changed." *Id.* at 853. The Ninth Circuit held that despite the trustee's administration of the residence, she was not equitably estopped from amending her exemption because her circumstances changed when "the bankruptcy court entered an order finding that the Property was 100% community property, providing Lua a new factual basis to claim a homestead exemption." *Id.*

After *Lua,* the bankruptcy court in *In re Gonzalez*, 620 B.R. 296 (Bankr. C.D. Cal. 2019), also applied equitable estoppel to deny the debtor's amended homestead exemption. Gonzalez, a real estate broker, originally disclosed a residence and commissions held by his realty corporation. *Id.* at 302-04. Postpetition, Gonzales received and spent a significant amount of

the outstanding commissions. The trustee informed Gonzalez that under California law he could exempt either the commissions under California's bankruptcy-like exemptions or the homestead under its general nonbankruptcy exemptions, but not both.[6] *Id.* at 304. After the trustee sued him for turnover of the commissions, Gonzalez amended his schedules to exempt roughly $28,000 in commissions under California's bankruptcy-like exemptions of CCP § 703.140(b). *Id.* at 305-06. Ultimately, the parties agreed that Gonzalez could exempt roughly $20,000 of the commissions and asked the court to decide whether the balance qualified as exempt tools of the trade. *Id.* at 306-07.

While the decision was pending, the trustee retained a real estate broker to sell Gonzalez's residence. Gonzalez did not object to the broker's employment but instead filed his third amended schedules to restate the value of his residence at a higher value and exempt the resulting equity under California's nonbankruptcy exemptions. *See* CCP § 704.010, *et seq.* The trustee objected to the homestead exemption. 620 B.R. at 308-09.

The bankruptcy court sustained the trustee's objection, holding that Gonzalez was equitably estopped from exempting the homestead. The court read *Lua* narrowly for the proposition that a debtor's omission of an exemption from her initial schedules did not by itself constitute a

[6] California permits bankruptcy debtors to choose either the bankruptcy exemptions of CCP § 703.140(b) or California's nonbankruptcy exemptions but not both. CCP § 703.140(a).

representation that she would not later amend her schedules to claim an exemption for purposes of equitable estoppel. *Id.* at 325. It pointed out that both the debtor and the trustee in *Lua* had access to the same set of facts. As a result, there could be no concealment of the true facts in that situation. *Id.* In contrast, the court noted that Gonzalez repeatedly advised the trustee that he affirmatively chose to elect the "bankruptcy-like" California exemptions under CCP § 703.140(b) to exempt his commissions to the exclusion of the homestead exemption available under the nonbankruptcy exemptions of CCP § 704.010, *et seq.* Additionally, it distinguished *Lua* by noting that Gonzalez did not involve a bona fide material change in circumstances that triggered his switch to the homestead exemption under California's non-bankruptcy exemptions. *Id.* at 325-26. Gonzalez's election and actions established the elements for equitable estoppel. *Id.* at 313-14, 319-20, 325-26.

With these decisions in mind, we turn to the merits of the issue on appeal.

C. The bankruptcy court erred when it denied Guevarra's amended wild card exemption based on equitable estoppel.

"The doctrine of equitable estoppel is based on the theory that a party who by his declarations or conduct misleads another to his prejudice should be estopped from obtaining the benefits of his misconduct." *Cotta v. City & Cnty. of San Francisco*, 157 Cal. App. 4th 1550, 1567 (2007) (quoting *Kleinecke v. Montecito Water Dist.,* 147 Cal. App. 3d 240, 245 (1983)).

Accordingly, the trustee was required to prove some misrepresentation or concealment of a material fact. *Vu v. Prudential Prop. & Cas. Ins. Co.,* 26 Cal. 4th 1142, 1149–1152 (2001).

The bankruptcy court found that Guevarra had "concealed the 'wild card' exemption otherwise available to exempt his interest in the Property." The court explained that Guevarra did so by repeatedly declaring that he held no interest in the Property or that it was valueless, and by not taking the exemption in his original schedules. Guevarra's purported denial of any interest in the Property is the cornerstone of the trustee's argument to deny the amended exemption. It informs each element necessary to establish equitable estoppel. Therefore, we first address the denial of ownership before considering the court's finding that Guevarra concealed an intent to exempt his interest in the Property.

1. Guevarra's "representation" regarding his ownership interest.

Guevarra, or his counsel, indisputably stated on several occasions that he had no interest in the Property. But such statements were part of a broader, more nuanced resulting trust argument under California and bankruptcy law that Guevarra held bare legal title to the Property and held equitable title in trust for his nephew's benefit. Guevarra never articulated this argument to the court in such a direct manner until the supplemental briefing on equitable estoppel after our remand. But for purposes of equitable estoppel, when Guevarra presented his resulting trust theory to the court is largely irrelevant. Equitable estoppel focuses on the

representation(s) to the party allegedly prejudiced. *See Simmons*, 44 Cal. 4th at 584-85. Here, the relevant party is the trustee, and the record is clear that Guevarra early on informed the trustee, through his counsel, of the facts and law supporting the resulting trust argument.

Guevarra listed the Property in his original Schedule A/B, disclosing an interest in the Property. Though he provided a valuation of the Property, he valued his interest at zero. In the schedule, he explained that he merely co-signed on the loan for his nephew to acquire the Property. The record does not include what information, if any, Guevarra provided the trustee at the meeting of creditors. So, we do not know what was asked, or said, about Guevarra's interest at that time. But the letter sent by the trustee's counsel afterwards reveals that Guevarra provided him with the Grant Deed which established Guevarra's joint tenancy interest.

More importantly, Guevarra never denied that the Grant Deed gave him a joint legal interest in the Property. Rather, he consistently argued that he had merely helped his nephew to purchase the Property. Guevarra maintained that his nephew wholly owned the Property despite the clear language of the Grant Deed. By December 2018, Guevarra's counsel had advised the trustee's counsel that the nephew had always lived at the Property and had made all the loan payments. Guevarra's counsel committed to sending the trustee proof to substantiate these facts, including Guevarra's rent for his residence at a different location.

Daryl's exclusive possession and payments were significant, material facts that Guevarra disclosed early and often to the trustee. These facts patently had the potential to drastically affect the nature of Guevarra's ownership under California law. As we recognized in our disposition of the trustee's bad faith argument, that Guevarra did not pay the purchase price for the Property triggered a presumption that he held his interest in a resulting trust for his nephew. *In re Guevarra*, 2021 WL 1179619, at *2 & n.4.

A resulting trust under California law had the potential to prevent Guevarra's joint ownership from becoming property of the bankruptcy estate. *Id.* If Guevarra's joint interest in the Property was equitably held in trust for his nephew, he would be left with bare legal title. And bare legal title is effectively without value because the substantive equitable interest does not become property of the bankruptcy estate. § 541(d); *see also Mitsui Mfrs. Bank v. Unicom Comput. Corp. (In re Unicom Comput. Corp.)*, 13 F.3d 321 (9th Cir. 1994) ("[S]omething held in trust by a debtor for another is neither property of the bankruptcy estate under section 541(d), nor property of the debtor for purposes of section 547(b)."); *Savin v. Kafka (In re Kafka)*, Case No. 17-30013 HLB, 2018 WL 6132506, at *12 (Bankr. N.D. Cal. Nov. 21, 2018) (determining that debtor held bare legal title to the property and held interest in a resulting trust for the beneficial owners of the property); *Airwork Corp. v. Markair Express, Inc. (In re Markair, Inc.)*, 172 B.R. 638, 641-42 (9th Cir. BAP 1994) ("The resulting trust having been determined by law

to exist, the trustee has no equitable rights in the trust, and the res is not property of the estate pursuant to § 541.”).

The record does not reveal whether the trustee ever received the documentation promised by Guevarra’s counsel. But the trustee’s motion to sell demonstrates that the trustee fully understood the significance of Guevarra’s argument. The trustee sought to sell Guevarra’s joint interest in the Property based on the Grant Deed. Despite the clear existence of that interest, the trustee included considerable discussion about his strong-arm powers as trustee. The obvious purpose of this discussion was to show that the trustee’s status as a bona fide purchaser for value under § 544(a)(3) could defeat any equitable interest Guevarra’s nephew might have in his uncle’s share of the Property. Given that the Grant Deed established their joint legal title, there was no reason for the trustee to include that discussion except to rebut Guevarra’s argument that a resulting trust arose from his nephew’s payments and possession of the Property. Indeed, the time records for the trustee’s counsel show that he spent several hours researching constructive and resulting trusts before filing the motion to sell.

We acknowledge that prior to his response to the trustee’s exemption claim objection, Guevarra’s terse arguments to the court never specifically and distinctly articulated his resulting trust theory. Instead, Guevarra only told the court he was a mere co-signer on the loan and that he made no payments for and did not live on the Property. But regardless of what the

court understood at the time, there is no doubt as to what the trustee knew and understood at the time. In fact, at the sale motion hearing, the trustee did not dispute any of Guevarra's alleged facts regarding possession of and payments for the Property. Rather, he invoked his strong-arm powers under § 544(a)(3) and argued that his status as a bona fide purchaser for value could defeat any prior equitable interest. The trustee also argued that the trustee's actual knowledge of the facts was irrelevant. But as we recognized in our prior decision, under California law "if a bankruptcy trustee has constructive notice of the resulting trust, it cannot be avoided under the trustee's strong-arm powers." *In re Guevarra,* 2021 WL 1179619 at 2 n.4 (citing *In re Sale Guaranty Corp.,* 220 B.R. at 665-66).

In short, there was no need for the trustee to invoke his strong-arm powers except as a means to respond to Guevarra's resulting trust argument. By that time, the trustee's discussions with Guevarra's counsel had made it clear to the trustee that Guevarra was asserting a resulting trust that limited his interest in the Property to bare legal title. The trustee's strong-arm powers may well have ultimately defeated Guevarra's resulting trust argument given the facts and circumstances of this case. *See generally McGranahan v. Dillard (In re Dillard),* Case No. 06-20596-A-7, 2007 WL 3237165 at *4 (Bankr. E.D. Cal. Oct. 30, 2007). But the ultimate outcome is not the issue. Whether or not successful, Guevarra's resulting trust argument, and the trustee's recognition of that argument, establishes that Guevarra did not merely deny his interest in the Property.

At bottom, no finder of fact reasonably could have found that Guevarra misled the trustee as to his ownership in the Property on the record before us. While Guevarra stated that he had no ownership interest of value, he explained the facts that created a presumption of a resulting trust under controlling law that supported his position. There was no misrepresentation of a material fact—only a dispute about the legal implications of those facts. Consequently, the bankruptcy court's finding that Guevarra knowingly misstated his ownership was clearly erroneous.

2. Guevarra's "concealment" of a present intent to exempt his interest in the Property.

Though Guevarra's putative misrepresentation of his ownership of the Property predominated the trustee's objection to the amended exemption, the court found that Guevarra induced the trustee to sell his interest in the Property by concealing an intent to exempt that interest. The court cited Guevarra's repeated denials of his interest in the Property as evidence of this concealment. But as explained above, Guevarra disclosed his ownership interest and argued that it was not property of the estate, or was worthless, because he held bare legal title. Because he believed that he held bare legal title, his interest was valueless without the equitable interest which was not property of the estate. Accordingly, there was no practical reason for Guevarra to exempt bare legal title. Guevarra's resulting trust argument was consistent with his original decision not to exempt his interest in the Property.

In *Lua,* the Ninth Circuit rejected an argument similar to the trustee's present concealment argument. There, the debtor challenged her interest in real property for years based on her belief that she did not hold any community interest in her residence. The chapter 7 trustee in *Lua* had argued that her failure to take a homestead exemption was proof that she concealed her intent to exempt her residence. The Ninth Circuit held to the contrary that Lua's original schedules "cannot form the basis of an estoppel because they set forth all of the existing facts known to [the debtor]." *In re Lua,* 692 F. App'x at 852. Given a debtor's right to amend her schedules, including her exemptions, "nothing in Lua's First Amended Schedules can be deemed a representation by Lua that she would not amend her exemptions again if circumstances changed." *Id.* at 853.

The bankruptcy court attempted to distinguish *Lua.* It cited *Aubry* in support of its conclusion that Guevarra concealed his exemption "by omitting the exemption from the initial Schedules and thereafter testifying at the § 341 meeting that the initial Schedules were accurate." It also cited *Gonzalez* for the proposition that Guevarra had mislead the trustee by originally using the wild card to exempt "a Wells Fargo 401(k) bank account." Finally, it reasoned that like the trustee in *Aubry,* the trustee in Guevarra was harmed because he incurred considerable expense to sell the Property based on the debtor's choice not to exempt a valuable asset.

Though *Lua* is an unpublished decision, we find it persuasive and adopt its reasoning. The absence of an exemption for his interest in the

Property in Guevarra's original schedules did not constitute a representation that he would not amend his exemption in the future. *In re Lua*, 692 F. App'x at 852-53; *see also In re Gilman*, 608 B.R. 714, 729 (Bankr. C.D. Cal. 2019) (following *Lua* and holding that the debtor's failure to disclose a prepetition escrow of a residence for sale in his initial schedules did not equitably estop the debtor from claiming an automatic homestead exemption in the residence), *aff'd*, 2020 WL 7087703 (C.D. Cal. Oct. 28, 2020). Nor are we persuaded that Guevarra's exemption of a 401(k) account under the wild-card exemption was meaningful as demonstrated by his subsequent amended exemption of the 401(k) account under the more applicable CCP § 703.140(b)(10)(E). In *Gonzalez* the debtor had the choice to exempt one of two assets under mutually exclusive exemptions. For whatever reason Guevarra originally decided to exempt his 401(k) account under the wild-card exemption, it did not preclude exemption under the more specific provision of CCP § 703.140(b)(10)(E).

Finally, Guevarra's case materially differs from *Aubry.* The trustee in *Aubry* incurred time and fees to administer an undisclosed annuity. For a year after discovery of the asset, the debtor did not challenge the estate's rights in the asset or exempt it despite filing amended exemptions when the case was reopened. Only after the trustee received an annual payment did the debtor exempt the annuity. Here, as in *Lua,* the debtor challenged the estate's rights in the asset the estate sought to administer. Once Guevarra lost that challenge, his circumstances changed, and he was

entitled to amend his exemption based on the court's decision to permit the estate to sell his interest in the Property. *In re Lua*, 692 F. App'x at 853 (holding that circumstances changed "when, at the request of the Trustee, the bankruptcy court entered an order finding that the Property was 100% community property, providing Lua a new factual basis to claim a homestead exemption"). Neither *Aubry* nor *Gonzalez* involved any legitimate change in circumstances that served as an impetus for the amended exemption. Rather, in both situations it was the trustee's administration of the nonexempt asset that prompted the belated exemption when it was available throughout the case. In contrast, the debtor in *Lua* and Guevarra both experienced bona fide changes in circumstances: the court's rejection of their respective legal positions that challenged whether the subject property was property of the estate.[7]

As in *Lua,* Guevarra provided the trustee with all the existing facts concerning his ownership. The parties merely disputed the legal significance of those facts. The trustee is not misled, and there is no concealment, where the parties disagree as to the legal significance of known facts. Nor can the trustee penalize a debtor for litigating his position, even when the debtor amends his or her exemptions if the debtor loses. Here, the court effectively disposed of Guevarra's resulting trust

[7] We express no opinion whether omitting an asset completely from the debtor's schedules ever could be, by itself, sufficient grounds for equitable estoppel under California law.

argument when it approved the sale of his interest in the Property. As a result of the court's decision, Guevarra's circumstances changed, and that change in circumstances provided him with a basis to claim an exemption he previously did not believe he had. Guevarra's situation was no different than the debtor in *Lua.* The record simply does not support any inference that Guevarra held a present intent to exempt a property interest that he believed was limited to bare legal title when he filed his original schedules and exemptions.

3. Given the absence of a misrepresentation or concealment, the other equitable estoppel elements also are absent.

There being no misrepresentation of Guevarra's ownership, or concealment of a pre-existing intent to exempt his interest in the Property, the rest of the elements needed to establish equitable estoppel also fail. The trustee was required to prove that he was actually and permissibly ignorant of the truth. But "where the person pleading estoppel had knowledge of the facts, there is no reliance." *In re Lua*, 692 F. App'x at 852 (quoting *Sidebotham v. Robison,* 216 F.2d 816, 829 (9th Cir. 1954)). The trustee knew of Guevarra's interest under the Grant Deed as well as his resulting trust argument. And as a trustee he knew, or should have known, there was no need for Guevarra to exempt an interest that was limited to bare legal title because the estate did not have any beneficial interest in such property. *See* § 541(d) (providing that when debtor holds only legal title to property, no equitable interest in that property passes to the bankruptcy

estate); *see also In re Markair, Inc.*, 172 B.R. at 641-42 (stating that trust res did not constitute estate property when the debtor had no equitable interest in the res to pass on to the trustee and the estate).

Similarly, the trustee is charged with knowing that if the court rejected Guevarra's resulting trust argument, Guevarra could amend his exemption in light of that ruling. *In re Gilman*, 608 B.R. at 729 ("[A] debtor's schedules cannot form the basis of an equitable estoppel claim because the parties are aware that the debtor may amend her schedules at any time."). That is exactly what happened here. As such, the trustee failed to establish that he was permissibly ignorant of either Guevarra's ownership or his ability to exempt that interest if the court rejected his resulting trust argument.

The record additionally provides no support for the court's findings that Guevarra induced the trustee to sell his interest while concealing an intent to exempt that interest. Based on the resulting trust argument, there was no need for Guevarra to exempt his interest if it was limited to bare legal title. That was the entire point of Guevarra's resulting trust argument: to prevent the trustee from selling his interest.

The bankruptcy court held that Guevarra intended to induce the trustee to sell his interest in the Property because he failed "to properly exempt his interest in the Property." In this instance, this amounts to nothing more than penalizing the debtor for raising an unsuccessful legal argument. The trustee was fully aware of Guevarra's argument, which was

entirely consistent with his not exempting an interest that he argued was limited to bare legal title.

CONCLUSION

There is an obvious tension between the debtor's right to amend his exemptions and application of equitable estoppel. As we noted in our prior decision, we have interpreted *Law v. Siegel*, 571 U.S. 415 (2014), "as overruling the bankruptcy court's authority to deny an exemption on grounds of bad faith." *In re Guevarra*, 2021 WL 1179619, at *4. Equitable estoppel is not a substitute for bad faith. Courts must be careful not to penalize debtors for exercising the statutory right to amend their exemptions or to read too much into a debtor's failure to exempt an asset. Without more, such an omission does not constitute a misrepresentation or concealment for purposes of equitable estoppel. Similarly, standing alone, the failure to exempt an asset does not impermissibly induce a trustee to administer an asset as he or she knows that debtors may amend their exemptions as a matter of right. Admittedly, this can place chapter 7 trustees in a tenuous position when faced with a valuable asset that the debtor has not exempted but could. Even so, we are not free to ignore the necessary implications of *Law v. Siegel* simply because they present a practical problem for chapter 7 trustees in administering estate assets.

As explained above, the record does not support the bankruptcy court's findings that Guevarra knowingly concealed his interest in the Property while the trustee was ignorant of that interest, or of Guevarra's

right to amend his exemptions. Accordingly, we REVERSE the bankruptcy court's order sustaining the trustee's exemption claim objection based on the application of equitable estoppel.

NOTES

53 F.4th 1160

IN RE: Sandra J. TILLMAN, Debtor,

United States of America, Appellant,
v.
Lawrence J. Warfield, Trustee; Sandra J. Tillman, Appellees.

No. 21-16034

United States Court of Appeals, Ninth Circuit.

Argued and Submitted July 5, 2022 Seattle, Washington
FILED NOVEMBER 18, 2022

Matthew S. Johnshoy (argued), Francesca Ugolini, and Ellen Page DelSole, Attorneys; David A. Hubbert, Deputy Assistant Attorney General; United States Department of Justice, Tax Division; Washington, D.C.; for Appellant.

Terry A. Dake (argued), Terry A, Dake Ltd, Phoenix, Arizona, for Appellee Lawrence J. Warfield.

Thomas H. Allen, Allen Barnes & Jones PLC, Phoenix, Arizona, for Appellee Sandra J. Tillman.

Before: CLIFTON and BUMATAY, Circuit Judges, and CHEN,* District Judge.

Opinion by Judge Chen;

Dissent by Judge Bumatay

CHEN, District Judge:

[53 F.4th 1163]

Sandra J. Tillman (the "Debtor") purchased a house in Prescott, Arizona (the "Prescott Property"). The Internal Revenue Service ("IRS" or "the government") held a secured claim on the Prescott Property arising from a tax penalty lien. Thereafter, Debtor filed a petition for Chapter 7 bankruptcy and claimed a $150,000 homestead exemption in the house under Arizona law. Appellee Trustee Lawrence J. Warfield (the "Trustee") instituted an adversary proceeding to avoid the IRS's tax lien on the exempt property and to preserve the value of the lien for the benefit of the bankruptcy estate. The Bankruptcy Court granted summary judgment to the Trustee and the District Court affirmed. The government appealed.

We are presented with a matter of first impression: may a trustee use 11 U.S.C. §§ 724(a) and 551 to avoid and preserve a tax penalty lien on a debtor's exempt property for the benefit of the bankruptcy estate? We hold that a trustee may not. Therefore, we reverse the decision of the District Court affirming the Bankruptcy Court.

I. BACKGROUND

A. LEGAL BACKGROUND

At the outset, we briefly summarize the terminology and statutory provisions of the Bankruptcy Code relevant to this dispute.

First, after a bankruptcy petition is filed, a bankruptcy estate is formed consisting of specified property interests of the debtor. 11 U.S.C. § 541(a).

* The Honorable Edward M. Chen, United States District Judge for the Northern District of California, sitting by designation.

Second, in some circumstances, a debtor may exempt property from the bankruptcy estate, thereby removing it from the bankruptcy estate. *Mwangi v. Wells Fargo Bank, N.A. (In re Mwangi)* , 764 F.3d 1168, 1175–76 & n.4 (9th Cir. 2014). In such circumstances, the debtor generally retains the exempt property, and the exempt property cannot be used by the bankruptcy estate to satisfy the claims of unsecured creditors. *Owen v. Owen* , 500 U.S. 305, 308, 111 S.Ct. 1833, 114 L.Ed.2d 350 (1991). Section 522 of the Bankruptcy Code enumerates exemptions available to an individual debtor in bankruptcy, but § 522(b)(1) also authorizes state legislatures to "opt out" of the § 522 exemption scheme and provide their own exemption schemes. "If a State opts out, then its debtors are limited to the exemptions provided by state law." *Owen* , 500 U.S. at 308, 111 S.Ct. 1833.

As relevant here, Arizona has opted out of the § 522 exemptions and provides its own set of exemptions to Arizona residents. Arizona Revised Statutes ("A.R.S.") § 33-1133(B). Among other things, Arizona provides a homestead exemption that permits a resident to exempt her "interest in real property ... in which [she] resides," up to $150,000 "in value." *Id.* § 33-1101(A)(1) (2004 version, effective prior to Jan. 1, 2022). Arizona, however, provides that consensual loans, such as mortgages, are not "subject to or affected by" the homestead exemption. A.R.S. § 33-1104(D). Thus, depending on the value of the property, a mortgage can diminish the amount of the homestead exemption available to the homeowners. Notably, the Arizona homestead exemption does *not* provide for any reduction in the exemption amount for tax liens.

Third, the Bankruptcy Code limits a debtor's ability to shield exempted property from liability for certain pre-petition debts. Section § 522(c) provides:

> (c) Unless the case is dismissed, **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, except** —

[53 F.4th 1164]

> ...
>
> (2) a **debt secured by a lien that is** —
>
> (A)(i) not avoided under subsection (f) or (g) of this section or under section 544, 545, 547, 548, 549, or 724(a) of this title; and
>
> (ii) not void under section 506(d) of this title; or
>
> (B) **a tax lien, notice of which is properly filed** ....

11 U.S.C. § 522(c) (emphasis added). In short, § 522(c) provides that a debtor remains liable for certain debts secured by liens, such as tax liens, even if the debtor has otherwise exempted property from the reach of unsecured creditors. Of note, an IRS tax lien lies "upon all property and rights to property, whether real or personal, belonging to such person." 26 U.S.C. § 6321.

Fourth, under § 724(a) of the Bankruptcy Code, a trustee may "avoid" a "lien that secures a claim of a kind specified in section 726(a)(4)" for the estate. Section 726 deals generally with distribution of property of the estate, and § 726(a)(4), as relevant here, addresses claims for non-compensatory penalties. 11 U.S.C. § 726(a)(4) (addressing "payment of any allowed claim, whether secured or unsecured, for any fine, penalty, or forfeiture, or for multiple, exemplary, or punitive damages, arising before the earlier of the order for relief or the appointment of a trustee, to the extent that such fine, penalty, forfeiture, or damages are not compensation for actual pecuniary loss suffered by the holder of such claim").

Fifth, if a trustee avoids a lien using § 724(a), the lien's priority position is automatically "preserved for the benefit of the estate but only with respect to property of the estate." 11 U.S.C. § 551. Thus, generally, once the trustee avoids a lien against property of the estate, he steps into the shoes of the lienholder and can recover that property interest for the estate, thereby increasing the property of the estate available to

satisfy claims of unsecured creditors. *Retail Clerks Welfare Trust v. McCarty (In re Van de Kamp's Dutch Bakeries)* , 908 F.2d 517, 519 (9th Cir. 1990).

B. FACTUAL BACKGROUND

Having described the relevant statutory provisions, we now turn to the facts of this case.

In 2015, Debtor purchased a residence in Prescott, Arizona and granted a mortgage to Bank of America. The Prescott Property became the Debtor's homestead under Arizona law. *See* A.R.S. § 33-1101 (2004 version, effective prior to Jan. 1, 2022). The Debtor owed income tax for 2015 but failed to timely file a return or pay her 2015 taxes. The IRS assessed Debtor's 2015 income tax liability and related penalties and interest. Debtor eventually fully paid the original tax liability but did not fully pay the penalties and interest, which initially totaled over $18,000. On December 24, 2018, the IRS recorded a notice of a federal tax lien (the "IRS Tax Lien") securing the penalties against the Prescott Property.

On January 30, 2019, Debtor filed a Chapter 7 bankruptcy petition in the U.S. Bankruptcy Court for the District of Arizona. The IRS filed a claim for Debtor's 2015 tax liabilities and indicated its claim was secured by the IRS Tax Lien it had filed. Debtor claimed a homestead exemption of up to $150,000 on the Prescott Property under A.R.S. § 33-101, which the Bankruptcy Court permitted. that time, the Debtor's mortgage was for $364,381 and the IRS's secured tax lien was for $24,686.26.

C. PROCEDURAL BACKGROUND

Thereafter, the Trustee filed the adversary proceeding currently at issue and

[53 F.4th 1165]

sought a summary judgment order: (1) avoiding the federal tax lien on the Prescott Property pursuant to 11 U.S.C. § 724(a), and (2) preserving the value of the avoided federal tax lien on the Prescott Property for the benefit of the bankruptcy estate pursuant to 11 U.S.C. § 551. The government responded that lien avoidance under § 724(a) and preservation under § 551 did not apply to liens encumbering exempt property, such as the Prescott Property, which was subject to Arizona's homestead exemption. The Debtor also intervened and asserted her right to an increased exemption under § 522(g).

The Bankruptcy Court granted the Trustee's summary judgment motion, holding that the Trustee could avoid the portion of the federal tax lien securing the tax penalties and interest under § 724(a) and that the value of the lien was preserved for the estate's benefit under § 551.

The Bankruptcy Court rejected the government's argument that lien avoidance under § 724(a) and preservation under § 551 for the benefit of the bankruptcy estate did not apply to the Debtor's exempted homestead property. Specifically, the Bankruptcy Court found that the IRS held a secured claim for a tax penalty, which is of the kind specified in § 726(a)(4), and was, thus, subject to avoidance by the Trustee under § 724(a). It observed that the IRS Tax Lien was held against the Prescott Property, which the Debtor claimed exempt under Arizona's homestead exemption—and which the Bankruptcy Court had previously granted—but that the grant of this exemption did not preclude the Trustee from avoiding the lien and preserving it for the benefit of the estate.

The Bankruptcy Court quoted *Heintz v. Carey* (*In re Heintz*) for the proposition that " § 551 does not exclude exempt property from preservation" and that "[a]n avoided interest or lien encumbering exempt property is automatically preserved for the benefit of the estate under § 551." 198 B.R. 581, 586 (B.A.P. 9th Cir. 1996). Relying on *Heintz* , the Bankruptcy Court concluded that the Debtor's homestead was property of the bankruptcy estate at the commencement of the case and remained property of the estate for purposes of § 551 even after the Debtor's homestead exemption was allowed.

The Bankruptcy Court further reasoned that, under Arizona law, the Debtor's exemption was limited to an "interest" in her homestead, up to $150,000, equal to the property's value after subtracting both the value of the mortgage lien and the value of the federal tax lien. The court explained that Arizona's exemption

laws explicitly excluded the value of consensual liens, such as her mortgage, from the amount of the Debtor's homestead exemption. And, as to the federal tax lien, the court observed that Arizona's exemption laws were "ineffective" against the federal tax lien. The Bankruptcy Court held this ineffectiveness meant the Debtor's homestead exemption did not include "the value of the lien positions occupied by [Bank of America] or the IRS," and it was only the Debtor's equity beyond the mortgage and tax lien that the Debtor was entitled to exempt. Thus, the Bankruptcy Court concluded that "[a]t all relevant times, the IRS's Tax Lien encumbered property of the estate."

Accordingly, the court explained that "[t]he trustee may avoid the IRS's Tax Lien under § 724(a)," and "[u]pon avoidance of the IRS's Tax Lien, the IRS's Tax Lien is preserved for the benefit of [the] bankruptcy estate under § 551."[1]

[53 F.4th 1166]

In so concluding, the Bankruptcy Court also rejected the government's argument that the court's holding would cause inequitable results for the Debtor, because the Debtor's exemption could be reduced twice as a result of the same lien—first, as a deduction from the amount that Debtor could exempt, and then, again, when the Debtor is required to satisfy the value of the lien to the IRS. The Bankruptcy Court reasoned that the Debtor would not have to unfairly pay twice on the same lien because the IRS Tax Lien "never attached to the Debtor's homestead exemption." "[T]he value of the Debtor's exemption was always subordinate to the Tax Lien" and "[w]hen the Tax Lien is avoided, the Trustee steps into that avoided position." Therefore, the court explained, "[i]f it so happens that the IRS's now unsecured claim is also nondischargeable, it is no different than any other nondischargeable claim which will need to be paid by the Debtor."

The government appealed the Bankruptcy Court's grant of summary judgment to Trustee, and the District Court affirmed in full. The District Court, also relying on *Heintz* , concluded that § 551's "property of the estate" limitation did not prevent the Trustee's avoidance and preservation of the IRS lien, and found that the Debtor was only entitled to use Arizona's homestead exemption to exempt unencumbered property – *i.e.* , the exemption excluded the mortgage and the IRS lien. The District Court agreed with the Bankruptcy Court that the IRS's tax lien never attached to Debtor's exemption. This appeal followed.

D. INTERVENING DEVELOPMENTS

During the pendency of the appeal from the adversary proceeding, on July 9, 2020, Debtor found a buyer for the Prescott Property and moved for approval to sell. The Bankruptcy Court permitted the sale of the Prescott Property for $475,000, of which Debtor was ordered to pay $378,062.78 to Bank of America to cover the cost of the mortgage. The Bankruptcy Court ordered the Trustee, after paying costs and the mortgage, to set aside a portion of the proceeds equal to the total value of the IRS's tax lien, $26,771, pending the outcome of the litigation now before this Court. The remaining proceeds of the sale after costs, approximately $30,000, were provided to Debtor as the value of her homestead exemption.

II. JURISDICTION AND STANDARD OF REVIEW

The government timely appealed the District Court's affirmance of the Bankruptcy Court's grant of summary judgment to the Trustee. We have jurisdiction over this appeal pursuant to 28 U.S.C. §§ 158(d), 1291. *See SS Farms, L.P. v. Sharp (In re SK Foods, L.P.)* , 676 F.3d 798, 802 (9th Cir. 2012).

We review *de novo* the district court's decision on appeal from a bankruptcy court. *Decker v. Tramiel (In re JTS Corp.)* , 617 F.3d 1102, 1109 (9th Cir. 2010). "We apply the same standard of review applied by the district court" and "review [the] bankruptcy court decision independently and without deference to the

[1] The Bankruptcy Court also rejected the IRS and Debtor's argument that the avoided lien is preserved for the benefit of *the debtor* under § 522(g) instead of for the benefit of the estate under § 551. This argument is not re-asserted on appeal.

district court's decision." *Id.* ; *see Galam v. Carmel (In re Larry's Apt., L.L.C.)* , 249 F.3d 832, 836 (9th Cir. 2001) (citing *Robertson v. Peters (In re Weisman)* , 5 F.3d 417, 419 (9th Cir. 1993)). As such, "[t]he bankruptcy court's findings of fact are reviewed for clear error, while its conclusions of law are reviewed de novo."

[53 F.4th 1167]

In re JTS Corp. , 617 F.3d at 1109 (quoting *Leichty v. Neary (In re Strand)* , 375 F.3d 854, 857 (9th Cir. 2004)).

III. DISCUSSION

A. AVOIDANCE AND PRESERVATION UNDER §§ 724(a), 551

The government argues that the Bankruptcy Court erred in holding that the Trustee could avoid a tax lien for penalties on the Debtor's exempt homestead property under 11 U.S.C. § 724(a) and then use 11 U.S.C. § 551 to take the value of the lien from the Debtor's exemption and preserve it for the benefit of the bankruptcy estate. In the government's view, the Bankruptcy Court erred because the Debtor's homestead exemption withdrew her exempt property from the property of the estate. Therefore, the government contends, the Trustee cannot use § 724(a) and § 551 to avoid and preserve a lien on exempted property, because such property is *not* property of the estate.

1. Parameters of § 724(a)

The parties do not dispute that the tax penalty lien at issue here is the type of lien contemplated for avoidance by a trustee under § 724(a). Under § 724(a), "[t]he trustee may avoid a lien that secures a claim of a kind specified in section 726(a)(4) of this title." 11 U.S.C. § 724(a). Section 726(a)(4), in turn, specifies "property of the estate shall be distributed ... in payment of any allowed claim, whether secured or unsecured, for any fine or forfeiture or for multiple, exemplary, or punitive damages, arising before the earlier of the order for relief or the appointment of a trustee ..." 11 U.S.C. § 726(a)(4). Under 11 U.S.C. § 551, "[a]ny transfer avoided under section ... 724(a) of this title ... is preserved for the benefit of the estate but only with respect to property of the estate." 11 U.S.C. § 551. The trustee's power under § 551 is thus predicated on its power first to avoid the tax lien under § 724(a). The key question here is whether the Debtor's exempted property—her homestead exemption under Arizona law—is subject to the Trustee's avoidance of the tax lien under § 724(a) and the ensuing preservation of the tax lien under § 551. It is not.

Property interests held by the estate evolve over the course of bankruptcy proceedings. Section 541(a)(1) of the Bankruptcy Code explains that the filing of a bankruptcy case "creates an estate ... comprised of" the debtor's specified property interests "as of the commencement of the case." 11 U.S.C. § 541(a). However, the holdings of the estate do not remain static after the commencement of the bankruptcy case. The term "estate" refers to the property at a particular point in time—such as at the commencement of the case as referred to in § 541(a)(1) —rather than the estate in perpetuity. *See Owen* , 500 U.S. at 308, 111 S.Ct. 1833 ("An estate in bankruptcy consists of all the interests in property, legal and equitable, possessed by the debtor at the time of filing, as well as those interests recovered or recoverable through transfer and lien avoidance provisions.").

Section 541(a) provides that a trustee may increase the property of the estate if the trustee can recover non-debtor interests in property through the various transfer and lien avoidance provisions in the Bankruptcy Code. *See* 11 U.S.C § 541(a)(3)–(7).

Conversely, the property interests of the estate may be reduced during the course of bankruptcy proceedings, such as through a judicially authorized sale of assets, payment of expenses related to the administration of the estate, or payment of a debtor's unexpired lease obligations. *See* 11 U.S.C. § 363(b) (sale of property of the estate); *Tamm v. U.S.T. (In re Hokulani Square, Inc.)* , 776 F.3d 1083, 1085 (9th Cir. 2015) (describing a secured creditor's purchase

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of estate property via credit bid, such that "the creditors get the property, and the estate's debt is reduced by the amount of the bid"); 11 U.S.C. § 503 (allowance of administrative expenses); 11 U.S.C. § 365 (payment on unexpired leases).

Additionally, the property interests of the estate may be reduced by a judicially authorized exemption. *See* 11 U.S.C. § 522. Although initially "[a]n estate in bankruptcy consists of all the interests in property legal and equitable, possessed by the debtor at the time of filing," "[a]n exemption is an interest *withdrawn* from the estate (and hence from the creditors) for the benefit of the debtor." *Owen* , 500 U.S. at 308, 111 S.Ct. 1833 (emphasis added). Likewise, § 522 of the Bankruptcy Code "authorizes a debtor to exempt certain property from the bankruptcy estate so that it may not be reached by the trustee in bankruptcy." *DeMarah v. United States (In re DeMarah)* , 62 F.3d 1248, 1250 (9th Cir. 1995). Indeed, § 522(b)(1) expressly states that "[*n*]*otwithstanding section 541 of this title* "—the statutory provision describing the property interests that comprise the estate at the *commencement* of proceedings—"an individual debtor may exempt from property of the estate the property" listed in the relevant subsections of § 522. 11 U.S.C. § 522(b)(1) (emphasis added).

We have consistently recognized that authorized exemptions modify the property interests of the estate. After the commencement of bankruptcy proceedings, property interests which are exempted by a debtor are "withdrawn from the estate," *Gebhart v. Gaughan (In re Gebhart)* , 621 F.3d 1206, 1210 (9th Cir. 2010), (quoting *Owen* , 500 U.S. at 308, 111 S.Ct. 1833) and are no longer property of the estate. *See In re Kahan* , 28 F.3d 79, 81 (9th Cir. 1994) ("The bankruptcy estate includes all of the debtor's interests in property at the commencement of the case, except property that the debtor elects to exempt based on applicable federal or state law.") (citing 11 U.S.C. §§ 541(a), 522(b)(2)). "The general rule is that exempt property immediately revests in the debtor." *In re Mwangi* , 764 F.3d at 1175.[2] *See In re Gebhart* , 621 F.3d at 1210 ("This principle is consistent with the text of the Bankruptcy Code, which defines exempt property as property that, unlike all the debtor's other property, does not belong to the bankruptcy estate.") (citing 11 U.S.C. § 522(b)(1)); S. Rep. No. 95-989, at 52 (1978), *as reprinted in* 1978 U.S.C.C.A.N. 5787, 5838 (recognizing that exempt property "ceases to be property of the estate"); *see also Owen* , 500 U.S. at 308, 111 S.Ct. 1833 (recognizing that the relationship between a debtor's exempt property and property of the estate may change, such that "[n]o property can be exempted (and thereby immunized) ... unless it *first* falls within the bankruptcy estate") (emphasis added).

Recognizing the dynamic nature of the bankruptcy estate through the pendency of bankruptcy proceedings, we must analyze the text of the avoidance provision at issue here, 11 U.S.C. § 724(a), and interpret it in context to determine whether the Trustee may avoid a tax lien on the Debtor's exempt property. *In re Consol. Freightways Corp. of Delaware* , 564 F.3d 1161, 1165 (9th Cir. 2009) ("[O]ur examination must begin with the words of the provision itself. Of course, that does not mean that we limit ourselves to the provision in perfect

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isolation. We must, instead, construe that [Bankruptcy Code] provision with the statutory scheme in which it is embedded." (internal citations omitted)).

Examining the statutory text in this context, under § 724(a), "[t]he trustee may avoid a lien that secures a claim of a kind specified in section 726(a)(4) of this title." 11 U.S.C. § 724(a). Section 726(a)(4), in turn, specifies that "*property of the estate* shall be *distributed* ... in payment of any allowed claim, whether secured or unsecured, for any fine or forfeiture or for multiple, exemplary, or punitive damages, arising

[2] Where an asset itself is exempt, the asset immediately revests in the debtor upon the end of the objection period. *In re Mwangi* , 764 F.3d at 1175–76. When the exemption consists of an interest in an asset, the asset remains in the estate while "only an ‘interest’ in the property equal to the value of the exemption claimed at filing is removed from the estate." *Id.* at 1174–75 (citation omitted).

before the earlier of the order for relief or the appointment of a trustee ...." 11 U.S.C. § 726(a)(4) (emphasis added); *see also id.* § 726 (statutory section is titled "Distribution of property of the estate"). Thus, § 724(a) applies to property that is part of the estate at the time of distribution based on its express reference to § 726(a)(4). *See Einstein/Noah Bagel Corp. v. Smith (In re BCE W., L.P.)* , 319 F.3d 1166, 1171 (9th Cir. 2003) ("Statutory construction of the Bankruptcy Code is 'a holistic endeavor' requiring consideration of the entire statutory scheme.") (quoting *United Sav. Ass'n of Texas v. Timbers of Inwood Forest Assocs., Ltd.* , 484 U.S. 365, 371, 108 S.Ct. 626, 98 L.Ed.2d 740 (1988)).

The statutory context makes this clear. First, § 724 deals with the "treatment of certain liens" at the point in time that property of the estate is to be *distributed* to creditors. *See, e.g.* , § 724(b) ("Property in which the estate has an interest and is subject to a lien that is not avoidable ... and secures an allowed claim for a tax, or proceeds of such property, shall be *distributed* ...."); § 724(c) ("If more than one holder of a claim is entitled to *distribution* ... *distribution* to such holders under such paragraph shall be in the same order as *distribution* to such holders would have been other than under this section.") (emphases added). Hence, § 724(a) operates on the bankruptcy estate not at the commencement of the proceedings but at a later stage—distribution.

Second, § 724(a) only permits lien avoidance of a lien that secures an "allowed claim." 11 U.S.C. § 726(a)(4). By definition, the Bankruptcy Code provides that an allowed claim is one in which sufficient proof has been provided to the bankruptcy court *after* the commencement of proceedings and any objections to the proof of claim have been resolved. *See* 11 U.S.C. § 502(a).

Thus, it is clear from the express language of § 724(a) and its cross-reference to § 726(a)(4), as well as the statutory context provided by §§ 724 and 726, that § 724(a) concerns the trustee's avoidance of qualifying liens attached to the *property of the estate* at the time of *distribution* .

When a debtor properly exempts a property interest under § 522, the exemption withdraws that property interest from the estate and, thus, from the reach of the trustee for distribution to creditors. *See Owen* , 500 U.S. at 308, 111 S.Ct. 1833 ; *In re DeMarah* , 62 F.3d at 1250. Such an exempted property interest revests with the debtor and no longer belongs to the estate. *In re Gebhart* , 621 F.3d at 1210. Accordingly, because exempt property is not "property of estate" which may be "distributed," we conclude that a trustee may not avoid a lien under § 724(a) (that secures the kind of claim specified in § 726(a)(4)) attached to exempt property which is no longer part of the estate.

2. Prior Rulings

This holding is consistent with our prior rulings. We have not previously had the occasion to expressly address whether a trustee may use § 724(a) to avoid a lien which is not secured by property of the estate, such as a lien secured only by a debtor's exempt property. The district court in *DeMarah v. United States* , 188 B.R. 426, 431 (E.D. Cal. 1993), *aff'd* ,

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62 F.3d 1248 (9th Cir. 1995), concluded (as we do here) that § 724(a) lien avoidance actions are limited to property of the estate, explaining

> The trustee's avoiding powers under Section 724(a) are limited to the types of liens secured by claims specified in Section 726(a)(4). Section 726(a)(4) concerns non-compensatory tax penalty claims. However, § 726(a)(4) does not stand in isolation, it is a part of Section 726 which is concerned only with "property of the estate." 11 U.S.C. § 726(a)(4) allows the trustee to avoid claims for penalties against the property of the estate. The avoiding powers of Debtor, like those of the trustee, are limited to penalty claims against property of the estate.

Id. In affirming the district court's holding in *DeMarah* , we neither reached nor cast doubt on the district court's analysis that lien avoidance actions under § 724(a) are limited to liens on property of the estate. *See In re DeMarah* , 62 F.3d at 1252.

In *DeMarah* , we addressed whether a *debtor* could assert a trustee's avoidance and preservation authority against a tax lien on the debtor's exempt property for the *debtor's* own benefit. We affirmed the district court's decision that a debtor could not do so by acknowledging that, *even if* avoidance of a tax lien on exempt property under § 724 in the first instance were permissible, the debtor could not ultimately escape liability for the tax lien on his exempt property because § 522(c)(2)(B) "brings back the whole of any tax lien" on the exempt property. *In re DeMarah* , 62 F.3d at 1252. In so noting, we observed that the outcome—that a debtor may not avoid and preserve a tax lien on exempt property for his own benefit—is the same whether the analysis is based on a finding that the policies behind §§ 724 and 726 prevent avoidance of liens on tax penalties attached to exempt property, or whether the analysis is based on the statutory language of § 522(c) preventing a debtor from avoiding a tax lien penalty. *Id.* We recognized two district court decisions that interpreted § 724(a) differently, but we did not need to decide which interpretation was correct because both confirmed the relevant holding that a debtor could not escape liability for a tax penalty lien. *Id.* (*citing In re Carlton* , 19 B.R. 73, 75 (D.N.M. 1982) ; *In re Gerulis* , 56 B.R. 283, 287 (Bankr. D. Minn. 1985)).

Because a trustee may not *avoid* a tax lien attached to exempt property through § 724(a), it follows that a trustee is not permitted to *preserve* the tax lien for the benefit of the estate under § 551. Section 551 provides for automatic preservation of certain avoided liens, including liens avoided under § 724(a). *See In re Van de Kamp's Dutch Bakeries* , 908 F.2d at 519 ; 11 U.S.C. § 551. But where there is no avoidance under § 724(a), there is no avoided lien for the trustee to preserve.[3]

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[3] Having assumed that the Trustee could use § 724(a) to avoid the tax lien on the Debtor's exempt property, the Bankruptcy Court focused on whether the Trustee could then preserve the value of the avoided lien for the benefit of the estate under § 551. The Bankruptcy Court relied on the Bankruptcy Appellate Panel's decision in *In re Heintz* , 198 B.R. 581, 583 (B.A.P. 9th Cir. 1996) addressing "[w]hether an avoided lien is preserved for the benefit of the estate pursuant to § 551 when the avoided lien encumbers exempt property." The BAP construed § 551's language that an avoided lien "is preserved for the benefit of the estate but only with respect to property of the estate" to apply to property of the estate as defined as what was held by the estate *at the commencement of proceedings. Id.* at 585–86. The BAP explained that "the fact that property was removed from the estate after a case is commenced, through exemption or some other means, does not change the fact that it was property of the estate as of the commencement of the case." *Id.* at 585. Therefore, the BAP concluded, "[g]iven that all exempt property is property of the estate as of the commencement of the case, we conclude that § 551 does not exclude exempt property from preservation. An avoided interest or lien encumbering exempt property is automatically preserved for the benefit of the estate under § 551." *Id.* at 586.

The government urges us to declare *Heintz* wrongly decided. The government requests a categorical rule that § 551 *never* applies to exempt property. It is unnecessary for us to decide this issue. As we have already explained, the Bankruptcy Court erred in overlooking the predicate question of whether § 724(a) permits avoidance of tax liens attached to exempt property. Because we hold that § 724(a) does not allow the Trustee to avoid a lien on exempt property, there is no avoided lien to which § 551's preservation power could apply. Thus, § 551 does not apply here and we need not construe the provision.

The dissent errs in stating that the majority relies on § 551 and its reference to "with respect to property of the estate" in determining that the tax penalty lien on exempt property is immune from avoidance. Dissent at ——. Our holding only addresses the predicate question of the application of § 724(a), not the scope of § 551.

In summary, we conclude that § 724(a) does not permit a trustee to avoid a tax lien secured by exempt property because such securing property is not property of the estate. Accordingly, because a trustee may not use § 724(a) to avoid the lien, the trustee does not trigger operation of § 551's automatic preservation authority.

In reaching our holding, we conclude that the Bankruptcy Court erred by overlooking the key question of first impression before us: whether a trustee may use § 724(a) to avoid a lien secured by a debtor's exempt property. The Bankruptcy Court did not analyze this question. Instead, the Bankruptcy Court appears to have assumed that the Trustee could use § 724(a) to avoid a lien on the Debtor's exempt property.[4]

Specifically, the Bankruptcy Court noted that in *In re Bolden* , 327 B.R. 657, 665 (Bankr. C. D. Cal. 2005), the "bankruptcy court refused to order the abandonment of debtor's exempt homestead where IRS penalty tax liens could be avoided for the benefit of the bankruptcy estate." But in *Bolden* the government did not dispute that the trustee could avoid a tax penalty lien on exempt property under § 724(a). Indeed, *Bolden* noted that "[i]n this case, the trustee ... is seeking, *with the cooperation of the IRS* , to avoid the penalty portion of the IRS tax liens in order to benefit unsecured creditors of the estate." 327 B.R. at 663 n.5 (emphasis added). There is no indication in the *Bolden* decision that any party challenged the propriety of the trustee's avoidance of tax penalties on exempt property; the bankruptcy court in *Bolden* was not presented with and, therefore, did not address this question.

Similarly, the Bankruptcy Court cited approvingly to *In re Gill* , 574 B.R. 709 (9th Cir. BAP 2017) for the BAP's rejection of a debtor's request for an order requiring

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the estate to abandon the debtor's homestead exemption and determination that the trustee could avoid an IRS tax lien under § 724(a) and create value for the estate by preserving the value of the tax lien through § 551 for the benefit of the estate. But, again, in *Gill* there was no dispute as to the propriety of the trustee's authority to avoid a lien under § 724(a) on exempt property, as there was evidence that the IRS consented to the avoidance, and there is no indication that the debtor challenged the avoidance. *See* 574 B.R. at 717. Thus, because the courts in *Bolden* and *Gill* were not presented with and did not decide the question of whether § 724(a) applies to a debtor's exempt property, the Bankruptcy Court's reliance on those decisions was misplaced.

Our analysis and holding here are consistent with our recent decision in *Hutchinson v. IRS (In re Hutchinson)* , 15 F.4th 1229 (9th Cir. 2021). In *Hutchinson* , the government and the trustee of the estate entered into a stipulated judgment in which the trustee "and the Government agreed that the ‘penalty portions’ of certain of ‘the IRS's liens’ against Plaintiffs’ [ ] residence ‘are avoided pursuant to 11 U.S.C. § 724(a).’ " *Id.* at 1232. The debtors asserted an entitlement to a homestead exemption of up to $100,000 in the residence under California law. *Id.* The debtors did not contest the agreement between the

[4] The Bankruptcy Court suggested that the IRS tax lien never attached to Debtor's exempt property because the IRS tax lien was simply deducted from the value that Debtor could exempt under Arizona law. This analysis was incorrect for two reasons. First, it fails to properly apply binding *federal* law making clear that an IRS tax lien attaches to all of a debtor's property interests, with no carve-out for exempt property, and that an exemption authorized under the Bankruptcy Code remains liable for tax penalty liens. *See* 26 U.S.C. § 6321 ; 11 U.S.C. § 522(c)(2)(B) ; *In re DeMarah* , 62 F.3d at 1251. Second, the Bankruptcy Court misapplied *state* law, as Arizona's homestead exemption statute does not deduct the value of tax liens from the amount that a debtor may exempt. *See* A.R.S. § 33-1101(A)(1). Indeed, the Arizona statute *does* state that a "consensual lien, including a mortgage," "shall not be subject to" the homestead exemption, but makes no such statement as to tax liens. *Id.* § 33-1104(D). Thus, the Bankruptcy Court's suggestion that the IRS tax lien never attached to the Debtor's exempt property is incorrect.

government and the trustee to avoid the IRS's tax penalty lien against the debtor's property, including the exempt property under § 724(a). Rather than contest the legality of the agreement as applied to the exempt property, the debtors sought to take advantage of the § 724(a) avoidance agreement between the government and trustee by seeking to preserve the avoided lien for the benefit of the *debtors* . *Id.* ("Plaintiffs alleged that, to the extent the liens were avoided, they should be preserved 'for the benefit of the Plaintiffs.' "). The debtors argued that they should be able to parlay the government and trustee's § 724(a) avoidance agreement into assets for themselves by using § 522(i)(2), which allows a debtor to preserve a lien avoided by a trustee under § 724(a) "for the benefit of the *debtor* to the extent that the debtor may exempt such property" under the relevant subsection. *See id.* at 1234 (citing 11 U.S.C. § 522(i)(2)) (emphasis added). The debtors contended that because the government and trustee's § 724(a) avoidance agreement concerned debtors' exempt homestead property interest, the debtors had satisfied the requirements of § 522(i)(2) and were entitled to preserve the avoided lien for the benefit of the debtors. *Id.*

We rejected the debtors' attempt to *preserve* the value of the tax lien for their own benefit, applying our holding in *DeMarah* that § 522(c)(2)(B) "makes quite clear ... that debtors cannot use exemption authority to escape tax liens." *Id.* at 1235. We further observed that " § 522(c)(2)(B) would operate, vis-à-vis a debtor, to preserve 'tax lien[s]' against otherwise exempt property *regardless* of whether the trustee had avoided them." *Id.* (emphasis and alteration in the original). Considering the clear and unambiguous language of § 522(c)(2)(B), we explained that "it would be completely contradictory to then construe § 522(i)(2) (or § 522(g), for that matter) as allowing a debtor, after a *trustee* has avoided the tax lien, to then preserve the avoided lien 'for the benefit of the *debtor* ' by claiming an exemption under § 522(g)." *Id.* (emphases in original). "Such a result—having the trustee avoid the lien only to turn over the benefits to the debtor, whose exempt property would then be free of the lien—would create precisely the kind of end-run around § 522(c)(2)(B) that we rejected in *DeMarah.* " *Id.* at 1236. We, therefore, rejected the debtors' theory that §§ 522(i)(2) or 522(g) could be used by the debtors to transform a tax lien for which

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they were responsible into an asset which they could protect for their own benefit. *Id.* ("The only way to read these provisions sensibly together is to conclude that, with respect to a tax lien covered by § 522(c)(2)(B), a debtor may not invoke § 522(i)(2) in order to override § 551's otherwise applicable rule that, after the trustee avoids a lien under § 724(a), the lien 'is preserved for the benefit of the estate.' ") (citation omitted).

We do not disturb *Hutchinson* 's careful reasoning and construction of § 522(i)(2). In *Hutchinson* , we accepted the government and the trustee's stipulated agreement that the trustee could avoid the tax lien on debtor's property under § 724(a), including the portion of the property which was exempted under California law. No party objected to the stipulated agreement and no argument was presented to us as to whether the trustee could avoid a lien on debtor's exempt property under § 724(a). Indeed, the debtors accepted the premise that § 724(a) could be used by the trustee to avoid a lien on debtors' exempt property and attempted to transform that premise into an argument that the *debtors* could preserve the avoided lien for the debtors' benefit. The parties did not present us with the question of whether § 724(a) could be used to avoid a lien on exempt property.

Thus, in *Hutchinson* we were not called upon to resolve any dispute as to the applicability of § 724(a) to the property at issue, and, abiding by the party presentation principle, we had no occasion nor any need to address the question. *See United States v. Sineneng-Smith* , —— U.S. ——, 140 S. Ct. 1575, 1579, 206 L.Ed.2d 866 (2020) ("As a general rule, our system is designed around the premise that parties represented by competent counsel know what is best for them, and are responsible for advancing the facts and argument entitling them to relief.") (cleaned up). Accordingly, nothing in our decision here conflicts

with our analysis or holding in *Hutchinson.*[5] Indeed, *Hutchinson* 's holding that "a debtor may not invoke § 522(i)(2) in order to override § 551's otherwise applicable rule that, after the trustee avoids a lien under § 724(a), the lien 'is preserved for the benefit of the estate,' " 15 F.4th at 1236, applies with full force.

B. APPLICATION

We conclude that the Trustee may not use § 724(a) to avoid the $26,771 IRS tax penalty lien on the Debtor's exempt interest in the Prescott Property and, accordingly, cannot preserve the value of the tax penalty lien for the benefit of the estate through § 551. Once the Bankruptcy Court allowed the Debtor's homestead exemption under Arizona law, the Debtor withdrew her exempted property interest from the property of the estate. Therefore, the Debtor's exempt homestead interest in the Prescott Property is no longer property of the estate and, therefore, is not property to which § 724(a) applies.

Accordingly, the Debtor is entitled to exempt up to the full $150,000 value of the homestead exemption interest permitted under the applicable version of Arizona's exemption law, A.R.S. § 33-1101(A)(1) (2004 version, effective prior to Jan. 1, 2022), after accounting for the Debtor's responsibility for her consensual

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loan, the Bank of America mortgage, *id.* § 33-1104(D). The value of the Debtor's homestead exemption is *not* subject to a deduction of the IRS tax penalty lien. However, as compelled by our holding in *DeMarah* , the Debtor takes her exempt interest in the Prescott Property subject to the IRS tax penalty lien. *See* 62 F.3d at 1252 ("We hold that Congress has denied debtors the right to remove tax liens from their otherwise exempt property. *See* 11 U.S.C. § 522(c)(2)(B). Moreover, we hold that even the penalty portion of the tax lien remains fixed on that property. We see nothing capricious or absurd about that. It simply adds to the taxpayer's incentive to render unto the government that which is its due.").

Moreover, the Bankruptcy Court's holding that permits the Trustee to avoid the IRS's tax lien on the exempt property and to apply the value of the lien for the benefit of the bankruptcy estate, while the exempt homestead of the Debtor remains encumbered by the tax lien, creates a troubling result: the Debtor is burdened twice by the same debt, resulting in a double penalty. The first penalty flows from the Bankruptcy Court's holding that the Trustee's avoidance and preservation of the tax lien on the Debtor's exempt property reduced the value of the exemption by the amount of the tax lien. The second penalty flows from the operation of 11 U.S.C. § 522(c)(2)(B) and our binding precedent that a tax lien remains attached to property which is exempted. *See In re DeMarah* , 62 F.3d at 1251 ("[I]t is pellucid that property exempted from the estate remains subject to tax liens."). In effect, the Debtor is required to pay twice on the same tax lien: first, in the reduction of value in her homestead exemption by the value of the lien (here amounting to $26,771), and then, a second time, when she is required to pay off the lien that survives and remains attached to her already reduced exempt property (for another $26,771).[6] That makes her worse off, with regard to the tax lien debt, than she was before she filed the bankruptcy petition.

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[5] In *Hutchinson*, having accepted the undisputed fact that the trustee and government entered an uncontested stipulated judgment through which the trustee avoided the tax penalty liens on the property at issue under § 724(a), we referenced *Heintz* for the notion that § 551 operated to preserve those liens avoided by stipulation for the benefit of the estate. 15 F.4th at 1234. As noted previously, we do not address *Heintz* 's interpretation of § 551 here.

[6] The Bankruptcy Court purported to resolve this double penalty by concluding the "tax lien position against the [Prescott] Property never attached to the Debtor's homestead exemption," such that "[w]hen the lien is avoided, the Trustee steps into that avoided position." The Bankruptcy Court held that the Trustee's avoidance and preservation of the tax lien extinguished the tax lien. This conclusion, however, conflicts with § 522(c)(2)(B) and our binding authority holding that a tax lien remains attached to exempt property. *See In re DeMarah* , 62 F.3d at 1251. Therefore, the Bankruptcy Court did not resolve the double penalty. *See infra* § III(A)(2).

This result cannot be what is intended by the Bankruptcy Code, which is aimed at giving the debtor a "fresh start," subject to the decision of Congress to maintain a debtor's responsibility for a tax lien. *See In re DeMarah* , 62 F.3d at 1252 (" 11 U.S.C. § 522 allows debtors to exempt stated property from the bankrupt estate so that they may have a fresh start. It also provides for the survival of tax liens on that property. 11 U.S.C. § 522(c)(2)(B). In defining fresh start, Congress took cognizance of the fact that tax liens would survive.") (quoting *In re Isom* , 901 F.2d 744, 746 (9th Cir. 1990)).

That fresh start would hardly be served by doubling the burden of the previously existing tax lien on the debtor. We are not aware of any policy rationale articulated by Congress, nor endorsed in any of our previous decisions, that supports the view that a debtor should pay *twice* on a tax penalty lien. Our holding provides that the Debtor will be subject to the IRS tax lien once—as a surviving lien on her homestead exemption. It thus vindicates the debtor's homestead exemption under Arizona law, which reduces the value available

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to exempt by the value of a mortgage, but not by the value of an IRS tax lien. *See* A.R.S. §§ 33-1101(A)(1), 33-1104(D).

It seems highly unlikely to us that our dissenting colleague's bankruptcy professor would countenance an interpretation of bankruptcy law that imposed a double penalty on the debtor. *See* Dissent at 27. That the dissent's interpretation of the statute produces such a perverse result provides powerful reason to reject that interpretation.

At the same time, our holding does not disturb the application of § 724(a) to *non-exempt* property of the estate and is consistent with our recognition that " ‘Congress could logically have wanted to allow tax penalties to be avoided if that would benefit unsecured creditors,’ while ‘eschew[ing] benefiting debtors who incurred those penalties by failing to pay their taxes.’ " *In re Hutchinson* , 15 F.4th at 1233 (quoting *In re DeMarah* , 62 F.3d at 1252). Indeed, we do not quibble with the dissent's assertion that "the asset remains estate property" when a statute "does not allow the debtor to exempt the entire property interest, but instead permits exemption of an interest in the property up to a particular dollar amount." Dissent at 33 (citing *In re Mwangi* , 764 F.3d at 1172–73). But while the trustee may certainly avoid the tax lien on non-exempt property that remains in the estate, the circumstances of this case—specifically, the fact that the mortgage on the Prescott Property renders any lien on the estate's portion of the property valueless—demarcate our holding to only the application of § 724(a) to exempt property.

IV. CONCLUSION

The Trustee may not use 11 U.S.C. § 724(a) to avoid the $26,771 IRS tax penalty lien on the Debtor's exempt interest in the Prescott Property and, therefore, cannot preserve the value of the tax penalty lien for the benefit of the estate through § 551. Accordingly, the Debtor is entitled to exempt up to the full value of the homestead exemption interest permitted under the applicable version of Arizona's exemption law, after accounting for the Debtor's responsibility for her mortgage. A.R.S. §§ 33-1101(A)(1), 33-1104(D). The value of the Debtor's homestead exemption is not subject to a deduction of the IRS tax penalty lien. However, the Debtor takes her exempt interest in the Prescott Property subject to the IRS tax penalty lien.

REVERSED and REMANDED to the District Court with instructions for further proceedings consistent with this order.

BUMATAY, Circuit Judge, dissenting:

As my bankruptcy professor once said, a bankruptcy case is like dividing a pie. *See* Elizabeth Warren, *Bankruptcy Policy* , 54 U. Chi. L. Rev. 775, 785 (1987). The pie owner promises different slices of the pie to others—sometimes in exchange for other items, sometimes as a payment for other debts. And sometimes, the pie owner overpromises—leaving not enough pie to go around. All those promised pie

must then get in line and try to claim their piece. In bankruptcy, a trustee steps in and distributes the slices in the order of priority set by law and approved by a bankruptcy judge.

The Bankruptcy Code also grants a trustee a special authority. It allows the trustee to "avoid" a federal tax penalty lien and "preserve" the lien for the benefit of the bankruptcy estate. *See* 11 U.S.C. §§ 724(a), 726, 551. That means, in divvying up the pie, the trustee may save the piece belonging to the IRS for a debtor's failure to pay taxes and hold it for others in line. This increases the amount of pie for distribution to others.

In this case, the IRS challenges the trustee's express avoidance authority. The

[53 F.4th 1176]

IRS contends that a trustee can't avoid a federal tax lien on "exempt" property. Exempt property is generally the piece of the pie that a debtor gets to keep throughout the bankruptcy. But the Bankruptcy Code creates no exception to the trustee's avoidance power for liens on exempt property. So we should have affirmed the trustee's avoidance of the IRS tax penalty lien here.

In invalidating the trustee's avoidance authority, the majority is more concerned with the Bankruptcy Code's "troubling result" than its text. Maj. Op. at 24. It lets concerns over the consequences of avoidance override the statutory text and it nullifies the trustee's avoidance power to prevent these consequences. But because our duty is to follow the text of the Bankruptcy Code no matter how the pie gets sliced, I respectfully dissent.

I.

"The plain text of the Bankruptcy Code begins and ends our analysis." *Puerto Rico v. Franklin Cal. Tax-Free Tr.* , 579 U.S. 115, 125, 136 S.Ct. 1938, 195 L.Ed.2d 298 (2016). The Bankruptcy Code is straightforward; by its ordinary meaning, a trustee may avoid an IRS tax penalty lien and preserve it for the benefit of the bankruptcy estate. *See* 11 U.S.C. §§ 724(a), 726, 551. Our precedent confirms that. *See Hutchinson v. United States* (*In re Hutchinson*), 15 F.4th 1229, 1234 (9th Cir. 2021). And nothing in the Code sets aside the trustee's avoidance authority just because the tax penalty lien attaches to exempt property.

A.

Under the Bankruptcy Code, a trustee may avoid a federal tax penalty lien in distributing the property of the estate. Section 724 of the Code provides that "[t]he trustee may avoid a lien that secures a claim of a kind specified in section 726(a)(4) of this title." 11 U.S.C. § 724. In this context, "avoid[ance]" means that the trustee may take the slice of pie reserved for a specific lienholder and distribute it to others in line. *See Retail Clerks Welfare Tr. v. McCarty* (*In re Van de Kamp's Dutch Bakeries*), 908 F.2d 517, 519 (9th Cir. 1990) (explaining the "well-established principle that a trustee who avoids an interest succeeds to the priority that interest enjoyed over competing interests"). Avoidance increases the property of the estate available to satisfy claims of unsecured creditors. *See id.* In other words, instead of a lienholder being at the front of the line, the holder must wait for a share like everyone else, which increases the amount of pie for others.

The Code then specifies the types of claims a trustee may avoid. The trustee's avoidance power applies to:

> [A]ny allowed claim, whether secured or unsecured, for any fine, penalty, or forfeiture, or for multiple, exemplary, or punitive damages, arising before the earlier of the order for relief or the appointment of a trustee, to the extent that such fine, penalty, forfeiture, or damages are not compensation for actual pecuniary loss suffered by the holder of such claim[.]

11 U.S.C. § 726(a)(4). In short, a trustee has the authority to avoid any claim for non-compensatory penalties, including a federal tax penalty lien. *See Hutchinson* , 15 F.4th at 1232 (By stipulation, "the Government agreed that the ‘penalty portions’ of certain of ‘the IRS's liens’ against ... [the] residence ‘are

avoided pursuant to 11 U.S.C. § 724(a).' "); *Gill v. Kirresh* (*In re Gill*), 574 B.R. 709, 716 (9th Cir. BAP 2017) ("Taken together, §§ 724(a) and 726(a)(4) allow a chapter 7 trustee ... to avoid a lien to the extent the lien secures the claim for a penalty, including a tax penalty.").

Next, when a trustee avoids a transfer, the transfer is automatically preserved for

[53 F.4th 1177]

the benefit of the estate. That's because under § 551 of the Code "[a]ny transfer avoided under section ... 724(a) ... is preserved for the benefit of the estate but only with respect to property of the estate." 11 U.S.C. § 551. So when a trustee avoids the penalty portions of the tax liens under § 724(a), "it follows that, under the plain language of § 551, those liens are preserved for the benefit of the estate." *Hutchinson* , 15 F.4th at 1234. Doing so expands the pie available for unsecured creditors. As we've said, "Congress created avoidances of noncompensatory penalties to protect unsecured creditors from the debtor's wrongdoing." *DeMarah v. United States* (*In re DeMarah*), 62 F.3d 1248, 1252 (9th Cir. 1995) (simplified). Avoiding the tax penalty and preserving it for the estate "benefit[s] unsecured creditors" by allowing the amount on the penalty to go to them instead of the IRS. *Id.*

So as a straightforward matter of text and precedent, the answer here is simple: a trustee may avoid a federal tax lien and preserve it for the benefit of the estate. We've already endorsed this view in *Hutchinson* , where we clearly stated: "a trustee is 'expressly authorized ... to avoid, subordinate and preserve the penalty portion of the IRS's tax lien for the benefit of the estate's unsecured creditors.' " *Id.* at 1233 (quoting *Gill* , 574 B.R. at 716).

Here, the bankruptcy court and the district court both concluded that the trustee was permitted to avoid the IRS penalty lien on Sandra Tillman's house and preserve its value for Tillman's bankruptcy estate. Based on the above authorities, we should have easily affirmed here. And as discussed below, it makes no difference that a portion of the value of Tillman's house was exempt property.

B.

Contrary to the IRS and majority's view, the trustee's authority to avoid a federal tax penalty lien isn't nullified because it encumbers exempt property. The majority incorporates § 726's reference to the distribution of the "property of the estate" to bar a trustee's avoidance authority. The IRS instead relies on § 551's limitation of preservation of liens "only with respect to property of the estate." In both cases, they insist that "exempt property" isn't "property of the estate" and so a trustee can't avoid a lien on exempt property. In the majority's view, estate property "evolve[s] over the course of bankruptcy proceedings" and a lien on exempt property somehow disappears from such property. Maj. Op. 10. No matter the supposed statutory basis for curbing a trustee's avoidance power, because a tax penalty lien on exempt property is undoubtedly "property of the estate," the IRS and majority's view is incorrect.

To understand why the majority's "evolution" idea is mistaken, some background in bankruptcy is necessary. The Supreme Court has helpfully summarized where exempt property falls into the bankruptcy scheme:

> Chapter 7 of the Bankruptcy Code gives an insolvent debtor the opportunity to discharge his debts by liquidating his assets to pay his creditors. 11 U.S.C. §§ 704(a)(1), 726, 727. The filing of a bankruptcy petition under Chapter 7 creates a bankruptcy "estate" generally comprising all of the debtor's property. § 541(a)(1). The estate is placed under the control of a trustee, who is responsible for managing liquidation of the estate's assets and distribution of the proceeds. § 704(a)(1). The Code authorizes the debtor to "exempt," however, certain kinds of property from the estate, enabling him to retain those assets post-bankruptcy.

[53 F.4th 1178]

> § 522(b)(1). Except in particular situations specified in the Code, exempt property "is not liable" for the payment of "any [prepetition] debt" or "any administrative expense." § 522(c), (k).

Law v. Siegel , 571 U.S. 415, 417–18, 134 S.Ct. 1188, 188 L.Ed.2d 146 (2014). In other words, with some statutory exceptions, exempt property is "immunized against liability for prebankruptcy debts." *Owen v. Owen* , 500 U.S. 305, 308, 111 S.Ct. 1833, 114 L.Ed.2d 350 (1991). Thus, the Court only describes exempt property as protected from prepetition debts, but not wholly removed from the bankruptcy estate.

The Code specifies what property is exempted and even allows States to set their own criteria for exemptions. 11 U.S.C. § 522(b)(3)(A), (d). Many States have set a "homestead exemption" that is more generous than under federal law. *Law* , 571 U.S. at 418, 134 S.Ct. 1188. At the time of this case, Arizona permitted a person to keep "interest in real property ... in which the person resides," up to $150,000 in value, subject to any "recorded consensual lien," such as a mortgage. Ariz. Rev. Stat. §§ 33-1101(A)(1), 33-1105(D) (2004). Thus, up to $150,000 in equity from an Arizona home is generally immune from prepetition debts.

The question then is whether a tax penalty lien on exempt property constitutes "property of the estate." The answer is easily yes. The Code defines "property of the estate," in relevant part, as consisting of "all legal or equitable interests of the debtor in property *as of the commencement of the case.* " 11 U.S.C. § 541(a)(1) (emphasis added). Defining the property of the estate in this way creates a "sharp cleavage between the prepetition and postpetition worlds with regard to estate property." Charles Jordan Tabb, Law of Bankruptcy 404 (5th ed. 2020). The Code "takes a snapshot of the debtor's assets at the moment of filing, bringing all of those assets into the estate," and then "settles the debtor's financipal affairs, assets and liabilities alike, as of th[at] time." *Id.*

Under the straightforward language of § 541(a)(1), "property of the estate" includes all property at the filing of the bankruptcy petition, including what's later claimed exempt. As the Court has clearly stated, "[a]n estate in bankruptcy consists of all the interest in property, legal and equitable, possessed by the debtor *at the time of filing* , as well as those interests recovered or recoverable through transfer and lien avoidance provisions." *Owen* , 500 U.S. at 308, 111 S.Ct. 1833 (emphasis added). So exempt property and its encumbrances must be "property of the estate"; after all, "[n]o property can be exempted (and thereby immunized) ... unless it first falls *within* the bankruptcy estate." *Id.* at 308, 111 S.Ct. 1833 (simplified). Thus, it is well-settled that "[a]ll of the debtor's property[ ] as ... defined in section 541 of the Bankruptcy Code, as of the commencement of a case ..., including property which may be claimed as exempt, becomes property of the estate." 4 Collier Bankruptcy Practice Guide ¶ 74.02[1] (1st ed. 2022).

It is a misconception to think that a lien on exempt homestead property is immediately removed from the bankruptcy estate. Rather,

> [I]f the statute permitting the debtor to claim a particular exemption does not allow the debtor to exempt the entire property interest, but instead permits exemption of an interest in the property up to a particular dollar amount, ... [then] the asset remains estate property, and the estate does not relinquish the property until it is administered in the bankruptcy, the trustee abandons the

[53 F.4th 1179]

> property, or the bankruptcy case is closed.

Mwangi v. Wells Fargo, N.A. (*In re Mwangi*), 764 F.3d 1168, 1172–73 (9th Cir. 2014) (simplified). This case provides a good example of why this so. The IRS tax penalty lien is on *all of* Tillman's house. In contrast, Arizona law only allows Tillman to exempt a *portion* of the value of the house. Thus, in no way does the homestead exemption remove the entirety of Tillman's house or its lien from the bankruptcy estate. The lien on the house always remains part of the bankruptcy estate even if a specific dollar amount

of the house's value is protected from pre-petition debts. So there's no reason to treat the lien on the exempt property as removed from the bankruptcy estate for § 551 purposes.

This too makes intuitive sense with the pie analogy. Exempt property generally means that a debtor gets to keep a small piece of the pie even after the pie is divvied up among the creditors—no matter what. The pie is "set" at the time of the bankruptcy filing. And when a slice of the pie is saved for the debtor, that piece remains *within* the pie until distribution. Contrary to the majority's view then, the size of the pie does not "evolve" during the bankruptcy proceedings based on exempt property. *See* Maj. Op. ——. Rather, exempt property only tells us what assets a debtor may "retain ... post-bankruptcy," *Law* , 571 U.S. at 417, 134 S.Ct. 1188, or which slice of pie is left for the debtor at the end of bankruptcy proceedings.

Moreover, even under the majority's "evolving" bankruptcy estate thesis, the majority doesn't explain why a lien on both *exempt* and *non -exempt* property, like the tax lien on Tillman's residence, falls out of the bankruptcy estate. If any part of Tillman's house remains non-exempt estate property, then any lien on the house necessarily remains estate property. So, under any theory of bankruptcy law, the IRS tax lien here is property of the estate.

Thus, a trustee retains authority to avoid and preserve a tax penalty lien, even when it attaches to exempt property. As we've recently acknowledged, "regardless of whether the debtor claims an exemption, any interest of the debtor in property at the commencement of the bankruptcy case is ‘property of the estate’ as that phrase is used in § 551." *Hutchinson* , 15 F.4th at 1234 (referencing the holding of *Heintz v. Carey* (*In re Heintz*), 198 B.R. 581, 585–86 (9th Cir. BAP 1996)).

Indeed, it is hard to square the majority's holding with *Hutchinson. Hutchinson* assumed—over and over—the trustee's authority to avoid and preserve a tax penalty lien on exempt property. While explaining why a *debtor* could not avoid a properly filed tax penalty lien, *Hutchinson* repeatedly contrasted the case with the *trustee* 's ability to avoid the lien under § 724(a). *See, e.g., Hutchinson* , 15 F.4th at 1233 ("We acknowledged in *DeMarah* that this reading of the code could lead to a disparity in which *trustees* might be able to avoid such liens under § 724(a), while debtors cannot.") (simplified); *id.* at 1234 ("Under our binding decision in *DeMarah* , Plaintiffs cannot invoke § 522(h) to avoid a properly filed tax lien, *even if that lien would be avoidable by the trustee under § 724(a).* ") (emphasis added). Even though the trustee's avoidance power wasn't the precise issue in *Hutchinson* , "[w]ell-reasoned dicta is the law of the circuit." *Li v. Holder* , 738 F.3d 1160, 1164 n.2 (9th Cir. 2013) (simplified).

The majority justifies the departure from precedent and statutory text based on the fear of a so-called "double penalty." *See* Maj. Op. —— – ——. The majority contends that allowing the trustee to avoid the penalty lien here would lead to the "troubling result" of penalizing Tillman twice.

[53 F.4th 1180]

Id. at ——. That's because the bankruptcy judge reduced her homestead exemption by the amount of the lien even though the IRS may still seek the value of the lien from her after bankruptcy.[7] But even if the trustee's tax penalty avoidance here creates a "double penalty," we cannot circumvent the plain text of the Bankruptcy Code or our precedent to avoid those concerns. This is an issue for Congress—not for us—to resolve.

[7] The Code appears to permit a tax lien on a debtor's exempt property to remain post-bankruptcy, which means that IRS may still collect on the penalty. *See* 11 U.S.C. § 522(c)(2)(B). But I take no position on whether the bankruptcy court was correct to deduct the amount of the tax penalty lien from Tillman's homestead exemption. That question is immaterial to the question before us, which is whether the trustee is permitted to avoid the tax lien in the first place.

II.

Because the Code and our caselaw require affirming here, I respectfully dissent.

NOTES

75 F.4th 1052

In the MATTER OF: John Felix CASTLEMAN, Sr.; Kimberly Kay Castleman, Debtors,

John Felix Castleman, Sr.; Kimberly Kay Castleman, Appellants,
v.
Dennis Lee Burman, Chapter 7 Trustee, Appellee.

No. 22-35604

United States Court of Appeals, Ninth Circuit

Argued and Submitted May 9, 2023 Seattle, Washington
Filed July 28, 2023

[75 F.4th 1054]

Appeal from the United States District Court for the Western District of Washington, John H. Chun, District Judge, Presiding, D.C. No. 2:21-cv-00829-JHC

Steven Hathaway (argued), Law Office of Steven C. Hathaway, Bellingham, Washington, for Appellants.

Peter H. Arkison (argued), Bellingham, Washington, for Appellee.

Russell D. Garrett, Jordan Ramis PC, Portland, Oregon, for Amicus Curiae National Association of Bankruptcy Trustees.

Before: Michael Daly Hawkins, Richard C. Tallman, and Sandra S. Ikuta, Circuit Judges.

Opinion by Judge Hawkins;

Dissent by Judge Tallman.

OPINION

HAWKINS, Circuit Judge:

We must decide whether post-petition, pre-conversion increases in the equity of an asset—i.e., the difference between a home's value and how much is owed on the mortgage, whether a result of market appreciation, payment of secured debt, improvements or otherwise—belong to the bankruptcy estate or to debtors who, in good faith, convert their Chapter 13 reorganization petition into a Chapter 7 liquidation.

Debtors John Felix Castleman, Sr. and Kimberly Kay Castleman (the "Castlemans") filed for Chapter 13 bankruptcy. They listed their home among their assets with a value of $500,000, a mortgage with an outstanding balance of $375,077, and a homestead exemption of $124,923. The bankruptcy court confirmed a Chapter 13 plan, but after roughly twenty months, which included a temporary job loss and deferral of mortgage payments due to the pandemic, Mr. Castleman contracted Parkinson's Disease, and the couple could no longer make their required payments. The Castlemans exercised their right to convert to Chapter 7. In the interim, their home had risen in value an estimated $200,000.[1] Dennis Burman, the Chapter 7 trustee ("Trustee"), filed a motion to sell the Castlemans' home to recover the value for creditors. The Castlemans objected and argued that the home's increased equity belongs to them and not the bankruptcy estate under 11 U.S.C. § 348(f)(1)(A).[2]

[75 F.4th 1055]

[1] In this case, it appears the increase in equity was attributable primarily, if not exclusively, to market appreciation. Due to the deferral of mortgage payments during the pandemic, the Castlemans actually owed more at the time of filing for conversion ($390,763) than they did at the time of their initial filing.

[2] Unless otherwise noted, all statutory references are to the Bankruptcy Code, 11 U.S.C. § 101 et seq.

Although courts are heavily divided on this question,[3] we conclude on de novo review, *Simpson v. Burkart (In re Simpson)*, 557 F.3d 1010, 1014 (9th Cir. 2009), that the plain language of § 348(f)(1)(A), coupled with this circuit's previous interpretation of § 541(a), compel the conclusion that any appreciation in the property value and corresponding increase in equity belongs to the estate upon conversion. We therefore affirm the decisions of the bankruptcy and district courts.

The purpose of the Bankruptcy Code is to grant a "fresh start to the honest but unfortunate debtor." *Marrama v. Citizens Bank of Mass*., 549 U.S. 365, 367, 127 S.Ct. 1105, 166 L.Ed.2d 956 (2007) (internal quotation marks and citation omitted). Individual debtors may petition for bankruptcy under Chapter 7 (liquidation) or Chapter 13 (reorganization). *Harris v. Viegelahn*, 575 U.S. 510, 513-14, 135 S.Ct. 1829, 191 L.Ed.2d 783 (2015). Chapter 13 "allows a debtor to retain his property if he proposes, and gains court confirmation of, a plan to repay his debts over a three-to-five-year period." *Id*. at 514, 135 S.Ct. 1829 (citing §§ 1306(b), 1322, 1327(b)). Chapter 13 can benefit the debtor and creditors: the former keeps his assets, and the latter "usually collect more under a Chapter 13 plan than they would have received under a Chapter 7 liquidation." *Id*.

However, most debtors fail to successfully complete a Chapter 13 repayment plan, which is why "Congress accorded debtors a nonwaivable right to convert a Chapter 13 case to one under Chapter 7 'at any time.' " *Id*. (quoting § 1307(a)). The property of this converted Chapter 7 estate is defined by § 348(f), which provides in relevant part:

> (1) Except as provided in paragraph (2), when a case under chapter 13 of this title is converted to a case under another chapter under this title-
>
> (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;**
>
> [. . .]
>
> (2) If the debtor converts a case under chapter 13 of this title to a case under another chapter under this title in bad faith, the property of the estate in the converted case shall consist of the property of the estate as of the date of conversion.

(emphasis added). The Trustee does not assert that the Castlemans converted in bad faith, and the Castlemans retained possession of the home on the date of conversion.

In interpreting the Bankruptcy Code, "the first step . . . is to determine whether the language [of a statute] has a plain and unambiguous meaning with regard to the particular dispute." *Hawkins v. Franchise Tax Bd. of Cal*., 769 F.3d 662, 666 (9th Cir. 2014). If the plain meaning is unambiguous, it controls. *Id*.; *Puerto Rico v. Franklin Cal. Tax-Free Tr*., 579 U.S. 115, 125, 136 S.Ct. 1938, 195 L.Ed.2d 298 (2016).

[75 F.4th 1056]

Section 348(f) does not define the word "property" or the phrase "property of the estate." However, "property of the estate" is a term of art which appears throughout the Bankruptcy Code. *See*, *e.g*., §§ 541, 554(a), 726(a), 1306(a); *see also* Keith M. Lundin, *Lundin On Chapter 13* § 46.1 (2023) (" 'Property of the estate' is a phrase of art that is fundamental to almost everything that happens in Chapter

[3] *Compare In re Goins*, 539 B.R. 510, 515-16 (Bankr. E.D. Va. 2015), *In re Goetz*, 647 B.R. 412, 416-17 (Bankr. W.D. Mo. 2022), *In re Peter*, 309 B.R. 792, 794-95 (Bankr. D. Or. 2004), and *Potter v. Drewes* (*In re Potter*), 228 B.R. 422, 424 (B.A.P. 8th Cir. 1999), *with In re Barrera*, 22 F.4th 1217 (10th Cir. 2022), *In re Cofer*, 625 B.R. 194, 202 (Bankr. D. Idaho 2021), *In re Hodges*, 518 B.R. 445, 451 (E.D. Tenn. 2014), and *In re Niles*, 342 B.R. 72, 75 (Bankr. D. Ariz. 2006).

13 practice."); 4 William L. Norton III, *Norton Bankruptcy Law and Practice* § 61:1 (3d ed. 2023) ("[F]or more than two centuries 'property of the estate' has become a term of art unique to bankruptcy law.").

"Statutory construction . . . is a holistic endeavor. A provision that may seem ambiguous in isolation is often clarified by the remainder of the statutory scheme." *United Sav. Ass'n of Tex. v. Timbers of Inwood Forest Assocs., Ltd.*, 484 U.S. 365, 371, 108 S.Ct. 626, 98 L.Ed.2d 740 (1988). We therefore look to the definitions of "property of the estate" set forth in other provisions of the Code itself. *See Robinson v. Shell Oil Co.*, 519 U.S. 337, 340, 117 S.Ct. 843, 136 L.Ed.2d 808 (1997) ("The plainness or ambiguity of statutory language is determined by reference to the language itself, the specific context in which that language is used, and the broader context of the statute as a whole.").

Under § 541(a)(1), filing for bankruptcy creates an estate which includes "all legal or equitable interests of the debtor in property as of the commencement of the case." The estate also includes all "[p]roceeds, product, offspring, rents, or profits of or from property of the estate, except such as are earnings from services performed by an individual debtor after the commencement of the case." § 541(a)(6).

In *In re Goins*, the court found the trustee was entitled to any post-petition appreciation in assets of the estate, explaining: "[T]he equity attributable to the post-petition appreciation of the property is not separate, after-acquired property . . . The equity is inseparable from the real estate, which was always property of the estate under Section 541(a)." 539 B.R. at 516; *see also In re Goetz*, 647 B.R. at 416 (the broad definition of "property of the estate" in § 541(a) "captures the debtor's entire ownership interest in each asset that exists on the petition date without fixing the estate's interest to the precise characteristics the asset has on that date"). Other courts have held that any post-petition increase in the property's equity is the "proceeds, product, offspring, rents or profits" of the estate's original property under § 541(a)(6), and so became part of the estate when the case commenced. *See In re Potter*, 228 B.R. at 424; *In re Peter*, 309 B.R. at 794-95.

In this circuit, we have likewise concluded that the broad scope of § 541(a), and especially § 541(a)(6), means that post-petition "appreciation [i]nures to the bankruptcy estate, not the debtor." *Schwaber v. Reed* (*In re Reed*), 940 F.2d 1317, 1323 (9th Cir. 1991). We recently re-affirmed this in *Wilson v. Rigby*, noting that when a debtor files for bankruptcy, the "proceeds, product, offspring, rents, or profits" which become part of the estate under § 541(a)(6) "include[ ] the appreciation in value of a debtor's home." 909 F.3d 306, 309 (9th Cir. 2018). The Castlemans point out that *Wilson* was originally filed as a Chapter 7 case, but the definition of property of the estate in § 541(a) applies equally to Chapter 13. There is no textual support for concluding that § 541(a) has a different meaning upon conversion from Chapter 13. As the district court in this case aptly summarized the significance of these prior Ninth Circuit decisions:

It is well settled that in a Chapter 7 case, all property that the debtor acquires

[75 F.4th 1057]

> post-petition is excluded from the estate. *See*, *e.g.*, *Harris*, 575 U.S. at 514, 135 S.Ct. 1829 (citing § 541(a)(1)). Therefore, if appreciation were a separate, after-acquired property interest, it would have to inure to the debtor. The Ninth Circuit, in finding that appreciation inures to the estate under § 541(a)(6), has necessarily found that increased equity in a pre-petition asset cannot be a separate, after-acquired property interest. This logic applies with equal force in a conversion case.

Many of the courts who have reached a different conclusion regarding post-petition changes in equity have relied on various statements or examples in the legislative history surrounding § 348(f), which was enacted to clarify whether new property acquired during the course of Chapter 13 proceedings becomes property of the converted estate (under § 348(f)(2), this occurs only if the debtor was acting in bad faith). *See*, *e.g.*, *In re Cofer*, 625 B.R. at 200-02; *In re Nichols*, 319 B.R. at 856. However, because

we conclude the language of § 348(f), when read in conjunction with the remainder of the Bankruptcy Code, is not ambiguous, we do not look to legislative history for guidance. *Robinson*, 519 U.S. at 340, 117 S.Ct. 843 ("Our inquiry must cease if the statutory language is unambiguous.").[4]

Some courts have also relied on the implicit operation of § 1327(b), which provides: "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." Under this reasoning, equity increases from the time of the initial filing up until plan confirmation would inure to the estate, then from time of confirmation until conversion would vest in the debtor, and finally upon conversion, any additional post-conversion changes would benefit the estate. *See*, *e.g.*, *In re Barrera*, 22 F.4th at 1223-24. However, we find it difficult to believe Congress envisioned this valuation and accounting process without making any explicit cross-reference to § 1327(b), and because in other instances where Congress wanted to exclude assets or certain interests of the debtor from the bankruptcy estate, it has done so with specificity. *See*, *e.g.*, § 541(a)(6) (excluding post-petition earnings by an individual in a Chapter 7 case) and § 541(b) (excluding various specific items from the estate, such as funds used to purchase a 529 education plan). If, as the dissent suggests, Congress actually intended to exclude from the revived estate any increase in equity of an estate asset that may have occurred from the time of plan confirmation to conversion, it could have amended § 348(f) further to make this result clear. As written,

[75 F.4th 1058]

§ 348(f) only clarified that newly-acquired, post-petition property would not become part of the converted estate if the debtor had been acting in good faith.

In sum, the plain language of § 348(f)(1) dictates that any property of the estate at the time of the original filing that is still in debtor's possession at the time of conversion once again becomes part of the bankruptcy estate, and our case law dictates that any change in the value of such an asset is also part of that estate. In this case, that property increased in value. In other cases, the value might decline, or the value of one asset in the estate might increase while other property depreciates in value. This is simply a happenstance of market conditions, which sometimes will benefit the debtor and sometimes benefit the estate.[5] The district court and bankruptcy court correctly concluded that the Castlemans' home (including

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[4] We recognize that some courts have found § 348(f) to be ambiguous. However, the existence of a division of judicial authority does not itself establish ambiguity in the text. *See*, *e.g.*, *Roberts v. Sea-Land Servs.*, *Inc.*, 566 U.S. 93, 132 S. Ct. 1350, 182 L.Ed.2d 341 (2012) (holding provision of Longshore and Harbor Workers' Compensation Act is unambiguous despite disagreement between Fifth, Ninth and Eleventh Circuits); *Mohamad v. Palestinian Auth.*, 566 U.S. 449, 132 S. Ct. 1702, 182 L.Ed.2d 720 (holding term used in Torture Victim Protection Act was unambiguous despite disagreement among several circuits); *Reno v. Koray*, 515 U.S. 50, 64-65, 115 S.Ct. 2021, 132 L.Ed.2d 46 (1995) ("A statute is not ambiguous for purposes of lenity merely because there is a division of judicial authority over its proper construction.") (internal quotation and citation omitted). As we have explained, even if § 348(f) in isolation might be ambiguous, when read in connection with the remainder of the bankruptcy statute as already interpreted by this circuit, its meaning becomes clear. *See United Sav. Ass'n of Tex.*, 484 U.S. at 371, 108 S.Ct. 626 ("A provision that may seem ambiguous in isolation is often clarified by the remainder of the statutory scheme.").

[5] Note that, for example, the debtor's homestead exemption is fixed as of the "snapshot" value on the date of the original filing. *See Hyman v. Plotkin (In re Hyman)*, 967 F.2d 1316, 1321 (9th Cir. 1992) ("Were we to accept the Hymans' argument that they're entitled to post-filing appreciation, we would also have to hold that a debtor is subject to post-filing depreciation, which would give debtors in falling property markets less than the [homestead exemption] guaranteed them by state law.").

any post-petition, pre-conversion increase in equity) was again part of the bankruptcy estate pursuant to § 348(f)(1) and available to the Trustee for the benefit of the creditors.[6]

AFFIRMED.[7]

TALLMAN, Circuit Judge, dissenting.

As counsel for the trustee aptly put it, John and Kimberly Castleman "tried to do good and tried to pay off their bills" by petitioning for bankruptcy under Chapter 13 and proposing a plan to repay their creditors.[8] But, unable to complete the repayment plan, they were forced into a Chapter 7 liquidation. We now must decide whether appreciation in the value of their home during Chapter 13 proceedings becomes part of the converted Chapter 7 bankruptcy estate—an issue which has confounded judges all over the country. In holding that postpetition, pre-conversion increases in equity belong to the estate, the court both creates a circuit split and effectively punishes the Castlemans for filing under Chapter 13 with the forced sale of their home. Because that outcome is not the best reading of the Bankruptcy Code or our precedents, I respectfully dissent.

I

A

Upon filing for bankruptcy, a debtor's assets are immediately transferred to a bankruptcy estate. 11 U.S.C. § 541(a). However, the debtor may exempt some property—such as an equitable interest in real property used as a residence—from the estate. *See* § 522(b)(3)(A), (d)(1). This

[75 F.4th 1059]

exemption is commonly referred to as the "homestead exemption." In 2019, Washington State allowed a maximum homestead exemption of $125,000. WASH. REV. CODE § 6.13.030 (2019). After creation of the estate, the bankruptcy court appoints a trustee to oversee it for the benefit of creditors and other interested parties. *See* 11 U.S.C. §§ 704, 1302. If, after accounting for encumbrances and exemptions, a particular asset is "of inconsequential value and benefit to the estate," a debtor may ask the court to "order the trustee to abandon" it. § 554(b).

Filing under Chapter 7 "allows a debtor to make a clean break from his financial past, but at a steep price: prompt liquidation of the debtor's assets." *Harris v. Viegelahn*, 575 U.S. 510, 513, 135 S.Ct. 1829, 191 L.Ed.2d 783 (2015). The trustee will sell the non-exempt property of the estate and distribute the proceeds to creditors. *Id*. (citing §§ 704(a)(1), 726). But the Chapter 7 estate does not include wages earned or assets acquired by the debtor after filing for bankruptcy. *Id*. at 513-14, 135 S.Ct. 1829. After liquidation, the debtor's pre-petition debts will generally be discharged. § 727(a). "Thus, while a Chapter 7 debtor must forfeit virtually all his prepetition property, he is able to make a 'fresh start' by shielding from creditors his post-petition earnings and acquisitions." *Harris*, 575 U.S. at 514, 135 S.Ct. 1829.

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[6] As noted above, in this case it appears that the increased equity was attributable to market conditions. However, the district court indicated that the debtors could file an administrative priority claim for mortgage payments they had made in accordance with the confirmation plan for the benefit of the estate pursuant to § 503(b). *See In re Peter*, 309 B.R. at 795. The resolution of any such claim is not before us at this time.

[7] The motion filed by National Association of Bankruptcy Trustees for leave to file an amicus brief [Dkt. Entry No. 17] is granted. The amicus brief filed on January 9, 2023, is deemed filed.

[8] Oral Argument at 14:07, *Castleman*, *Sr*., *v*. *Burman*, No. 22-35604 (9th Cir. May 9, 2023), https://www.youtube.com/watch?v=_TBWjDPd10k.

A Chapter 13 estate works quite differently: the debtor retains possession of all property, § 1306(b), and proposes a plan to repay creditors over a three-to-five-year period. §§ 1321-22. If the bankruptcy court confirms the plan, confirmation "vests all of the property of the estate in the debtor" unless the plan or a court order says otherwise. § 1327(b). However, "property accumulated during the repayment period becomes part of the bankruptcy estate and is used to repay creditors." *Brown v. Barclay* (*In re Brown*), 953 F.3d 617, 620 (9th Cir. 2020). The Bankruptcy Code encourages Chapter 13 filings because they can "benefit debtors and creditors alike." *Harris*, 575 U.S. at 514, 135 S.Ct. 1829. Debtors may keep assets, such as a home or car, and creditors "usually collect more under a Chapter 13 plan than they would have received under a Chapter 7 liquidation." *Id*.

When a debtor converts from Chapter 13 to Chapter 7 in good faith, the property of the converted estate is defined by § 348(f)(1)(A), which provides that the "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."[9] This statute removes a potential disincentive to Chapter 13 filings: if all assets acquired after filing of the Chapter 13 petition were available to creditors after conversion, the debtor would be "in a worse position than if the petition had been filed in Chapter 7 initially." *Brown*, 953 F.3d at 620. By limiting the converted estate to the property a debtor had at the time of the initial petition, § 348(f) "put[s] the debtor where he would have been, had he filed in Chapter 7 initially." *Id*.

B

On June 19, 2019, when the Castlemans petitioned for bankruptcy under Chapter 13, their home was worth an estimated $500,000. They claimed a homestead exemption of $124,923, which was only $77 less than the legally allowed maximum under

[75 F.4th 1060]

then-existing Washington law. The Castlemans also reported that their home was encumbered by a secured mortgage of $375,077. The bankruptcy court confirmed their Chapter 13 plan on September 25, 2019, and the Castlemans made payments under the plan for twenty months, including a mortgage payment.

On January 12, 2021, with Mr. Castleman unable to work and facing a significant loss of income, the couple moved to convert their case to Chapter 7. After conversion, the Chapter 7 trustee hired a realtor, who estimated the Castlemans' Bellingham home was worth $700,000 as of April 19, 2021. Believing the home now had value to the estate, the trustee filed a motion to sell it so that the additional equity could be distributed to creditors. The Castlemans objected, arguing that postpetition, pre-conversion increases in equity are not "property of the estate" upon conversion under § 348(f)(1)(A). This is the question that divides our panel.

II

A

The Castlemans' reading of § 348(f) is correct. In interpreting the Bankruptcy Code, we must begin with the text. *Hawkins v. Franchise Tax Bd. of Cal*., 769 F.3d 662, 666 (9th Cir. 2014). There is no debate that the phrase "property of the estate" in § 348(f) is a term of art in bankruptcy law or that the term should be defined by looking to the "broader context of the [Bankruptcy Code] as a whole." *Robinson v. Shell Oil Co*., 519 U.S. 337, 341, 117 S.Ct. 843, 136 L.Ed.2d 808 (1997). But the court errs

[9] If a debtor converts in bad faith, § 348(f)(2) makes postpetition, pre-conversion acquisitions available to creditors. Here, all agree the Castlemans converted in good faith due to a pandemic layoff and Mr. Castleman's unfortunate medical diagnosis.

in how it applies those principles here. By adopting the trustee's preferred interpretation of § 348(f), the majority sacrifices the text of the bankruptcy statutes on the altar of simplicity.

The court rightly begins by looking to § 541(a), which defines the property of the bankruptcy estate upon filing under either Chapter 7 or Chapter 13. Section 541(a)(1) declares that the estate includes "all legal or equitable interests of the debtor in property as of the commencement of the case." It also includes all "[p]roceeds, product, offspring, rents, or profits of or from property of the estate, except such as are earnings from services performed by an individual debtor after the commencement of the case." § 541(a)(6). We have already held that in a Chapter 7 case, § 541(a)(6) means that "appreciation enures to the bankruptcy estate, not the debtor." *Schwaber v. Reed* (*In re Reed*), 940 F.2d 1317, 1323 (9th Cir. 1991). This is because in Chapter 7, the "proceeds, product, offspring, rents, or profits of or from property of the estate" under § 541(a)(6) "include[ ] the appreciation in value of a debtor's home." *Wilson v. Rigby*, 909 F.3d 306, 309 (9th Cir. 2018).

The majority decides that because we have held appreciation becomes part of the estate in a Chapter 7 case, the same must be true in Chapter 13.[10] Admittedly, this is a simple resolution to an issue that has vexed bankruptcy courts across the country.[11] But simplicity cannot take precedence

[75 F.4th 1061]

over the text of the Bankruptcy Code, and if we read § 348(f) in light of the Code "as a whole"—rather than just § 541(a)—*Wilson* is not dispositive. *See Robinson*, 519 U.S. at 341, 117 S.Ct. 843. The remainder of the Bankruptcy Code clarifies that in Chapter 13 cases, "property of the estate" is defined differently. § 348(f)(1)(A).

As discussed, a Chapter 7 estate is short-lived: it sweeps in all the debtor's property upon filing and is promptly liquidated to pay creditors. § 541(a)(1); *Brown*, 953 F.3d at 620. But in Chapter 13, the debtor retains possession of all property, § 1306(b), and proposes a plan to repay creditors over a period of years. *See* §§ 1321-22. If the bankruptcy court confirms that plan, confirmation "vests all of the property of the estate *in the debtor*" unless the plan or a court order says otherwise. § 1327(b) (emphasis added).[12] Thus, upon confirmation of a Chapter 13 plan, the debtor is once again the owner of the property. *Cal. Franchise Tax Bd. v. Jones* (*In re Jones*), 420 B.R. 506, 514-15 (B.A.P. 9th Cir. 2009), *aff'd*, 657 F.3d 921, 928 (9th Cir. 2011); *see also Berkley v. Burchard* (*In re Berkley*), 613 B.R. 547, 552-53 (B.A.P. 9th Cir. 2020).

It follows that when a Chapter 13 plan has been confirmed, appreciation accrues to the debtor. In *Black v. Leavitt* (*In re Black*), our Bankruptcy Appellate Panel (BAP) considered a case where the debtor

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[10] The trustee's briefing faults the Castlemans for not claiming the increase in equity as exempt. But property which does not become part of the converted estate belongs to the debtor regardless of exemptions. *See Harris*, 575 U.S. at 521, 135 S.Ct. 1829.

[11] *Compare In re Goins*, 539 B.R. 510, 515-16 (Bankr. E.D. Va. 2015) (holding appreciation belongs to the estate), *In re Goetz*, 647 B.R. 412, 416-17 (Bankr. W.D. Mo. 2022) (same), *aff'd*, 651 B.R. 292 (B.A.P. 8th Cir. 2023), *In re Hayes*, Case No. 15-20727-MER, 2019 Bankr. LEXIS 4203, at *22, (Bankr. D. Colo. March 28, 2019) (same), *and In re Peter*, 309 B.R. 792, 794-95 (Bankr. D. Or. 2004) (same), *with In re Barrera* (*Barrera I*), 620 B.R. 645, 649-54 (Bankr. D. Colo. 2020) (holding appreciation belongs to the debtor), *aff'd*, *Barrera II*, No. BAP CO-20-003, 2020 WL 5869458 (B.A.P. 10th Cir. Oct. 2, 2020), *In re Cofer*, 625 B.R. 194, 202 (Bankr. D. Idaho 2021) (same), *In re Hodges*, 518 B.R. 445, 451 (E.D. Tenn. 2014) (same), *In re Niles*, 342 B.R. 72, 75-76 (Bankr. D. Ariz. 2006) (same), *In re Boyum*, No. 05-1044-AA, 2005 WL 2175879, at *2-3 (D. Or. Sept. 6, 2005) (same), *and In re Nichols*, 319 B.R. 854, 857 (Bankr. D. Ohio 2004) (same).

[12] No such provision or order exists in this case.

moved to sell a rental property after the bankruptcy court had confirmed a Chapter 13 plan revesting that property in the debtor. 609 B.R. 518, 521 (B.A.P. 9th Cir. 2019). The bankruptcy court ordered the debtor to turn over the proceeds of the sale to the trustee. *Id*. at 523. On appeal, the trustee argued that the proceeds and any postpetition appreciation in the property's value were part of the estate under §§ 541(a)(6) and 1306. *Id*. at 528. The BAP rejected that argument, holding that "the revesting provision of the confirmed plan means that the debtor owns the property outright and that the debtor is entitled to any postpetition appreciation." *Id*. at 529.

The Tenth Circuit reached a similar conclusion in *Rodriguez v. Barrera* (*Barrera III*), 22 F.4th 1217 (10th Cir. 2022). There, the debtors confirmed their Chapter 13 plan, sold their home, and then converted from Chapter 13 to Chapter 7 under § 348(f)(1)(A). *Id*. at 1221-22. Observing that "only proceeds 'of or from property of the estate' become property of the bankruptcy estate" under § 541(a)(6), the Tenth Circuit concluded that section is "operative only before confirmation of the Chapter 13 plan because confirmation 'vests all of the property of the estate in the debtor.' " *Id*. at 1223 (quoting § 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."[13] *Id*.

[75 F.4th 1062]

The Tenth Circuit declined to decide whether postpetition, pre-conversion appreciation would be included in the converted estate when the property has not been sold before conversion. *Id*. at 1223 n.1. But while this case does not involve a pre-conversion sale, we have already held that postpetition appreciation—like the cash proceeds from the sale in *Barrera III*—is "proceeds" of estate property under § 541(a)(6). *Wilson*, 909 F.3d at 309. Here, the underlying property is the Castlemans' home, and their Chapter 13 plan was confirmed on September 29, 2019. When that occurred, the home was no longer "property of the estate" and therefore any appreciation in its value is not "[p]roceeds . . . of or from property of the estate."[14] § 541(a)(6). I would hold, consistent with the Tenth Circuit, that postpetition, pre-conversion appreciation belongs to the Castlemans rather than the converted Chapter 7 estate. *See United States v. Anderson*, 46 F.4th 1000, 1005 (9th Cir. 2022) ("In cases requiring statutory interpretation . . . we will not create a circuit split unnecessarily.").

B

While the text of the Bankruptcy Code as a whole establishes that postpetition, pre-conversion appreciation belongs to the Castlemans, the majority's reading of § 348(f)(1)(A) is also inconsistent with

[13] The majority claims this interpretation of § 1327(b) would require a third valuation at confirmation because the trustee would be entitled to pre-confirmation appreciation. Op. at 1057-58. But the Tenth Circuit did not adopt this approach, *see Barrera III*, 22 F.4th at 1223-24, and neither should we. In most Chapter 13 cases, the debtor must propose a plan within 14 days of the petition date, *see* FED. R. BANKR. P. 3015(b), and the creditors' meeting generally occurs within 50 days of the petition date, see FED. R. BANKR. P. 2003(a). A confirmation hearing must occur within 45 days of that. 11 U.S.C. § 1324(b). Thus, for most debtors, a Chapter 13 plan will either be confirmed within a few months of the initial petition, or else the case will be dismissed or converted. A property will virtually never significantly change in value in such a short period—in fact, the realtor hired in this case estimated the 2021 value of the Castlemans' home by reviewing sales of comparable homes over a period of six months. If we followed our sister circuit's approach, all postpetition appreciation would belong to the Castlemans.

[14] The court implies this approach would mean that debtors must bear the risk of depreciation as well. Op. at 1057-58. But depreciation in a home's value would not change the amount of the debtor's homestead exemption, *see Law v. Siegel*, 571 U.S. 415, 424-25, 134 S.Ct. 1188, 188 L.Ed.2d 146 (2014), and a trustee would probably abandon any asset which depreciated such that it had no value to the estate. *See* § 554(a).

the statute's structure, object, policies, and legislative history. *See Hawkins*, 769 F.3d at 666; *Brown*, 953 F.3d at 623.

In the early 1990s, a circuit split developed on the question of what property should be included in a Chapter 7 estate upon conversion from Chapter 13. Some courts held that "upon conversion, all post-petition earnings and acquisitions became part of the new Chapter 7 estate, thus augmenting the property available for liquidation and distribution to creditors." *Harris*, 575 U.S. at 517, 135 S.Ct. 1829 (citing *Calder v. Job* (*In re Calder*), 973 F.2d 862, 865-66 (10th Cir. 1992), and *In re Lybrook*, 951 F.2d 136, 137 (7th Cir. 1991)). However, the Third Circuit had taken the opposite view in *Bobroff v. Continental Bank* (*In re Bobroff*), 766 F.2d 797, 802-03 (3d Cir. 1985), and held that a tort claim which accrued during Chapter 13 proceedings was not part of a Chapter 7 estate upon conversion and belonged to the debtor.

Congress resolved this dispute in the Bankruptcy Reform Act of 1994, which added § 348(f) to the Bankruptcy Code. *See* Pub. L. No. 103-394, § 311, 108 Stat. 4106, 4138 (1994) (prior to 2005 amendment). The House Report on the Act made it clear Congress intended to adopt the Third Circuit's view:

> This amendment overrules the holding in cases such as *Matter of Lybrook*, 951

[75 F.4th 1063]

> F.2d 136 (7th Cir. 1991) and adopts the reasoning of *In re Bobroff*, 766 F.2d 797 (3d Cir. 1985). However, it also gives the court discretion, in a case in which the debtor has abused the right to convert and converted in bad faith, to order that all property held at the time of conversion shall constitute property of the estate in the converted case.

H.R. REP. NO. 103-835, at 57 (1994), *reprinted in* 1994 U.S.C.C.A.N 3340, 3366. The report included a specific example:

> [Courts following the *Bobroff* approach] have noted that to hold otherwise would create a serious disincentive to chapter 13 filings. For example, a debtor who had $10,000 equity in a home at the beginning of the case, in a State with a $10,000 homestead exemption, would have to be counseled concerning the risk that after he or she paid off a $10,000 second mortgage in the chapter 13 case, creating $10,000 in equity, there would be a risk that the home could be lost if the case were converted to chapter 7 (which can occur involuntarily). If all of the debtor's property at the time of conversion is property of the chapter 7 estate, the trustee would sell the home, to realize the $10,000 in equity for the unsecured creditors and the debtor would lose the home.

Id. Clearly, Congress believed that home equity which accrued during Chapter 13 proceedings should not be included in the converted estate.

The example in the House Report discusses an increase in equity resulting from the paydown of a secured loan, but the court's decision today covers equity from any source and creates the same disincentive to Chapter 13 filings. When the Castlemans filed for bankruptcy, all of their home equity was exempt. Between that exemption and a secured mortgage, the home had no value to the estate. Had they filed under Chapter 7, they could have either resolved the case quickly or moved to force the trustee to abandon the property. *See* § 554(b); *Barrera I*, 620 B.R. at 655-54. Instead, the Castlemans committed themselves to a five-year Chapter 13 plan, paid creditors out of their postpetition income, and made payments on their mortgage. By the time they were forced to convert to Chapter 7, their home had appreciated in value, so the trustee sought to sell it. Allowing that sale leaves them "in a worse position than if the[ir] petition had been filed in Chapter 7 initially"—the exact situation Congress sought to prevent. *Brown*, 953 F.3d at 620.

The majority refuses to consider this history because it finds the text of the Bankruptcy Code unambiguously shows that appreciation belongs to the estate. Op. at 1056-57. I respectfully disagree. But that assertion is all the more remarkable in light of the Tenth Circuit's decision in *Barrera III*, 22 F.4th at 1223, and the majority's recognition that courts are "heavily divided" on the proper meaning of § 348(f).[15] Op. at 1054-55. Indeed, even counsel for the trustee seemed to believe that § 348(f) was ambiguous: when asked at oral argument, he admitted the statute is poorly drafted and agreed that "there is no way to reconcile" the text of § 348(f) with § 541(a).[16] To be sure, legislative history is often unhelpful as an aid to statutory

[75 F.4th 1064]

construction. *See* ANTONIN SCALIA & BRYAN A. GARNER, READING LAW 376-78 (2012). But here, it is consistent with the text of the Bankruptcy Code, directly relevant to the case at hand, and unequivocally confirms that appreciation in the value of the Castlemans' home should not become part of the converted estate.

III

Because reasonable judicial minds disagree, there is—once again—a need for Congress to clarify the operation of § 348. Though I dissent from my colleagues' reading of the statute, it is far from unfounded. Whether Congress thinks postpetition, pre-conversion appreciation of an asset in the course of Chapter 13 proceedings should or should not become part of the converted Chapter 7 estate, it should amend § 348(f) to make the answer clear. At least one scholar has already proposed amendments to § 348(f) which would resolve the dispute. *See* Lawrence Ponoroff, *Allocation of Property Appreciation: A Statutory Approach to the Judicial Dialectic*, 13 WM. & MARY BUS. L. REV. 721, 756-57 (2022). States may also wish to amend their homestead exemptions. *See* § 522(b)(3)(A). For example, while the change came too late to help the Castlemans, Washington State responded to our decision in *Wilson* by allowing debtors to exempt "[a]ny appreciation in the value of the debtor's exempt interest in the property during the bankruptcy case." *See* Act of May 12, 2021, Ch. 290 § 5, 2021 Wash. Sess. Laws 2306-07 (codified at WASH. REV. CODE § 6.13.070(2) (2022)).

In the absence of legislative action, it remains our duty to read § 348(f) and say what the law is. I have no doubt that in holding that postpetition, pre-conversion appreciation becomes part of the converted bankruptcy estate, my colleagues in the majority have discharged that duty to the best of their abilities. But in striving to do the same, I find the text, structure, and history of the statute compel the opposite conclusion. Because I would hold that the appreciation belongs to the Castlemans, I respectfully dissent.

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[15] Certainly a division of authority, standing alone, does not establish ambiguity. But other courts have identified powerful arguments for a different reading of § 348(f), and the creation of a circuit split in particular is to be "avoid[ed] if at all possible." *Anderson*, 46 F.4th at 1008. We ought to employ the full panoply of statutory interpretation tools before departing from the Tenth Circuit's approach.

[16] Oral Argument at 24:06-24:52.

108 F.4th 1195

IN RE: Monte L. MASINGALE; Rosana D. Masingale, Debtors.
John D. Munding, Chapter 7 Trustee, Appellant,
v.
Rosana D. Masingale; State of Washington, Appellees.
In re: Monte L. Masingale; Rosana D. Masingale, Debtors.

State of Washington, Appellant,
v.
Rosana D. Masingale; Gregory M. Garvin, Acting U.S. Trustee;
John D. Munding, Chapter 7 Trustee, Appellees.

No. 22-60050
No. 22-60053

United States Court of Appeals, Ninth Circuit

Argued and Submitted February 5, 2024 Portland, Oregon
Filed July 26, 2024

[108 F.4th 1196]

Appeal from the Ninth Circuit Bankruptcy Appellate Panel Faris, Lafferty III, and Brand, Bankruptcy Judges, Presiding, BAP No. 22-1016

John D. Munding (argued), Munding PS, Spokane, Washington, for Appellant.

Darren M. Digiacinto (argued), Winston & Cashatt, Spokane, Washington; Dina L. Yunker (argued), Susan Edison, and Colleen M. Melody, Assistant Attorneys General; Robert W. Ferguson, Attorney General of Washington; Office of the Attorney General, Seattle, Washington; for Appellee.

Norma L. Hammes, Gold & Hammes, San Jose, California; for Amicus Curiae National Consumer Bankruptcy Rights Center.

Christina L. Henry, Seattle Consumer Justice PS, Seattle, Washington; for Amicus Curiae Northwest Consumer Law Center.

Before: Ronald M. Gould, Daniel A. Bress, and Lucy H. Koh, Circuit Judges.

OPINION

BRESS, Circuit Judge:

Debtors may exempt from the bankruptcy estate an interest in their residence, up to a statutory limit. But in some circumstances, if a debtor attempts to exempt more than the statutory amount and no party in interest objects within thirty days of the creditors' meeting, the debtor retains an above-limit exemption, even if the debtor had no colorable basis for claiming the exemption. *See Taylor v. Freeland & Kronz*, 503 U.S. 638, 112 S.Ct. 1644, 118 L.Ed.2d 280 (1992).

In this case, the debtors stated on a bankruptcy schedule that they were exempting "100% of FMV," or fair market value, in their homestead. No party in interest objected within the 30-day period. The question is whether the debtors successfully exempted an above-limit interest, so that the statutory cap for the homestead exemption no longer applies. We hold that in the circumstances presented, the initial failure to object does not mean the debtor can exempt more than the statutory limit. Because this case began as a Chapter 11 bankruptcy, in which the debtors owed fiduciary duties to their creditors, and in light of specific and conflicting representations that the debtors made within the 30-day objection window, the debtors did not properly claim an above-limit exemption. Resultingly, no early objection to the homestead exemption was required.

[108 F.4th 1197]

The debtors' homestead exemption is limited to the statutory cap; the remaining proceeds from the sale of the home are part of the bankruptcy estate. We reverse the decision of the Bankruptcy Appellate Panel.

I

A

"When a debtor files for bankruptcy, it 'creates an estate' that includes virtually all the debtor's assets." *Harrington v. Purdue Pharma L.P.*, — U.S. —, 144 S. Ct. 2071, 2081, --- L.Ed.2d — (2024) (quoting 11 U.S.C. § 541(a)). But to help debtors get back on their feet, the Bankruptcy Code permits them to exempt interests in specified property from the estate, with debtors having the option of choosing federal exemptions or exemptions created by state law. *See* 11 U.S.C. § 522(b). The Code sets a statutory cap on the value that may be exempted for certain types of assets. *Id*. § 522(d); *see also Rousey v. Jacoway*, 544 U.S. 320, 325, 125 S.Ct. 1561, 161 L.Ed.2d 563 (2005) ("To help the debtor obtain a fresh start, the Bankruptcy Code permits him to withdraw from the estate certain interests in property, such as his car or home, up to certain values.").

The debtor "shall file a list of property that the debtor claims as exempt" under § 522(b), and, "[u]nless a party in interest objects, the property claimed as exempt on such list is exempt." 11 U.S.C. § 522(*l*). "The effect of an exemption is that the debtor's interest in the property is 'withdrawn from the estate (and hence from the creditors) for the benefit of the debtor.' " *In re Gebhart*, 621 F.3d 1206, 1210 (9th Cir. 2010) (quoting *Owen v. Owen*, 500 U.S. 305, 308, 111 S.Ct. 1833, 114 L.Ed.2d 350 (1991)).

B

In 2015, Rosana and Monte Masingale filed for Chapter 11 bankruptcy in the Eastern District of Washington. The Masingales proposed a partial liquidation of their property but emphasized that in allowing them to continue managing their businesses, they expected that a Chapter 11 plan would provide more value to creditors than a Chapter 7 total liquidation. As part of the Chapter 11 Plan, the Masingales further proposed that they would retain their home in Greenacres, Washington.

The Masingales also claimed a federal "homestead" exemption in their Greenacres residence. *See* 11 U.S.C. § 522(d)(1) (creating an exemption for "[t]he debtor's aggregate interest . . . in real property . . . that the debtor or a dependent of the debtor uses as a residence"). The value of that exemption is subject to a fixed cap of $15,000 that has been adjusted every three years since 1998 to reflect changes in the Consumer Price Index for All Urban Consumers. *See id*. §§ 104(a), 522(d)(1). In joint bankruptcy cases, as with a married couple, the value of the debtors' exemptions can be combined. *Id*. § 522(m). The parties agree that the maximum homestead exemption the Masingales could claim under federal law at the time their petition was filed was $45,950.

Schedule A of the Masingales' Chapter 11 petition listed their real property, including their home. The Masingales claimed it was worth $165,430 and encumbered by a $130,724 mortgage:

[108 F.4th 1198]

Image materials not available for display.

Exemptions are listed on Schedule C of the bankruptcy petition, *see* Fed. R. Bankr. P. 4003(a), which on the applicable form required the debtor to provide a description of the property, the law justifying the exemption, the value of the claimed exemption, and the current property value. The Masingales' Schedule C listed their homestead exemption in this manner:

Image materials not available for display.

"100% of FMV," as listed under "Value of Claimed Exemption," means "100% of Fair Market Value."

Under the Bankruptcy Rules, a party in interest (such as a trustee or creditor) has thirty days from the date of the creditors' meeting to object to the claimed homestead exemption. Fed. R. Bankr. P. 4003(b)(1). The Masingales' meeting of creditors was held on November 25, 2015. The State of Washington was a creditor in the bankruptcy.

On December 16, 2015, before the 30-day objection window closed, the Masingales filed two additional documents in the Chapter 11 proceeding that are relevant here. First, the Masingales filed a Disclosure Statement to "disclose that information deemed . . . material, important, and necessary to Creditors to arrive at a reasonably informed decision" in determining whether to accede to the Masingales' proposed Chapter 11 Plan. *See* 11 U.S.C. § 1125. Second, the Masingales filed a proposed Chapter 11 Plan. *See id*. § 1121; *see also Purdue Pharma*, 144 S. Ct. at 2081 ("Under Chapter 11, the debtor can work with its creditors to develop a reorganization plan governing the distribution of the estate's assets; it must then present that plan to the bankruptcy court and win its approval."). In these documents, the Masingales made several representations that are important to our assessment of whether the debtors claimed an above-limit homestead exemption to which parties in interest had an obligation to object within thirty days of the creditors' meeting.

Article VII of the Disclosure Statement set forth "[a] list, with values of all Debtors' property claimed exempt," with the Masingales explaining in Article VIII that the list reflected their belief that "they [were] retaining only those exemptions allowed by law." The Masingales also stated that "to the extent Debtors are retaining property exceeding their exemptions, *only as described in Article VII* supra, Debtors are paying for the right," through the payment obligations detailed in the Plan. (Emphasis added). The Masingales' list of exemptions in Article VII, which set forth

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"[t]he property to be retained, its value as listed in the Schedules . . . and [the] amount by which the property exceeds the allowable exemptions, if any," indicated that, for the Greenacres home, the Masingales were not asserting an amount above the exemption. The Disclosure Statement included the following information about their homestead exemption (under item 2), listing the "Amount by which Exemption Exceeded" as "$ 0.00":

Item	Amount by which Exemption Exceeded
1. Cash and Deposits ($1,500.00). No liens. All exempt pursuant to 11 U.S.C. § 522(d)(5) leaves	$0.00
2. Debtors' Home. Value: $165,430.00. Less lien of Class 9 ($130,724) and 10% sales cost ($16,543) leaves $18,163. All exempt pursuant to 11 U.S.C. §522(d)(1) leaves	$0.00

For other items in their list of "Property to be Retained," the Masingales' Disclosure Statement did indicate their intent to exclude amounts exceeding the allowable exemptions.

In their Chapter 11 Plan, the Masingales represented that creditors would be paid before any above-limit exemptions were permitted. Per the Plan, the Masingales' "exemptions are not allowed, to the extent they exceed the statutory limit, until full payment is made pursuant to this Plan." If the Masingales did not "make the payments proposed" in the Plan, they would claim exemptions, but "the property which exceeds allowable exemptions would be available to Creditors." The Plan also said that because some of their exempted property "does exceed th[e] amount allowable," "Debtors shall pay an amount to Creditors, which is greater than the amount by which the claimed exemptions exceed those allowable by statute," through the payments outlined in the Plan. More generally, the Plan represented that "Debtors believe the payment and distribution under this Plan will benefit and pay all Creditors in full."

No party in interest objected to the Masingales' homestead exemption before the 30-day objection window closed. In August 2017, by which point Mr. Masingale had died, the bankruptcy court entered an order confirming the Chapter 11 Plan, with immaterial modifications. Because of Mr. Masingale's passing, all future references to "Masingale" in this opinion are to Mrs. Masingale.

C

In 2018, after Masingale failed to file required financial reports, the United States Trustee moved to convert the case to a Chapter 7 liquidation. In November 2018, over a year after the original plan confirmation, the bankruptcy court granted the Chapter 7 conversion. The court subsequently appointed a Chapter 7 trustee, John Munding, to administer the case. Under the Bankruptcy Rules, no new objections to the Masingales' claimed exemptions could be filed upon conversion to Chapter 7 because the conversion had occurred over a year after the Plan had been confirmed. *See* Fed. R. Bankr. P. 1019(2)(B)(i). Thus, Munding was unable to object to the homestead exemption.

In 2021, Masingale moved to sell the homestead property and receive all the proceeds, with none of the money going to the bankruptcy estate. She claimed the property had appreciated in value and that she could sell it for over $400,000. The Trustee and the State of Washington objected

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to the sale, arguing that the home was property of the estate. Masingale withdrew the sale motion.

A month later, Masingale moved to compel the Trustee to abandon the property because, she claimed, her listing "100% of FMV" as the value of the exemption on her Schedule C made the property fully exempt, and no party in interest had objected within the 30-day period. The Trustee objected that Masingale's exemption was statutorily capped at $45,590 when her petition was filed, and that any post-petition appreciation inured to the benefit of the bankruptcy estate. The Trustee then filed a motion to sell the property.

The Bankruptcy Court for the Eastern District of Washington granted the Trustee's motion to sell and denied Masingale's motion to compel abandonment. The bankruptcy court found that Masingale was only entitled to the $45,950 statutory cap on her homestead exemption, with the remaining value belonging to the bankruptcy estate.[1] The Trustee then sold the home for $422,000 (the home had significantly appreciated in value over the years). The bankruptcy estate currently holds $357,022.94, of which $223,033.34 was derived from the sale of the Greenacres property. We are told that, to date, Masingale has not paid her creditors much of anything and the Greenacres home is the main asset that could enable some amount of payment.

D

With the Trustee ordered to hold the home's sale proceeds pending appeal, Masingale appealed to the Ninth Circuit's Bankruptcy Appellate Panel (BAP). In a published opinion, the BAP reversed the bankruptcy court and held that Masingale was entitled to all the sale proceeds on the home ($422,000), without regard for the statutory limit. *In re Masingale*, 644 B.R. 530 (B.A.P. 9th Cir. 2022).

The BAP treated the Supreme Court's decisions in *Taylor v. Freeland & Kronz*, 503 U.S. 638, 112 S.Ct. 1644, 118 L.Ed.2d 280 (1992), and *Schwab v. Reilly*, 560 U.S. 770, 130 S.Ct. 2652, 177 L.Ed.2d 234 (2010), as controlling. It reasoned that because the Masingales claimed "100% of FMV" exempt on their Schedule C, they successfully removed their home's entire fair market value from the bankruptcy estate, including post-petition appreciation, after no party in interest objected within the 30-day period. 644 B.R. at 538-44. In the BAP's view, "100% of FMV" was dispositive, as "parties must

[1] The Trustee did not argue that Masingale's exemption should be limited to $34,706, the amount of equity Masingale had in the home. The bankruptcy court accordingly concluded that "the Trustee consents to an exemption of $45,950." Appellants do not challenge this finding on appeal.

timely object to any improper exemption claim, no matter how frivolous." *Id*. at 534. Masingale was thus not limited to the amount of the statutory cap. The BAP reached this conclusion notwithstanding what it described as "the confusing and contradictory nature of the plan." *Id*. at 543 n.7.

Though it ruled for Masingale, the BAP expressed concern with debtors "[i]mproperly claiming exemptions" above the statutory cap. *Id*. at 544. According to the BAP, "[w]e do not condone the conduct of the Masingales and their counsel, and we do not mean to immunize them from all consequences for making a baseless claim of exemption," suggesting the possibility of sanctions. *Id*. The BAP further noted that "[h]ad a party in interest timely objected to the Masingales' homestead exemption that blatantly exceeded the statutory limits, the bankruptcy court probably would

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and should have sustained that objection." *Id*. at 541 n.6.

The Trustee and State timely appealed. We have jurisdiction under 28 U.S.C. § 158(d). We review the BAP's decision de novo. *Wilson v. Rigby*, 909 F.3d 306, 308 (9th Cir. 2018); *In re Padilla*, 222 F.3d 1184, 1190 (9th Cir. 2000).

II

The question we must decide is whether the failure of any party in interest to object to the Masingales' claimed homestead exemption within thirty days of the creditors' meeting means that the debtor can now exempt more than the statutory limit. If no such objection was then required to preserve the estate's ability to retain above-cap value in the home, those amounts that exceed the homestead exemption's statutory limit are instead part of the bankruptcy estate.

This issue implicates two Supreme Court cases, *Taylor v. Freeland & Kronz*, 503 U.S. 638, 112 S.Ct. 1644, 118 L.Ed.2d 280 (1992), and *Schwab v. Reilly*, 560 U.S. 770, 130 S.Ct. 2652, 177 L.Ed.2d 234 (2010). For the reasons we explain, the BAP read too much into these decisions. In our view, the Masingales did not properly claim an exemption above the statutory limit. As a result, no early objection to the claimed homestead exemption was required to preserve the estate's ability to retain above-limit value in the home.

A

We begin with an overview of *Taylor* and *Schwab*.

Taylor concerned a debtor, Emily Davis, who was pursuing an employment discrimination claim in state court against Trans World Airlines (TWA). 503 U.S. at 640, 112 S.Ct. 1644. While her discrimination claim was on appeal, Davis filed a Chapter 7 bankruptcy petition. *Id*. Her bankruptcy schedule claimed an exemption for the damages she expected to win in her employment discrimination case. *Id*. The bankruptcy schedule listed the value of the claimed exemption as "unknown." *Id*. When the creditors' meeting was held, the bankruptcy trustee, Robert Taylor, was informed that Davis might win $90,000 in the suit. *Id*. He was later told that Davis's counsel was optimistic that a $110,000 settlement could be secured. *Id*.

Believing that Davis's discrimination lawsuit would not yield a payout, the trustee did not object to Davis's claimed exemption. *Id*. at 641, 112 S.Ct. 1644. But Davis won her appeal and TWA settled with her for $110,000. *Id*. Once the trustee learned of the settlement, he filed a complaint in the bankruptcy court and claimed that the settlement proceeds were property of the estate. *Id*. The parties "agree[d] that Davis did not have a right to exempt more than a small portion of these proceeds," even though she had "claimed the full amount as exempt." *Id*. at 642, 112 S.Ct. 1644. The Supreme Court was thus faced with the issue of "whether the trustee may contest the validity of an exemption after the 30-day period if the debtor had no colorable basis for claiming the exemption." *Id*. at 639, 112 S.Ct. 1644.

Taylor held that the trustee's failure to object to the claimed exemption within the 30-day timeframe prevented the trustee from challenging the validity of the exemption. *Id*. at 642, 112 S.Ct. 1644. Because Davis had claimed the lawsuit proceeds as exempt on her schedule, § 522(*l*) "made the property exempt" once the 30-day window had passed without an objection. *Id*. at 643, 112 S.Ct. 1644. As a result, the trustee could not later "contest the exemption[,] . . . whether or not Davis had a colorable statutory basis for claiming it." *Id*. at 643-44, 112 S.Ct. 1644.

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Taylor recognized that "[d]eadlines may lead to unwelcome results, but they prompt parties to act and they produce finality." *Id*. at 644, 112 S.Ct. 1644. If the trustee "did not know the value of the potential proceeds of the lawsuit," he could have sought a hearing or asked the bankruptcy court for an extension of the objection period. *Id*. But having failed to do either, the trustee could not deprive the debtor of the exemption. *Id*. Thus, under *Taylor*, "[i]f an interested party fails to object within the time allowed, a claimed exemption will exclude the subject property from the estate even if the exemption's value exceeds what the Code permits." *Schwab*, 560 U.S. at 775-76, 130 S.Ct. 2652 (citing *Taylor*, 503 U.S. at 642-43, 112 S.Ct. 1644). The Court in *Taylor* acknowledged that this could lead debtors to claim improper exemptions but reasoned that existing protections against fraudulent claims provided some safeguards against this. *Taylor*, 503 U.S. at 644, 112 S.Ct. 1644. And, "[t]o the extent that they do not, Congress may enact" further rules to prevent it. *Id*.

Eighteen years later, in *Schwab*, the Supreme Court held that a debtor could not claim an exemption above the statutory limits, even though no objection was made within the 30-day period. The debtor, Nadejda Reilly, filed for Chapter 7 bankruptcy after her catering business failed. *Id*. at 774, 130 S.Ct. 2652. On her bankruptcy schedules, Reilly listed cooking and kitchen equipment, to which she assigned an "estimated market value" of $10,718. *Id*. at 775, 130 S.Ct. 2652. Reilly claimed two exempt interests in this equipment: a "tools of the trade" exemption of $1,850, 11 U.S.C. § 522(d)(6), and a federal miscellaneous "wildcard" exemption of $8,868, *id*. § 522(d)(5). *Schwab*, 560 U.S. at 775, 130 S.Ct. 2652. Combined, these two exemptions equaled the total "market value" Reilly listed for the equipment: $10,718. *Id*. No creditor objected to these claimed exemptions because the dollar value that Reilly assigned to each exemption fell within the monetary limits that the Code provided. *Id*. at 776, 130 S.Ct. 2652.

An appraisal later valued the equipment at approximately $17,200. *Id*. The bankruptcy trustee, William Schwab, then moved to auction the equipment, award Reilly the $10,718 she claimed as exempt, and distribute the equipment's remaining surplus value to the creditors. *Id*. Opposing the motion, Reilly argued that "by equating on Schedule C the total value of the exemptions she claimed in the equipment with the equipment's estimated market value," Reilly "had put Schwab and her creditors on notice that she intended to exempt the equipment's full value, even if that amount turned out to be more than the dollar amount she declared, and more than the Code allowed." *Id*. Relying on *Taylor*, Reilly asserted that the trustee's failure timely to object to her claimed exemption meant that she could receive the excess value from the equipment's sale. *Id*.

The Supreme Court considered whether the trustee was required to object when the debtor in her schedule of exempt property declared the value of the assets "to be an amount within the limits that the Code prescribes." *Id*. at 774, 130 S.Ct. 2652. The Court held that the trustee in these circumstances was not required to object within the 30-day window. *Id*. at 794-95, 130 S.Ct. 2652. As the Bankruptcy Code typically allows a debtor to exempt only a monetary interest "in the assets described in the category, *not* as the assets themselves," *id*. at 782, 130 S.Ct. 2652 (citing 11 U.S.C. § 522(d)), the trustee was not required to object to property claimed as exempt when the stated value of the interest "was within the limits the Code allows." *Id*.

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The Court distinguished *Taylor* based on the facial validity of the debtor's exemption in *Schwab*. "Critically . . . the debtor in *Taylor* did *not*, like the debtor here, state the value of the claimed exemption as a specific dollar amount at or below the limits the Code allows." *Id*. at 788, 130 S.Ct. 2652. Instead, "[t]he interested parties in *Taylor* agreed that this entry rendered the debtor's claimed exemption objectionable on its face." *Id*. at 789, 130 S.Ct. 2652. *Taylor* thus "concerned a trustee's obligation to object to the debtor's entry of a 'value claimed exempt' that was *not* plainly within the limits the Code allows." *Id*. But in *Schwab*, "the opposite is true. The amounts . . . *are* facially within the limits the Code prescribes and raise no warning flags that warranted an objection." *Id*. Because of this distinction, *Schwab* allowed the trustee to retain the excess sale proceeds for distribution to creditors, even though no party in interest had lodged an objection within the 30-day window. *Id*. at 789-91, 130 S.Ct. 2652.

Reilly responded that such an approach "creates perverse incentives for trustees and creditors to sleep on their rights." *Id*. at 792, 130 S.Ct. 2652. In a passage that is important for Masingale's use of the "100% of FMV" notation, the Supreme Court offered the following guidance:

> Where, as here, it is important to the debtor to exempt the full market value of the asset or the asset itself, our decision will encourage the debtor to declare the value of her claimed exemption in a manner that makes the scope of the exemption clear, for example, by listing the exempt value as "full fair market value (FMV)" or "100% of FMV." Such a declaration will encourage the trustee to object promptly to the exemption if he wishes to challenge it and preserve for the estate any value in the asset beyond relevant statutory limits. 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. If the trustee objects and the objection is sustained, the debtor will be required either to forfeit the portion of the exemption that exceeds the statutory allowance, or to revise other exemptions or arrangements with her creditors to permit the exemption. See Fed. Rule Bkrtcy. Proc. 1009(a). Either result will facilitate the expeditious and final disposition of assets, and thus enable the debtor (and the debtor's creditors) to achieve a fresh start free of the finality and clouded-title concerns Reilly describes.

Id. at 792-94, 130 S.Ct. 2652 (footnotes omitted).

In 2015, changes were made to the Schedule C form, now numbered Official Form 106C and entitled "Schedule C: The Property You Claim as Exempt." *See* U.S. Admin. Off. of the Cts., Bankr. Forms: Official Form 106C (April 2022). Under a column labeled "Amount of the exemption you claim," debtors are instructed to check only one of two boxes:

Image materials not available for display.

If debtors do choose "100% of fair market value" on Official Form 106C, that amount is limited to any applicable statutory cap—seemingly reducing the incidence of facially invalid exemptions and any corresponding need to object.

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The Advisory Committee Notes to Official Form 106C explained the relevant revisions to the form as follows:

> The form has also been changed in light of the Supreme Court's ruling in *Schwab v. Reilly*, 560 U.S. 770, 130 S.Ct. 2652, 177 L.Ed.2d 234 (2010). Entries in the "amount of the exemption you claim" column may now be listed as either a dollar limited amount or as 100% of fair market value, up to any applicable statutory limit. For example, a debtor might claim 100% of fair market value for a home covered by an exemption capped at $15,000, and that limit would be applicable. This choice would impose no dollar limit where the

> exemption is unlimited in dollar amount, such as some exemptions for health aids, certain governmental benefits, and tax-exempt retirement funds.

U.S. Admin. Off. of the Cts., Advisory Comm. on Rules of Bankr. Proc., Official Form 106C (Committee Note) at 4 (April 2022). Official Form 106C was not in place when the Masingales filed for bankruptcy, so we must consider the implications of a debtor claiming a "100% of FMV" exemption on a Schedule C without checking a box that limits the value to the applicable statutory limit.

B

We now turn back to the facts of our case and consider whether the lack of objection to the Masingales' claimed homestead exemption within the 30-day period means that Masingale is entitled to sale proceeds exceeding the statutory cap.

1

The BAP concluded that the debtor was not limited to the statutory cap because the Masingales listed "100% of FMV" for the homestead on their Schedule C. Relying on the same passage from the end of *Schwab* that we set forth in block-quote above, the BAP reasoned that by using "100% of FMV," "[t]he Masingales followed the Supreme Court's suggestion to the letter." *In re Masingale*, 644 B.R. at 540. The BAP thus treated the "100% of FMV" notation as dispositive of whether the Masingales claimed an above-limit exemption sufficient to require an objection under *Taylor*. The BAP reasoned that because "100% of FMV" "is not a dollar value" and "can only refer to the value of the entire asset," it is just as facially invalid as the "unknown" value listed in the *Taylor* schedule. *Id*. at 541. The BAP thus believed this notation required an objection within the 30-day window, just as the notation in *Taylor* did.

The State protests that the Supreme Court's discussion of "100% of FMV" at the conclusion of *Schwab* was dicta. But we agree with the BAP that this portion of *Schwab* cannot be so easily dismissed. The Supreme Court there provided explicit direction that debtors who want to "exempt the full market value of the asset" may be able to do so by "listing the exempt value as 'full fair market value (FMV)' or '100% of FMV.' " *Schwab*, 560 U.S. at 792-93, 130 S.Ct. 2652. We do not discount this clear guidance from the Supreme Court. It seems more than apparent that, in a given case, a "100% of FMV" notation, without more, could be sufficient to require an early objection to a claimed exemption.

But we need not consider the full import of a stand-alone "100% of FMV" notation on a Schedule C, and we do not do so in this case. We will assume that if all we had here was the debtors' schedules, the failure to object within thirty days of the creditors' meeting would have meant that Masingale was not limited to the homestead exemption's statutory dollar limit. Where we part ways with the BAP is on whether the Masingales' "100% of FMV"

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notation was sufficient to require an objection in this particular case.

2

This case is different from both *Taylor* and *Schwab* in that it began as a Chapter 11 proceeding (and produced a confirmed Chapter 11 plan) before later being converted to a Chapter 7 liquidation after Masingale failed to meet her Chapter 11 obligations. This case is also different than *Taylor* and *Schwab* because during the Chapter 11 proceedings—and with the goal of getting a Chapter 11 plan confirmed—the Masingales made critical representations within the 30-day objection period. As we now explain, the initial Chapter 11 posture and the Masingales' Chapter 11-related representations affect whether the "100% of FMV" notation on their Schedule C created the type of "clear" above-limit exemption or "warning flag[ ]" that required a make-it-or-lose-it objection within thirty days of the creditors' meeting. *Schwab*, 560 U.S. at 789, 130 S.Ct. 2652.

Most importantly, after submitting their Schedule C, the Masingales made several representations to their creditors within the objection period indicating that they were not claiming an above-limit homestead exemption, or that they would not be entitled to such an exemption until the creditors were paid in full. Article VII of the Masingales' Disclosure Statement specifically represented for the homestead that the "amount by which the property exceeds the allowable exemption[ ]" was "$0.00." In the section immediately following this representation, the Disclosure Statement says that the "Debtors believe they are retaining only those exemptions allowed by law," and that property retained in excess of their exemptions is "only as described in Article VII." And, unlike the Greenacres residence, for other items in their Article VII list of "Property to be Retained" the Masingales did indicate amounts by which the property exceeded the allowable exemptions.

The Masingales' proposed Chapter 11 Plan, meanwhile, represented that creditors would be paid before any exemptions above the statutory limit were permitted. The Plan stated that "Debtors' exemptions are not allowed, to the extent they exceed the statutory limit, until full payment is made pursuant to this Plan," and that if the Masingales did not follow through, "the property which exceeds allowable exemptions would be available to Creditors." The Plan also said that because some of their property claimed as exempt did "exceed that amount allowable," "Debtors shall pay an amount to Creditors, which is greater than the amount by which the claimed exemptions exceed those allowable by statute," through the payments outlined in the Plan. As the BAP explained, the Plan "acknowledged that the property would not be exempt until all creditors were paid in full." 644 B.R. at 534.

These representations were not mere legalese. They were included in the Chapter 11 documents to convince the Masingales' creditors to proceed with the Plan and so that the Masingales could, in their words, "prevent the forced sale and liquidation of [their] property" and avoid a tax liability that would be created by liquidation. These representations were made to the Masingales' creditors before the objection window on exemptions closed. And the representations were made in the context of Chapter 11 proceedings, in which the Masingales were serving as debtors-in-possession and owed attendant fiduciary obligations to their creditors. *See In re Perez*, 30 F.3d 1209, 1214 n.5 (9th Cir. 1994) (explaining that a Chapter 11 debtor in possession has "a fiduciary relationship to the estate's creditors"); *Wolf v. Weinstein*,

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372 U.S. 633, 649, 83 S.Ct. 969, 10 L.Ed.2d 33 (1963) ("[S]o long as the Debtor remains in possession, it is clear that the [debtor] bears essentially the same fiduciary obligation to the creditors as does the trustee for the Debtor out of possession."); *see also* 11 U.S.C. § 1107(a).

Under these circumstances, we do not think it correct to apply *Taylor*'s rule of decision. Even if "100% of FMV" on a Schedule C can be sufficient standing alone to demonstrate a debtor's intention to exempt the full market value of the asset, here the Masingales said more than this. Within the 30-day period, they also represented in Chapter 11 papers that, for the homestead, the "amount by which the property exceeds the allowable exemption[ ]" was "$0.00," and that creditors would be fully paid before above-limit exemptions were allowed.

The idea expressed at the end of *Schwab* was that a notation like "100% of FMV" would make the "scope of the exemption clear." *Schwab*, 560 U.S. at 792, 130 S.Ct. 2652. Given the Masingales' representations on their Disclosure Statement and Chapter 11 Plan—representations that were heightened in significance by the Masingales' fiduciary duties as debtors-in-possession—"100% of FMV" on this Schedule C does not have nearly the clarity the Supreme Court was suggesting it could. *See* 4 Collier Bankr. Practice Guide § 74.09 (2024) (explaining that the 30-day deadline "may not apply if the debtor fails to make clear an intent to exempt the debtor's full interest in property"). The "100% of FMV" notation here thus does not carry the same "warning flag" connotation that it otherwise might in a case lacking these features. *See Schwab*, 560 U.S. at 789, 130 S.Ct. 2652; *Masingale*, 644 B.R. at 543 n.7 (describing "the confusing and contradictory nature of the [Masingales'] plan").

Masingale argues that notwithstanding the originating Chapter 11 context of this case, Supreme Court precedent requires that we focus only on the Schedule C to the exclusion of all other representations the Masingales made within the relevant time period. In particular, Masingale relies on *Schwab*'s statement that the trustee there "was entitled to evaluate the propriety of the claimed exemptions based on three, and only three, entries" on a Schedule C. 560 U.S. at 785, 130 S.Ct. 2652.

This misunderstands *Schwab*. *Schwab* made this statement in the context of a facially *valid* Schedule C, holding that the trustee was not required to rummage through other documents to determine if the debtor had a different intent to claim an exemption greater than the within-limit amounts listed on the schedule. *Id*. at 779, 130 S.Ct. 2652 (rejecting this "complicated view of the trustee's statutory obligation"). Here, Masingale claims that the exemption was facially *in*valid under *Taylor*, which, if true, could require a prompt objection. That parties in interest are "entitled to rely upon" a facially *valid* Schedule C, *see Schwab*, 560 U.S. at 794, 130 S.Ct. 2652, does not mean they are required to act upon a potentially invalid one regardless of whatever else the debtor may say about the exemption within the 30-day period. *Schwab* did not address that issue.

Schwab, moreover, did not originate in Chapter 11, and we have found no case involving this question that did. We can assume that the Masingales' homestead exemption on Schedule C was facially invalid standing alone. But at least in the context of a case that begins in Chapter 11, when debtors make later contradictory statements within the 30-day period—including that they will pay their creditors in full before taking any above-limit exemptions—those later statements can inform whether the debtor sufficiently claimed an

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objection-warranting exemption. Here again, *Schwab* does not dictate otherwise.

Taylor provides further support for looking outside the Schedule C in this case. *Taylor* noted that the debtor and her counsel there had informed the trustee that the "unknown" value of the debtor's pending lawsuit might bear fruit, but that the trustee did not believe them. 503 U.S. at 640-41, 112 S.Ct. 1644. The Court faulted the trustee for failing to rely on that information, which was information outside of the bankruptcy schedule on which the exemption was claimed. *Id*. at 644, 112 S.Ct. 1644 ("In this case, despite what respondents repeatedly told him, Taylor did not object to the claimed exemption."). *Taylor* is thus consistent with the notion that when it comes to facially invalid exemptions on a bankruptcy schedule, courts may consider other representations made within the 30-day period in considering whether "100% of FMV" reflects a *Taylor*-style exemption and, relatedly, the need for a party in interest to object.

Masingale further argues that even with the potentially contradictory representations in the Chapter 11 documents and the Chapter 11 genesis of this case, the better rule is still that whenever a debtor says "100% of FMV" on a bankruptcy schedule, an objection within the 30-day period is required, no matter what. The Masingales' objection-forcing rule is not without some merit. Given the Supreme Court's guidance in *Schwab* about the use of "100% of FMV" when a debtor wants to exempt the full market value of an asset, *see Schwab*, 560 U.S. at 792-93, 130 S.Ct. 2652, parties in interest take a considerable risk when they do not levy an early objection to a "100% of FMV" exemption on a schedule, when that notation is unaccompanied by any other information.

At the same time, at least in the context of a bankruptcy proceeding that originated in Chapter 11, in which debtors owe fiduciary duties to their creditors, precedent does not suggest that we should endorse what happened here: debtors saying one thing about the homestead exemption on their Schedule C, saying something contradictory in their Disclosure Statement and proposed Chapter 11 Plan, and then capitalizing on the lack of any objection within the 30-day period. Masingale has no explanation for the statements in the debtors' Disclosure Statement and Chapter 11 Plan except to say that we should ignore them.

Indeed, at oral argument, Masingale all but confirmed her position that, after noting "100% of FMV" on her Schedule C—and regardless of what other contrary representations she might later make within the 30-day period—if creditors did not object to the exemption they were out of luck. Even though *Taylor* allows debtors to secure above-limit exemptions that lack any colorable basis, 503 U.S. at 643-44, 112 S.Ct. 1644, it does not justify the far greater inequity of Masingale's proposed rule. Though *Taylor* will control in many situations, *Schwab* itself did not enforce *Taylor*'s objection deadline. Neither *Taylor* nor *Schwab* require the extreme result that Masingale seeks.

Masingale's proposed rule is not costless, either, as it would require objections anytime "100% of FMV" is used. A rule that incentivizes protective objections en masse can reduce the efficiency of the bankruptcy process. *See In re Biondo*, 59 F.4th 811, 814-16 (6th Cir. 2023) ("[P]rophylactic objections can slow down bankruptcies and waste judicial resources."). Indeed, it is such a regime—in which debtors use "100% of FMV" to claim an invalid exemption, only to be met with a valid objection—that new Official Form 106C is

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seemingly trying to avoid by directing debtors to choose "100% of fair market value, *up to any applicable statutory limit*." U.S. Admin. Off. of the Cts., Bankr. Forms: Official Form 106C (April 2022) (emphasis added); *see also* Peter Spero, Fraudulent Transfers, Prebankruptcy Planning and Exemptions § 12:35 (September 2023) (noting that "[n]ew Bankruptcy Form Schedule C may have eliminated much of the controversy" post-*Schwab*).[2]

* * *

The debtors did not properly claim an above-limit homestead exemption that required an objection within the 30-day period. Masingale's homestead exemption is thus limited to the amount of the statutory cap. The remaining proceeds of the sale of the Greenacres residence are property of the estate. The decision of the BAP is reversed, and this matter is remanded for proceedings consistent with this opinion.

REVERSED AND REMANDED.

[2] After concluding that Masingale was not limited to the federal cap for homestead exemptions, the BAP further held that Masingale was entitled to the fair market value of the home at the time it was sold, not its fair market value at the time the bankruptcy petition was filed. The State and Trustee argue that even if the statutory cap does not apply, under the "snapshot rule" Masingale was only entitled to the fair market value of the homestead as of the date of the petition, with any post-petition appreciation inuring to the estate. We do not reach this issue of post-petition appreciation in light of our conclusion that Masingale may receive only the statutorily capped amount.

NOTES

https://wcrer.be.uw.edu/wp-content/uploads/sites/60/2025/02/Washington-Housing-Market-Report-4th-Quarter-2024.pdf

NOTES

Quantum Leap! Oregon's Increased Homestead Exemption Makes up for Lost Ground

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On April 4, 2024, the Family Financial Protection Act (Senate Bill 1595, Or. Leg. Assembly, 2024) was signed into law in Oregon making significant changes to the exemption amounts for a homestead and a vehicle, allowing up to $2,500 in financial accounts as not subject to garnishment no matter the source of these funds, increasing the amount of wages as exempt from garnishment, and adding changes to the Oregon Unlawful Debt Collection Practices Act (commonly known as "OUDCPA") at ORS 646.639 and 646.641. While SB 1595 takes effect immediately upon passage and the changes made to the OUDCPA are effective immediately, the sections regarding exemptions and garnishment do not become operative until January 1, 2025. Family Financial Protection Act, SB 1595, 2024 Or. Reg. Sess., Section 32(1), Section 33.

Significant New Changes: Vehicle, Homestead, $2,500 as "base protected amount"

1. Vehicle Exemption

For a vehicle under ORS 18.345(1)(d), the exemption amount has been raised from $3,000 to $10,000 per vehicle per person. However, there is a new section carved out as ORS 18.345(1)(d)(B) for debts arising from child support or spousal support obligations or a money award judgment that includes restitution whereby the vehicle exemption is limited to $3,000. The carve out of this separate exemption amount for debts arising from child support, spousal support, and restitution judgments was a political compromise as the Oregon Department of Justice had raised concerns about the higher exemption amounts limiting recovery of these type of debts.

2. Homestead Exemption

For a homestead under ORS 18.395, the exemption amount has been raised from $40,000 to $150,000 for a single person and from $50,000 to $300,000 for a couple in a household. However, there is a new section carved out as ORS 18.395(1)(b) for debts arising from child support or spousal support obligations or a money award judgment that includes restitution whereby the homestead exemption is limited to $40,000 for a single person and $50,000 for a couple. Also, under new ORS 18.395(1)(d), the homestead exemption of $150,000/$300,000 is tied to the Consumer Price Index and will be adjusted on July 1st of each year beginning July 1, 2025. If the debt arises from child support, spousal support, or restitution, then the exemption amount of $40,000/$50,000 will not be adjusted for inflation.

3. $2,500 not subject to garnishment – new ORS 18.785

Former ORS 18.784 ("Certain financial institution deposits not subject to garnishment") has been repealed. SB 1595, Section 31. These provisions, regarding federal benefit payments, certain retirement benefits exempt from execution, public assistance, unemployment compensation, black lung benefits, and workers' compensation payments, are now part of ORS 18.785 at ORS 18.785(2)(a)-(i). This provides for a significantly expanded ORS 18.785.

An important new provision is now found at ORS 18.785 that allows for up to $2,500 protected from garnishment at any financial institution. "Financial institution" is further defined under ORS 18.600(7) and ORS 706.008 as an "insured institution" or credit union. Under new ORS 18.785(2)(j), the $2,500 is referred to as the "base protected account balance" and it is the combined total of all monies held in the judgment debtor's accounts at one financial institution. Any amount that is in excess of the initial base protected amount of $2,500 is potentially subject to garnishment. Further analysis of any excess amount above $2,500 and whether it is subject to garnishment would be required by the financial institution. Also, under new ORS 18.785(2)(j), the base protected amount of $2,500 is tied to the Consumer Price Index and will be adjusted on July 1st of each year beginning July 1, 2025.

The new $2,500 amount not subject to garnishment applies to each financial institution that holds funds of the judgment debtor. Practically speaking, it would be difficult for different financial institutions to coordinate with each other whether the $2,500 limit has been reached at one institution and to apply the $2,500 limit across multiple financial institutions. Therefore, hypothetically, a judgment debtor could protect up to $2,500 at multiple different financial institutions: for example, up to $2,500 in accounts at Bank A, up to $2,500 in accounts at Bank B, and up to $2,500 in accounts at Bank C. Certainly, the aim of the new law was to protect the judgment debtor's accounts from being totally wiped out through garnishment.

The $2,500 "base protected account balance" does not appear to be applicable for bankruptcy purposes as an exemption that can be used on Schedule C: Exemptions. In other words, the $2,500 does not appear to be an additional "wildcard" exemption that could potentially be added to the existing $400 "wildcard" exemption under ORS 18.345(1)(p) which is used for an exemption in any personal property. The $2,500 amount is not included at ORS 18.345 with the other personal property exemptions that are typically used for bankruptcy purposes. It is included at the new and greatly expanded ORS 18.785 which is the section involving garnishment review by a financial institution. The $2,500 is referred to as "the amount not subject to garnishment" at new ORS 18.785(1)(a) which contains a definition of the "base protected account balance" but then it is later referred to as an "exempted amount" at new ORS 18.785(2)(j). The new NOTICE OF EXEMPT PROPERTY AND INSTRUCTIONS FOR CHALLENGE TO GARNISHMENT form also refers to the $2,500 as "exempt under ORS 18.785".

It is not entirely clear but it does not appear that the $2,500 protected from garnishment was also intended to be a new exemption used for bankruptcy filing purposes on Schedule C. Odds are it is not an additional exemption available to a debtor in bankruptcy but this could be an issue to be eventually determined by the Court.

ORS 18.348 involving the exemption of certain funds in a financial institution that are reasonably identifiable and traceable, such as the exemption of 75% of reasonably identifiable wages under ORS 18.385(1), up to a limit of $7,500, has not changed in any respect and is available to a debtor filing bankruptcy. ORS 18.348(2) and ORS.18.385(1) in combination allow the debtor to protect 75% of amounts in an account that can be reasonable traced to wages up to $7,500.

Perhaps one way to test whether ORS 18.785 is available as an exemption in bankruptcy is to protect up to $7,500 of funds in an account that are traceable to wages using ORS 18.348(2) and ORS 18.385(1) and try to exempt any remaining amount in the financial institution up to the amount of $2,500 using ORS 18.785?

4. Changes to Garnishment Forms Required

Due to the significant changes to the state exemptions, the garnishment forms, such as the instruction forms, wage exemption calculation form, and notice of exempt property all must be updated, and likely have been by the time of this writing, to include the new amounts and other changes.

Impact on judgment lien avoidance inside and outside of bankruptcy

As far as the impact of the increased exemption amounts affecting judgment lien avoidance or discharge of judgment liens against the homestead, under 11 U.S.C. § 522(f) of the Bankruptcy Code the Debtor is required to use the exemption amounts that existed at the time the petition for bankruptcy was filed in avoiding a judgment lien through bankruptcy. However, under ORS 18.412, which is the alternative for discharging a judgment lien against a homestead under the state statutes, the applicable homestead exemption would be the homestead exemption that is in existence at the time that the Notice of Intent to Discharge Judgment Lien is filed in the county court records where the judgment was entered. This is not a change from current law but the increased homestead exemption of $150,000 or $300,000 may impact the ability of creditors to collect sale proceeds for a judgment lien that was entered before the increased homestead exemption took effect. *See also State ex rel. Nilsen v. Jones*, 577 P.2d 541,588 (Or. Ct. App. 1978) (homestead exemption increased from $7,500 to $12,000; held that $12,000 exemption allowed under state process to discharge judgment lien).

HYPOTHETICALS

Questions will inevitably arise as to how the new law regarding exemptions will be implemented in practice, especially given the separate exemption amounts that are dependent on the nature of the debt.

Hypothetical #1 – Debtor's Car

Scenario A: Debtor owns a vehicle valued at $20,000 and there is a $10,000 lien against the vehicle. He owes a judgment for back child support of $4,000. Can the child support creditor execute on the vehicle subject to the first lien?

Answer: Outside of bankruptcy, the child support creditor could execute on the vehicle subject to the first lien on the vehicle. The vehicle could be sold for $20,000, costs of sale paid of 15%, or $3,000, vehicle lien paid off of $10,000, exemption paid to Debtor of $3,000, leaving child support paid of $4,000.

Scenario B: What if the vehicle is worth only $17,000 and the first lien is $10,000? Costs of sale is $2,550 (15%) leaving $4,450 and the Debtor claims a $3,000 exemption. Can the child support creditor levy on the vehicle now if their proceeds are only $1,450 after the exemption of $3,000 and payoff of the first lien as long as the Debtor gets his exemption of $3,000?

Answer: Yes.

Scenario C: What if the vehicle is worth $20,000, a lien of $10,000, and is co-owned with a girlfriend who doesn't owe back child support but she is also on the debt to the first lien creditor?

Answer: In this case, if the co-owned vehicle were sold for $20,000, costs of sale were paid of $3,000 (15%), but charged against the Debtor's ½ of the equity the scenario would look like this:

Value of $20,000 minus the joint lien of $10,000 - leaves equity of $10,000 - ½ of the equity being the Debtor's equity, or $5,000. The costs of sale of $3,000 would be charged against the Debtor's ½ of the equity. Debtor's equity of $5,000 minus the costs of sale of $3,000 minus Debtor's available exemption of $3,000 leaves no equity available for the child support creditor. Therefore, the sale could not occur.

Hypothetical #2 – Real Estate

Scenario A: Husband and wife file a Chapter 13 bankruptcy case. Husband is 80 years old. His wife is 50 and in perfect health. Their plan provides for a small monthly payment and sale of the house in four years. The parties married 15 years ago before there was any past due spousal support. The parties hold the property as tenants by

the entirety. Their property is worth $400,000 and there is a lien of $90,000 owed to the first mortgage holder. Husband owes a past due spousal support obligation to an ex-spouse of $75,000 and she has a judgment against the real property. Debtor's wife owes no spousal support or child support. If they file bankruptcy jointly, are they limited to the $50,000 homestead exemption because of the husband's spousal support obligation or is husband limited to $40,000 and wife can assert an exemption of $150,000, for a combined homestead exemption of $190,000?

Answer: The combined homestead exemption should be $190,000. Or should it? In this scenario, under a Chapter 13 bankruptcy case the equity would be determined by the value of the real property of $400,000 minus the mortgage lien of $90,000 minus costs of sale of 7%, or $28,000 - leaving equity of $282,000 - ½ of the equity being $141,000 each for husband and wife if you split the equity down the middle. Husband's equity of $141,000 would be reduced by the judgment lien against him of $75,000 leaving $66,000 of equity against which his homestead exemption of $40,000 would apply and leaving $26,000 for other creditors in the Chapter 13 case. Or should husband get to keep all $66,000 because the judgment lien where the spousal support is owed would be completely paid off in the Chapter 13 case through a sale and wouldn't be an unsecured creditor in the case? If a child support or spousal support judgment is paid in full on a secured basis in a Chapter 13 case, should Debtor be allowed some remaining amount of the homestead exemption as to other creditors?

Scenario B: Same facts but husband has been diagnosed with pancreatic cancer and is expected to die within the next six months. His wife doesn't file. If the husband is near death, is his equity in the property worth anything close to his homestead exemption whether the exemption is $40,000 or $150,000? Could husband claim his ½ interest is worth substantially less than $66,000 (the equity if you split it down the middle and the spousal support judgment is paid off) Could he assert a homestead exemption of $150,000? Could he assert that a trustee in Chapter 7 couldn't prevail on a 363 motion to force the sale of the property if his wife doesn't file with him thereby reducing the value of his interest in the homestead?

Answer: Husband could argue that his tenants by the entirety interest is worth far less than ½ of the equity for multiple reasons, i.e. his entirety interest provides only a possessory interest and with death imminent and likely before his spouse, (and his interest soon to evaporate upon his death free and clear of any liens against the property) what is that entirety interest worth? Further, in Chapter 7 (the relevant inquiry in determining the liquidation value in Chapter13), could a trustee force the sale of the entire property and prevail on a 363 motion?

Scenario C: Same facts except husband also owes a second ex-wife he was married to in Utah $3,000 of past due child support which has never been reduced to judgment in Oregon. Does this limit husband's homestead exemption to $40,000?

Answer: Most likely yes. Even if husband can successfully argue that the lien owed for the spousal support judgment is secured and that his plan proposes a sale and payment

in full of that spousal support judgment, a second child support obligation that isn't reduced to judgment, would likely reduce his homestead exemption to $40,000. New ORS 18.395(1)(b) states that the homestead is limited to $40,000/$50,000 if there is a "liability in any form" that is arising out of a child support or spousal support obligation." The fact that a child support obligation from another state is not reduced to a judgment in Oregon should still prevent the Debtor from claiming the higher exemption amount. Query: Would a savvy Debtor's lawyer approach the ex-wife with the child support judgment prior to filing and offer to stipulate to judgment before filing thereby putting the second ex-wife in the same position to be paid upon sale or simply find a way for the Debtor to pay her before he files? Would it matter if the judgment were entered or payment was made within 90 days of filing the case?

In summary, now that the new exemptions have been in effect since January 1, 2025, it will take some time for the legal questions that may need resolution to come before the Bankruptcy Court.

O.R.S. § 18.345

18.345. Property against which writ may be levied; selected exemptions

(1) All property of a judgment debtor, including franchises, or rights or interest in the judgment debtor's property, is liable to an execution, except as provided in this section and in other statutes granting exemptions from execution. The following property of the judgment debtor, or rights or interest in the property, except as provided in ORS 18.305, is exempt from execution:

(a) Books, pictures and musical instruments to the value of $600.

(b) Wearing apparel, jewelry and other personal items to the value of $1,800.

(c) The tools, implements, apparatus, team, harness or library, necessary to enable the judgment debtor to carry on the trade, occupation or profession by which the judgment debtor habitually earns a living, to the value of $5,000.

(d) (A) A vehicle, including an automobile, truck, trailer, truck and trailer or other motor vehicle, to the value of $10,000; or

(B) If the judgment debtor owes a debt that arises out of a child support or spousal support obligation or a money award judgment that includes restitution, a vehicle, including an automobile, truck, trailer, truck and trailer or other motor vehicle, to the value of $3,000.

(e) Domestic animals and poultry kept for family use, to the total value of $1,000 and food sufficient to support such animals and poultry for 60 days.

(f) Household goods, furniture, radios, a television set and utensils all to the total value of $3,000, if the judgment debtor holds the property primarily for the personal, family or household use of the judgment debtor; provisions actually provided for family use and necessary for the support of a householder and family for 60 days and also 60 days' supply of fuel.

(g) All property of the state or any county or incorporated city therein, or of any other public or municipal corporation of like character.

(h) All professionally prescribed health aids for the judgment debtor or a dependent of the judgment debtor.

(i) Spousal support, child support, or separate maintenance to the extent reasonably necessary for the support of the judgment debtor and any dependent of the judgment debtor.

(j) The judgment debtor's right to receive, or property that is traceable to, an award under any crime victim reparation law.

(k) The judgment debtor's right to receive, or property that is traceable to, a payment or payments, not to exceed a total of $10,000, on account of personal bodily injury of the judgment debtor or an individual of whom the judgment debtor is a dependent.

(l) The judgment debtor's right to receive, or property that is traceable to, a payment in compensation of loss of future earnings of the judgment debtor or an individual of whom the judgment debtor is or was a dependent, to the extent reasonably necessary for the support of the judgment debtor and any dependent of the judgment debtor.

(m) Veterans' benefits and loans.

(n) The judgment debtor's right to receive an earned income tax credit under the federal tax laws and any moneys that are traceable to a payment of an earned income tax credit under the federal tax laws.

(o) The judgment debtor's right to the assets held in, or right to receive payments under, a medical savings account or health savings account authorized under section 220 or 223 of the Internal Revenue Code.

(p) The judgment debtor's interest, not to exceed $400 in value, in any personal property. However, this exemption may not be used to increase the amount of any other exemption.

(q) The judgment debtor's right to receive a tax credit under ORS 315.273, and any moneys that are traceable to a payment of a tax credit under ORS 315.273.

(2) If the property claimed by the judgment debtor as exempt is adjudicated by the court out of which the execution issued to be of a value in excess of that allowed by the appropriate paragraph of subsection (1) of this section, the officer seizing the property shall proceed to sell such property. Out of the proceeds of such sale, the officer shall deduct costs of sale and shall pay to the judgment debtor an amount equivalent to the value declared to be exempt by any of the paragraphs of subsection (1) of this section and shall apply the balance of the proceeds of sale on the execution. A sale may not be made under such execution unless the highest bid made exceeds the appropriate exemption claimed and allowed plus costs of sale. If no bid is received in excess of the value allowed by the appropriate paragraph of subsection (1) of this section, the costs of sale shall be borne by the judgment creditor.

(3) If two or more members of a household are joint judgment debtors, each judgment debtor shall be entitled to claim the exemptions in subsection (1)(a), (b), (c), (d) and (p) of this section in the same or different properties. The exemptions provided by subsection (1)(a), (b), (c), (d), (j), (k) and (p) of this section, when claimed for jointly owned property, may be combined at the option of the judgment debtors.

(4) Notwithstanding any other provision of law except ORS 657.855, if a writ of garnishment or other execution is issued to collect past due support as defined in ORS 18.600, 50 percent of unemployment compensation benefits, workers' compensation benefits and other benefits paid to the judgment debtor by the United States, by the state or by a political subdivision of the state are exempt. The exemption related to unemployment compensation benefits provided by this subsection is subject to ORS 657.855. The exemption provided by this subsection applies without regard to whether the payment is made on a periodic basis or in a lump sum, including any lump sum payable pursuant to a settlement or judgment. Notwithstanding subsection (1)(k) of this section, if a payment is made under a settlement or judgment on account of personal bodily injury and the garnishment or other execution is issued to collect past due support as defined in ORS 18.600, the lesser of 50 percent of the payment or $7,500 is exempt.

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Current through laws of the 2024 Regular Session of the 82nd Legislative Assembly, which convened February 5, 2024 and adjourned sine die March 9, 2024, in effect January 1, 2025.

O.R.S. § 18.348

18.348. Certain accounts; limitations

(1) Funds that are exempt from execution under ORS 18.358, 18.385, 178.345, 238.445, 344.580, 407.595, 411.760, 414.095, 655.530, 656.234, 657.855 and 748.207 remain exempt when deposited in an account in a financial institution as long as the exempt funds are reasonably identifiable.

(2) Subsection (1) of this section does not apply to any accumulation of funds greater than $7,500.

(3) All funds that are exempt under federal law remain exempt when deposited in an account in a financial institution as long as the exempt funds are reasonably identifiable.

(4) The application of subsections (1) and (3) of this section is not affected by the commingling of exempt and nonexempt funds in an account. For the purpose of identifying exempt funds in an account, first in, first out accounting principles shall be used.

(5) The provisions of this section do not affect the duties of a garnishee with respect to amounts in accounts that are not subject to garnishment under ORS 18.785.

Current through laws of the 2024 Regular Session of the 82nd Legislative Assembly, which convened February 5, 2024 and adjourned sine die March 9, 2024, in effect January 1, 2025.

O.R.S. § 18.385

18.385. Wage exemption; waiver; discharge of employee for garnishment prohibited

(1) Except as provided in this section, 75 percent of the disposable earnings of an individual are exempt from execution.

(2) Except as provided in subsection (6) of this section, the disposable earnings of an individual are exempt from execution to the extent that payment under a garnishment would result in net disposable earnings for an individual of less than the following amounts:

(a) For any period of one week or less:
(A) For wages payable before January 1, 2025, $254.
(B) For wages payable on or after January 1, 2025, and before July 1, 2025, $305.
(C) For wages payable on or after July 1, 2025, and before July 1, 2026, $338.
(D) For wages payable on or after July 1, 2026, and before July 1, 2027, $400.
(E) For wages payable on or after July 1, 2027, the minimum wage specified in ORS 653.025 (1), multiplied by 30.

(b) For any two-week period:
(A) For wages payable before January 1, 2025, $509.
(B) For wages payable on or after January 1, 2025, and before July 1, 2025, $611.
(C) For wages payable on or after July 1, 2025, and before July 1, 2026, $675.
(D) For wages payable on or after July 1, 2026, and before July 1, 2027, $832.
(E) For wages payable on or after July 1, 2027, the minimum wage specified in ORS 653.025 (1), multiplied by 60.

(c) For any half-month period:
(A) For wages payable before January 1, 2025, $545.
(B) For wages payable on or after January 1, 2025, and before July 1, 2025, $655.
(C) For wages payable on or after July 1, 2025, and before July 1, 2026, $737.
(D) For wages payable on or after July 1, 2026, and before July 1, 2027, $912.
(E) For wages payable on or after July 1, 2027, the minimum wage specified in ORS 653.025 (1), multiplied by 65.

(d) For any one-month period:
(A) For wages payable before January 1, 2025, $1,090.
(B) For wages payable on or after January 1, 2025, and before July 1, 2025, $1,309.
(C) For wages payable on or after July 1, 2025, and before July 1, 2026, $1,458.
(D) For wages payable on or after July 1, 2026, and before July 1, 2027, $1,792.
(E) For wages payable on or after July 1, 2027, the minimum wage specified in ORS 653.025 (1), multiplied by 130.

(e) For any other period longer than one week:

(A) The following amount multiplied by that fraction produced by dividing the number of days for which the earnings are paid by seven, rounded to the nearest dollar:
(i) For wages payable before January 1, 2025, $254.

(ii) For wages payable on or after January 1, 2025, and before July 1, 2025, $305.
(iii) For wages payable on or after July 1, 2025, and before July 1, 2026, $338.
(iv) For wages payable on or after July 1, 2026, and before July 1, 2027, $400.

(B) For wages payable on or after July 1, 2027, the minimum wage specified in ORS 653.025 (1), multiplied by 30 and multiplied again by that fraction produced by dividing the number of days for which the earnings are paid by seven. The amount calculated under this sub-paragraph must be rounded to the nearest dollar.

(3) Beginning in 2027, the State Court Administrator shall calculate the exemption amounts specified in subsection (2) of this section each year on or before July 1 and shall publish the results of the calculations on the Judicial Department website. In making the calculations, the State Court Administrator shall round to the nearest dollar. The adjusted exemption amounts become effective on July 1 of the year in which the State Court Administrator makes the calculation.

(4) If an individual is paid for a period shorter than one week:

(a) The exemption calculated under subsection (2) of this section may not exceed the following amount for any one-week period:
(A) For wages payable before January 1, 2025, $254.
(B) For wages payable on or after January 1, 2025, and before July 1, 2025, $305.
(C) For wages payable on or after July 1, 2025, and before July 1, 2026, $338.
(D) For wages payable on or after July 1, 2026, and before July 1, 2027, $400.
(E) For wages payable on or after July 1, 2027, the minimum wage specified in ORS 653.025 (1), multiplied by 30.

(b) The exemption calculated under subsection (6) of this section may not exceed $254.

(5) An employer shall deduct from the amount of disposable earnings determined to be nonexempt under subsections (1), (2) and (4) of this section any amounts withheld from the individual's earnings for the same period of time under an order issued pursuant to ORS 25.378 or 419B.408 or ORS chapter 110. The employer shall make payment under a garnishment only of those amounts remaining after the deduction is made.

(6) If a writ of garnishment includes or is attached to a notice from a state or federal child support agency, or includes or is attached to an attestation that a debt arises out of a child support or spousal support obligation or a money award judgment that includes restitution, the individual's disposable earnings are exempt only to the extent that payment under a garnishment would result in net disposable earnings for an individual of less than the following amounts:
(a) $254 for any period of one week or less;
(b) $509 for any two-week period;
(c) $545 for any half-month period;
(d) $1,090 for any one-month period; and
(e) For any other period longer than one week, $254 multiplied by that fraction produced by dividing the number of days for which the earnings are paid by seven. The amount calculated under this paragraph must be rounded to the nearest dollar.

(7) Subsections (1) to (6) of this section do not apply to:

(a) Any order of a court of bankruptcy.

(b) Any debt due for federal tax.

(8) Subsections (2) to (6) of this section do not apply to any debt due for state tax. Subsection (1) of this section does not apply to a debt due for state tax if a state agency issues a special notice of garnishment under ORS 18.855 (6).

(9) A court may not make, execute or enforce any order or process in violation of this section.

(10) Any waiver by an individual of the provisions of this section is void.

(11) An employer may not discharge any individual because the individual has had earnings garnished.

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Current through laws of the 2024 Regular Session of the 82nd Legislative Assembly, which convened February 5, 2024 and adjourned sine die March 9, 2024, in effect January 1, 2025.

O.R.S. § 18.395

18.395. Homestead

(1)(a) Except as provided in paragraph (b) of this subsection, a homestead is exempt from sale on execution, from the lien of every judgment and from liability in any form for the debts of the owner to the amount in value of $150,000, except as otherwise provided by law. The exemption is effective without the necessity of a claim thereof by the judgment debtor. When two or more members of a household are judgment debtors whose interests in the homestead are subject to sale on execution, the lien of a judgment or liability in any form, their combined exemptions under this section shall not exceed $300,000.

(b) A homestead is exempt from sale on execution, from the lien of every judgment and from liability in any form for the debts of the owner arising out of a child support or spousal support obligation or a money award judgment that includes restitution to the amount in value of $40,000, except as otherwise provided by law. The exemption is effective without the necessity of a claim thereof by the judgment debtor. When two or more members of a household are judgment debtors whose interests in the homestead are subject to sale on execution, the lien of a judgment or liability in any form, their combined exemptions under this section shall not exceed $50,000.

(c) To qualify for the exemption under paragraph (a) or (b) of this subsection, the homestead must be the actual abode of and occupied by the owner, or the owner's spouse, parent or child, but the exemption shall not be impaired by:

(A) Temporary removal or temporary absence with the intention to reoccupy the same as a homestead;

(B) Removal or absence from the property; or

(C) The sale of the property.

(d)(A) The State Court Administrator shall index the amounts identified as exempt from execution under paragraph (a) of this subsection each year on or before July 1 to reflect increases or decreases in the cost of living for the previous calendar year, based on changes in the Consumer Price Index for All Urban Consumers, West Region (All Items), as published by the Bureau of Labor Statistics of the United States Department of Labor or a successor agency. The State Court Administrator shall publish the adjusted exemption limitations on the Judicial Department website. In adjusting the amounts, the State Court Administrator shall round to the nearest $100, but shall use unrounded adjusted amounts to calculate the amounts of the exemptions during the succeeding year. The new amounts become effective on July 1 of the year in which the State Court Administrator makes the adjustment.

(B) The indexing described in subparagraph (A) of this paragraph does not apply to the amount of any exemption specified for a debt that arises out of a child support or spousal support obligation or a money award judgment that includes restitution.

(2) The exemption extends to the proceeds derived from selling the homestead in the amount that is applicable under subsection (1)(a) or (b) of this section, if the proceeds are held for a period not exceeding one year and held with the intention to procure another homestead therewith.

(3) The exemption period under subsection (1)(c)(B) and (C) of this section is one year from the removal, absence or sale, whichever occurs first.

(4) When the owner of a homestead has been granted a discharge in bankruptcy or has conveyed the homestead property, the value thereof, for the purpose of determining a leviable interest in excess of the homestead exemption, is the value on the date of the petition in bankruptcy, whether the value is determined in the bankruptcy proceedings or not, or on the date the conveyance becomes effective, whichever occurs first. However, with respect to judgments not discharged in the bankruptcy, or entered against the owner after discharge, the value on the effective date of conveyance is controlling.

(5) Except as provided in subsection (7) of this section, a homestead that is the actual abode of and occupied by the judgment debtor, or that is the actual abode of and occupied by a spouse, dependent parent or dependent child of the judgment debtor, may not be sold on execution to satisfy a judgment that at the time of entry does not exceed $3,000. However, such judgment remains a lien upon the real property, and the property may be sold on execution:

(a) At any time after the sale of the property by the judgment debtor; and

(b) At any time after the property is no longer the actual abode of and occupied by the judgment debtor or the spouse, dependent parent or dependent child of the judgment debtor.

(6) The limitation on execution sales imposed by subsection (5) of this section is not impaired by temporary removal or temporary absence with the intention to reoccupy the property as a homestead.

(7) The limitation on execution sales imposed by subsection (5) of this section does not apply if two or more judgments are owing to a single judgment creditor and the total amount owing to the judgment creditor, determined by adding the amount of each individual judgment as of the date the judgment was entered, is greater than $3,000.

(8) Upon the issuance of an order authorizing sale as required by ORS 18.904, and in conformance with subsection (5) of this section, the sheriff may proceed to sell the property. If the homestead exemption applies, the sheriff shall pay the homestead owner out of the proceeds the applicable amount under subsection (1)(a) or (b) of this section and apply the balance of the proceeds on the execution. However, the sheriff may not sell the homestead if an exemption applies unless the sum bid for the homestead exceeds the sum of the costs of the sale and the amount of the applicable exemption. If no such bid is received, the petitioner shall bear the expense of the sale.

(9) The homestead exemption provided by this section applies to a purchaser's interest under a land sale contract, as defined by ORS 18.960.

(10) The homestead exemption provided by this section applies to:

(a) A floating home, as defined by ORS 830.700; and

(b) A manufactured dwelling, as defined by ORS 446.003.

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O.R.S. § 18.785

18.785. Garnishment account review; definitions; debts arising out of child support or spousal support obligations; writ of garnishment including Notice of Right to Garnish Federal Benefits

(1) As used in this section:

(a) "Base protected account balance" means the amount not subject to garnishment calculated under subsection (2)(j) of this section.
(b) "Garnishment account review" means the review conducted under subsection (2)(c) of this section.
(c) "Lookback period" means the period described in subsection (2)(d) of this section.

(2)(a)(A) If a financial institution receives a writ of garnishment for a debtor that has an account with the financial institution, the financial institution shall first determine whether the writ of garnishment includes a Notice of Right to Garnish Federal Benefits from the United States Government or from a state child support enforcement agency, as provided in 31 C.F.R. part 212, or is attached to an attestation that a debt arises out of a child support or spousal support obligation or a judgment that contains a money award of restitution.

(B) If the writ of garnishment includes a Notice of Right to Garnish Federal Benefits, the provisions of paragraphs (b) to (j) of this subsection do not apply to the writ of garnishment and the financial institution shall proceed on the garnishment as provided in ORS 18.600 to 18.850.

(C) If the writ of garnishment is attached to an attestation that a debt arises out of a child support or spousal support obligation or a judgment that contains a money award of restitution, paragraphs (b), (c)(A), (e), (f) and (j) of this subsection do not apply to the writ of garnishment and the financial institution shall conduct a garnishment account review as provided in paragraphs (c)(B), (d) and (g) to (i) of this subsection.

(D) If the writ of garnishment does not include a Notice of Right to Garnish Federal Benefits or is not attached to an attestation that a debt arises out of a child support or spousal support obligation or a judgment that contains a money award of restitution, the financial institution shall immediately calculate and establish the total amount in all of the accounts the debtor has with the financial institution.

(b) If the total of the amounts in all of a debtor's accounts with the financial institution does not exceed the base protected account balance, the financial institution shall provide full customary access to the amounts in the debtor's accounts with the financial institution.

(c) If a financial institution finds under paragraph (a)(C) of this subsection that the total amount in all of a debtor's accounts with the financial institution exceeds the base protected account balance, the financial institution shall:

(A) Provide full customary access to the base protected account balance; and

(B) Conduct a garnishment account review to determine whether one or more of the payments listed in this subparagraph were made to any of the debtor's accounts by direct deposit or electronic transfer within the lookback period. The payments a financial institution must look for during a garnishment account review are:

(i) Federal benefit payments;

(ii) Payments from a public or private retirement plan as defined in ORS 18.358;

(iii) Public assistance payments or medical assistance, as defined in ORS 414.025, from the State of Oregon or an agency of the State of Oregon;

(iv) Unemployment compensation payments from the State of Oregon or an agency of the State of Oregon;

(v) Black lung benefits payments from the United States Department of Labor; and

(vi) Workers' compensation payments from a workers' compensation carrier.

(d) The lookback period during which a financial institution must determine whether a payment listed in paragraph (c) of this subsection was made to a debtor's account with the financial institution:

(A) Ends on the day before the day on which the financial institution conducts the garnishment account review; and

(B) Begins:
(i) On the day in the second calendar month preceding the month in which the financial institution conducts the garnishment account review that has the same number as the day on which the lookback period ends; or
(ii) On the last day of the second calendar month preceding the month in which the financial institution conducts the garnishment account review, if the day described in sub-subparagraph (i) of this subparagraph does not exist.

(e)(A) If a financial institution determines after conducting a garnishment account review that a payment listed in paragraph (c)(B) of this subsection was made by direct deposit or electronic transfer to an account the debtor has with the financial institution within the lookback period, the financial institution shall provide the debtor with full customary access to the sum of the following amounts, which are not subject to garnishment:

(i) The base protected account balance; and

(ii) The amount by which the sum of all payments listed in paragraph (c) of this subsection that were made by direct deposit or electronic transfer to the debtor's accounts with the financial institution within the lookback period exceeds the base protected account balance.

(B) The amounts in subparagraph (A) of this paragraph are calculated as of the effective date and time of the garnishment, but before the financial institution conducts the garnishment account review, and are not affected by withdrawals of funds by the debtor after the effective date and time of the garnishment.

(f) A financial institution that conducts a garnishment account review under paragraph (c) of this subsection shall proceed to deliver to the garnishor under ORS 18.600 to 18.850 any amount that exceeds an amount not subject to garnishment described in paragraph (e) of this subsection.

(g) If the writ of garnishment is attached to an attestation that a debt arises out of a child support or spousal support obligation or a judgment that contains a money award of restitution, the financial institution shall conduct a garnishment account review and provide the debtor with full customary access to all payments listed in paragraph (c)(B) of this subsection that were made by direct deposit or electronic transfer to an account the debtor has with the financial institution within the lookback period.

(h) A financial institution shall perform a garnishment account review only one time for a specific garnishment. If the same writ of garnishment is served on a financial institution more than once, the financial institution may not perform a garnishment account review or take any other action relating to the garnishment based on the second and any subsequent service of the writ of garnishment.

(i) The provisions of this subsection do not affect a debtor's ability to claim any exemption that otherwise is available to the debtor under law for any amounts in an account in a financial institution.

(j) The initial base protected account balance is the combined total of $2,500 in all of a debtor's accounts in the financial institution. The State Court Administrator shall index the base protected account balance amount each year on or before July 1 to reflect increases or decreases in the cost of living for the previous calendar year, based on changes in the Consumer Price Index for All Urban Consumers, West Region (All Items), as published by the Bureau of Labor Statistics of the United States Department of Labor or a successor agency. The State Court Administrator shall publish the adjusted exemption on the Judicial Department website. In adjusting the exempted amount, the State Court Administrator shall round to the nearest $100, but shall use the unrounded adjusted amount to calculate the exempted amount for the succeeding year. The new exempted amount becomes effective on July 1 of the year in which the State Court Administrator makes the adjustment and becomes the amount that the State Court Administrator must adjust in the succeeding year.

(3) A financial institution that conducts the garnishment account review described in subsection (2)(c) of this section shall, within three business days after conducting the garnishment account review, notify the debtor, or a fiduciary that administers the debtor's accounts and receives communications on behalf of the debtor, of the financial institution's actions. The financial institution shall provide the notice in substantially the form specified in ORS 18.847 and must send the notice to the debtor or fiduciary separately, not as part of any communications unrelated to the garnishment that the financial institution provides to the debtor or fiduciary.

(4) A financial institution must perform the calculations described in subsection (2)(c) of this section for each of the debtor's accounts with the financial institution, but may issue a single notice under subsection (3) of this section for multiple accounts of the same account holder.

(5) Issuing a notice under subsection (3) of this section does not constitute giving legal advice. A financial institution is not obligated to provide legal advice by reason of issuing a notice under subsection (3) of this section.

(6) The provisions of subsection (2)(c), (d), (e) and (f) of this section apply only to payments that a financial institution can identify, from information the payer transmits to the financial institution, as one of the types of payments listed in subsection (2)(c)(B) of this section.

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Current through laws of the 2024 Regular Session of the 82nd Legislative Assembly, which convened February 5, 2024 and adjourned sine die March 9, 2024, in effect January 1, 2025.

NOTES

Chapter 9

Merchant Cash Advances and Bankruptcy Reorganization

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NOTES

Merchant Cash Advances and Bankruptcy Reorganization

Christopher N. Coyle[1]

1. The Merchant Cash Advance Transaction

Merchant Cash Advance ("MCA") transactions remain a popular financial vehicle for small and medium sized businesses. In part by design, MCA transactions exist in the space between a traditional loan and a traditional factoring agreement. As a recent financial development, MCA transactions remain highly uncertain, to both the advantage and disadvantage of participants.

In a traditional loan, the business (the "Debtor") borrows a sum of money from a financial institution (the "Lender"); the Debtor repays the loan at a stated interest rate on a contractual repayment schedule. For example, the Debtor borrows $100,000 to be repaid over five years at 8% interest; the Debtor makes monthly payments of $2,027.64, repaying a total of $121,658.39. The concept of lending reaches to time immemorial; the Babylonian Code of Hammurabi defined silver prices and regulated interest on silver loans.

In a traditional factoring agreement, the business (the "Seller") sells its existing, unpaid account receivables to a third party (the "Factor") in exchange for the purchase price (typically discounted by 5%-30%). The Factor then collects the account receivable, with the Factor's profit being the difference between the collections and the amount paid to the Seller. Factoring agreements have existed for thousands of years: the Babylonian Code of Hammurabi also covered trade practices of merchant's agents guaranties of trade credits (the earliest recorded form of factoring).

Of course, as the parties apportion the financial risks, these transactions become more complicated. From the traditional loan side, the Lender may take a security interest in the Debtor's assets, including account receivables; this security interest extends to account receivables created after the origination of the loan. Likewise, the loan may be a line of credit, with the maximum determined by the amount of eligible collateral (borrowing base). Similarly, factoring agreements include a discount rate, holdbacks, and interest expense/factor's fees; in addition, the sale may be with recourse (obligated the Seller to re-purchase unpaid invoices).

The typical MCA transaction mixes aspects of these archetypes. Nominally, the MCA "buys" $120,000 of future receivables for $100,000 from the business (the "Debtor"). The Debtor then makes a frequent periodic payment (typically daily or every business day) based on a percentage of average daily receipts. At a five percent (5%) daily repayment of average receipts of $1,500, the transaction would be complete in 80 days; this results in an effective interest rate in excess of 90%. Unlike a factoring agreement, the MCA transaction is acquiring an interest in an asset which does not exist, and the MCA company collects from the debtor, not the debtor's customer.

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[1] The author thanks and is indebted to the prior work done by Andrew J. Geppart and Douglas R Ricks in their 2022 materials "*Schrodinger's Contract: Merchant Cash Advance Claims in Bankruptcy*". Materials used with permission.

MCA transactions, unlike loans or factoring, cannot trace its lineage to ancient Mesopotamia, but rather to a 1997 patent by Barbara Johnson and the company she (and others) founded, AdvanceMe (later becoming CAN Capital). Court decisions, regulations, and market competition have driven rapid changes to MCA transactions.

The traditional factoring agreement is a "true sale" as the risk of non-payment on the invoice is borne solely by the factoring company. As additional terms are added, including recourse obligations, the risk is shifted and the transaction moves further away from the pure "true sale" point on the spectrum. Eventually, however, the transaction shift beyond factoring agreements and enters a legal grey area between factoring and loan agreements; in determining whether a particular transaction is a true sale or a secured loan agreement, courts look at the following factors, none of which is independently determinative:

(1) whether the buyer has a right of recourse against the seller;
(2) whether the seller continues to service the accounts and commingles receipts with its operating funds;
(3) whether there was an independent investigation by the buyer of the account debtor;
(4) whether the seller has a right to excess collections;
(5) whether the seller retains an option to repurchase accounts;
(6) whether the buyer can unilaterally alter the pricing terms;
(7) whether the seller has the absolute power to alter or compromise the terms of the underlying asset; and
(8) the language of the agreement and the conduct of the parties.

CapCall, LLC v. Foster (In re Shoot the Moon, LLC), 635 B.R. 797, 813 (Bankr. D. Mont. 2021) (citing Robert D. Aicher & William J. Fellerhoff, *Characterization of a Transfer of Receivables as a Sale or a Secured Loan Upon Bankruptcy of the Transferor*, 65 AM. BANKR. L.J. 181, 186-94 (1991)).

MCA transactions have typically been governed by New York law, with state courts determining various MCA lender's agreements to be true sales. New York courts applied a non-exhaustive three-factor test to guide the loan-or-sale analysis: "(1) whether there is a reconciliation provision in the agreement; (2) whether the agreement has a finite term; and (3) whether there is any recourse should the merchant declare bankruptcy*." US Info. Grp. LLC v. EBF Holdings, LLC*, No. 22-CV-6661-PKC, 2023 WL 6198803, at *6 (S.D.N.Y. Sept. 22, 2023). Based on these factors, MCA agreements have incorporated a number of provisions that appear to allocate more risk to the MCA company in an effort to make these transactions appear more like true sales than disguised loans (e.g., reconciliation provisions, limited or no personal guaranty, no fixed repayment term, no repayment required if Seller business stops operating under certain circumstances, and Seller repurchase options).

Recently, however, application of these factors has transitioned from a mechanical approach (which favored MCA agreement drafting as a true sale) to focus on the ultimate consideration of transfer of risk:

> Ultimately, the three guides reduce to one overarching principle. The hallmark of a loan is that the lender is absolutely entitled to repayment under all circumstances, or put otherwise, the principal sum is repayable absolutely. The root of the analysis involves the question of whether the transaction involves a transfer of risk.

Lateral Recovery, LLC v. Cap. Merch. Servs., LLC, 632 F. Supp. 3d 402, 452 (S.D.N.Y. 2022) (cleaned up). *See also AKF, Inc. v. Haven Transportation Bus. Sols., Inc.*, No. 1:22-CV-269, 2024 WL 2941746, at *6 (N.D.N.Y. June 11, 2024) (outlining the three-factor test "to analyze who bears the ultimate risk"); *Haymount Urgent Care PC v. GoFund Advance, LLC*, 609 F. Supp. 3d 237, 248 (S.D.N.Y. 2022) (rejecting mechanical application of LG Funding and finding that "the LG Funding decision's holding is ultimately about whether the transaction represented a real transfer of risk").

In applying New York law to MCA transactions, this application has shifted from a mechanical approach to a focus on transfer of risk. For example, in *Fleetwood Services*, the court determined that an MCA agreement was, in fact, a usurious loan, focusing on the absolute right to repayment rather an the existence of a reconciliation provision (which the lender had ignored, both with respect to the particular borrower and in general) or the lack of a finite repayment period; the *Fleetwood* court concluded that the factors serve "only [as] a guide to analysis" rather than being determinative of the outcome. *Fleetwood Servs., LLC v. Ram Cap. Funding, LLC*, No. 20-CV-5120, 2022 WL 1997207, at *9 (S.D.N.Y. June 6, 2022).

This, in turn, has driven changes to MCA agreements: transitions from discretionary to mandatory reconciliations and removal of defaults based on bankruptcy. In addition (in many instances), security agreements have tightened to be limited to only future receivables rather than a blanket security interest. And, with respect to personal guaranties, those guaranties no longer guarantee payment in the event of a default. *See*, e.g., *Guttman v. EBF Holdings, LLC*, No. 21-17305, 2025 WL 1012721 (Bankr. Md. March 31, 2025).

2. Property of the Estate

The Bankruptcy Code defines property of the estate in expansive terms. 11 U.S.C. § 541(a). However, the property interests of the parties are generally a question of state law. A determination that the MCA transaction was a true sale would divest the estate of any interest in the future receivables, thereby foreclosing their collection and use to pay estate expenses and claims. Particularly in a reorganization case, where generation and collection of receivables would be expected to fund operations and a plan, the entire trajectory of the case may depend on resolution of this initial question.

If the transaction is categorized as a true sale, then the estate does not have a valuable source of funding for paying the continued operation of the debtor's business or for the claims of other creditors. If the transaction is categorized as a loan, the MCA company may still have a claim; however, the MCA company is interested in avoiding challenges to the industry's efforts to have these transactions categorized as sales.

Whether future receives are property of the estate also implicates the automatic stay. Actions prohibited by the automatic stay include (A) acts to obtain possession of property of the estate, (B) acts to enforce a lien against property of the estate, and (C) acts to recover a claim against the debtor. 11 U.S.C. § 362(a)(3), (4), and (6). In a true sale, the receivables are not property of the estate and the automatic stay does not implicate collection, by the MCA company, of the receivables. Conversely, if the transaction is determined to be a loan, an MCA company would quickly find itself in trouble by continuing, post-petition, to seize what would be property of the estate.

3. Proofs of Claim

Whether an MCA company, which has not yet collected the full amount under the applicable documents, has a claim is another critical question that depends, in part, on the true sale or loan categorization.

Consistent with the industry's efforts to be categorized as a true sale transaction, many MCA transaction agreements include language to excuse performance in the event that the business ceases operations, including through bankruptcy. For example:

> [MCA company] hereby acknowledges and agrees that Seller shall be excused from performing its obligations under this Agreement in the event Seller's business ceases operations exclusively do the following reasons (each a "Valid Excuse"): . . . ***bankruptcy of Seller***.

Such a provision is critical to the analysis of transfer of risk and the ultimate question of whether the obligation is "repayable absolutely." Such provisions demonstrate that the risks of loss of the debtor ceasing operations are borne by the MCA company and that no recourse exists. Typically, the filing of a bankruptcy proceeding by the seller/debtor is not a listed event of default because courts have held that requiring payment in full upon a bankruptcy filing means the Buyer has recourse against the Seller, which is more consistent with a loan than a sale. *Ideas v. 999 Restaurant Corp.*, 2007 WL 3234747 (N.Y. Sup. Ct. Oct. 12, 2007). Accordingly, where the underlying documents do, in fact, transfer the risk of loss to the MCA company "buyer", the MCA company would not have a claim against the debtor in a bankruptcy case where the business had ceased operations, such as a chapter 7 debtor.

However, MCA company proof of claim filings remain common. The end of payments to the MCA company is alleged to be a default under the underlying documents. Whether described as a "liquidated damages" provision or an "acceleration" provision, the MCA company asserts a claim for the unpaid portion of the purchased receivables, damages for breach, and sometimes even interest. For example:

> **Seller's Obligations Upon Default.** Upon occurrence of an Event of Default due to Seller's breach of its obligations under this Agreement, Seller shall immediately deliver to Buyer the entire unpaid portion of the Purchased Amount. In addition, Seller shall also pay to Buyer, as additional damages, any reasonable expenses incurred by Buyer in connection with recovering the monies due to

> Buyer from Seller pursuant to this Agreement, including without limitation the costs of retaining collection firms and reasonable attorneys' fees and disbursements (collectively, "Reasonable Damages"). The parties agree that Buyer shall not be required to itemize or prove its Reasonable Damages and that the fair value of the Reasonable Damages shall be calculated as thirty-three percent (33%) of the undelivered portion of the Purchased Amount of Future Receipts upon the occurrence of an event of default, or seventy-five hundred dollars ($7,500.00), whichever is greater. The entire sum due to Buyer pursuant to this Section shall bear simple interest from the Default Payment Date until is paid in full, at the rate of 9.00% per annum (and such interest shall accrue daily).

The triggering event of default is rarely the filing of the bankruptcy itself (see above). Rather, the MCA company will allege either a breach of a representation by the debtor (e.g. a representation that the debtor was not contemplating a bankruptcy filing) or a breach of another provision (e.g. an obligation to facilitate continued daily ACH withdrawals).

In addition, many MCA agreements include a grant of a security interest in collateral to secure the obligations under the MCA agreement. While a limited "backup" security interest in accounts reveivables being sold is consistent with the true sale, a security interest that extends beyond those accounts receivesables is more consistent with a transaction in the nature of a loan. *Compare In re R&J Pizza Corp.*, 2014 WL 12973408, at *3-4 (Bankr. E.D.N.Y. Oct. 14, 2014) with *Shoot the Moon, LLC*, 635 B.R. at 814-16. In addition to analysis of the associated security agreement with respect to the transfer of the risk of loss, the usual analysis of the validity of the security interest (collateral description, perfection, et al.) remains applicable.

4. Cash Collateral

Assuming the debtor's receivables are deemed to be property of the estate, use of those receivables by a DIP or the trustee will likely be conditioned on obtaining authority to use cash collateral. See 11 U.S.C. § 363(a), (c). As noted above, counsel for the DIP and/or trustee should closely evaluate the attachment and perfection of any asserted security interest claimed by the MCA company. That said, even a valid security interest against future receivables runs into further challenge as Section 552 frees post-petition property from any lien resulting from a pre-petition security agreement with the debtor. 11 U.S.C. § 552(a).

An exception exists within Section 552 to allow a valid security interest that extends to proceeds, products, offspring, or profits to continue to be valid as to such extensions to the pre-petition collateral. 11 U.S.C. § 552(b)(1). In the case of future receivables, however, this exception would appear to be of limited utility. More typically, an MCA company would seek a replacement lien as a condition for use of cash collateral, rather than relying upon this exception. In addition, this is another area where the nature of the debtor's business may limit the MCA company's ability to assert a security interest in the receivables where such business typically engages in point-of-sale transactions, rather than allowing for use of trade credit.

5. Adequate Protection

As highlighted above, the typical MCA transaction involves daily or weekly remittances to the MCA company from the debtor's receipts. Freeing the debtor and the estate from this payment obligation is critical in any attempt to reorganize and stabilize the debtor's cashflow. For the MCA company, the consideration for its bargain with the debtor is being put at issue for the competing claims of creditors and payment of expenses.

Valuation of any kind is always a fact-based determination, but for the MCA transaction, there are some particular issues and challenges. Returning to the fundamental question, the MCA company could urge a valuation of its interest based on the future receivables it "purchased" from the debtor. While claim determination is generally discouraged in connection with a determination on use of cash collateral, the MCA company could use the opportunity to set itself up for an administrative claim under Section 507(b). For the debtor, a successful challenge by the MCA company that removes a portion of future receivables from the estate could mean working with a more limited cashflow to fund operations. As mentioned above, a clear understanding and articulation of the nature of the debtor's business and payment for its good/services will aid the presentation of valuation information.

If adequation protection is provided in the form of payments, both the MCA company and the debtor benefit from a clear understanding of how such payments would be applied. Given the eye-popping interest rates that typically accompany MCA transactions, the debtor and the estate are best served by having any allowed post-petition interest controlled and, if necessary, paid down from the adequate protection payments.

6. Avoidance Actions

With daily payments to the MCA company, there is typically a significant sum of prepetition payments within the 90-day period prior to the petition date. Section 547 states, in relevant part, that the trustee may avoid any transfer of an interest of the debtor in property (a) to or for the benefit of a creditor; (b) for or on account of an antecedent debt owed by the debtor before such transfer was made; (c) made while the debtor was insolvent; (d) made on or within 90 days before the date of the filing of the petition or, if the creditor was an insider, between 90 days and one year before the date of the filing of the petition; and (e) that enables such creditor to receive more than such creditor would receive if the case were a Chapter 7 case, the transfer had not been made, and the creditor received payment to the extent provided by the Bankruptcy Code.

The categorization of true sale or loan again drives this analysis. If the MCA transaction is characterized as a true sale, there would not be an antecedent debt with respect to the pre-petition "collection" of the MCA company's receivable.

Even if the debtor prevails on recharacterizing the MCA transaction as a loan, and therefore satisfies the antecedent debt element of a preference claim, there may nevertheless be applicable defenses. Most notably, because payments made under MCA agreements are automatic, subject to adjustment in amount pursuant to the reconciliation provision in the MCA agreement, MCA companies will assert an ordinary course of business defense under 11 U.S.C. § 547(c)(2).

Conversely, the "ordinary course of business" exception is "intended to protect ordinary trade credit transactions, and not those outside the normal course of either the debtor's or creditor's business." *In re Pioneer Tech., Inc.*, 107 B.R. 698, 702 (B.A.P. 9th Cir. 1988). Few, if any, debtors engage in MCA transactions as its ordinary financing; rather, debtors utilize MCA transactions only when in dire financial circumstances and such transactions represent a significant aberration from its normal course of business.

The MCA company will focus on the usually limited history of the parties' relationship, arguing that the payments during the preference period aligned with the parties' historical course of dealings and the parties' agreement. The focus is on the extremely regular payment history; of course, the payment schedule in MCA transaction is automatic withdrawals against receipts or bank accounts, a practice seemingly designed to satisfy the ordinary course defense. The recency and short duration of the debtor-MCA relationship, however, may also be interpreted to mean that the debtor's entry into the transaction itself was not ordinary course and the payments were not entitled to protection under the defense. *Matter of Cornerstone Tower Servs., Inc.*, 2018 WL 6199131, at *10 (Bankr. D. Neb. Nov. 9, 2018).

MCA transactions are potentially avoidable under Section 548 of the Bankruptcy Code, but in circumstances where the debtor filed bankruptcy prior to paying the MCA company the amount it initially funded—which is often the case—courts have concluded that the debtor could not satisfy its burden to demonstrate that it received less than reasonably equivalent value in exchange for the transfer. In re Hill, 589 B.R. 614, 630 (Bankr. N.D. Ill. 2018). In Hill, the MCA company purchased $176,432 in future receivables for $125,000. On the petition date, the debtor had only paid $112,979 to the CMA company, which the court concluded foreclosed the trustee's fraudulent transfer claim. Id.

7. Non-Dischargeability Actions

MCA transactions are common source of non-dischargeability actions; this can be applicable to both individual and potentially a corporate debtor in a subchapter V reorganization. *See Ivanov v. Van's Aircraft*, Adv. Case No. 24-6011-dwh, June 11, 2024; *but see In re Off-Spec Solutions, LLC*, 651 B.R. 862 (9th Cir. BAP 2023).

Irrespective of whether the MCA transaction is a true sale or a loan, fraud claims, under section 523(a)(2), can arise from the origination of the transaction. The debtor will have submitted an application (usually electronically) and provided some financial information, such as historical statements of income, listing of business assets, or statement of accounts receivables.

In addition, the typical MCA agreement documents include various representations. Very common amongst the representations is that the debtor's future receivables are wholly unencumbered. For example:

> **Unencumbered Receipts.** Seller has good, complete, unencumbered and marketable title to all Future Receipts, free and clear of any and all liabilities, liens, claims, changes, restrictions, conditions, options, rights, mortgages, security interests, equities, pledges and encumbrances of any kind or nature whatsoever or any other rights or Interests that

> may be Inconsistent with the transactions contemplated with, or adverse to the Interests of Purchaser.

However, it is very common for financially distressed debtors to have engaged in "MCA stacking," with multiple outstanding MCA transactions. In addition, debtors have MCA transaction financing statements will receive solicitations from MCA companies, offering both financing to pay off prior MCA transactions or additional funds.

Other non-dischargeability allegations can vary based on whether the MCA transaction is a true sale or a loan. For example, under a true sale MCA transaction, the debtor's retention of the MCA company's acquired future receivables may have engaged in conduct falling within the ambit of larceny, embezzlement, or conversion. For example:

> **SELLER Deposit Account.** […] Additionally, the Remittance Percentage of Receipts are to be held in trust in the Designated Account for the benefit of BUYER and SELLER shall have no legal or equitable interest in said Receipts. Upon an Event of Default, the Remittance Percentage shall equal 100% of all Receipts.

This conduct may form the basis for a non-dischargeability claim under sections 523(a)(4) or (a)(6) of the Bankruptcy Code.

Counsel for either the MCA or the debtor should be wary of non-dischargeability litigation. For example, assertion of a non-dischargeability claim for larceny (under a true sale articulation of the MCA transaction) may be incompatible with a Proof of Claim asserted under a loan articulation of the MCA transaction or treatment as a secured creditor.

In addition, counsel should be prepared to undertake substantial discovery. Particularly true with fraud claims, obtaining the evidence with respect to reliance and intent is critical to understanding the respective risks in the adversary proceeding. In addition, in furtherance of the analysis of the allocation of risk, the parties should expect discovery, both with respect to the individual debtor and the MCA company's clients in general, of the utilization of relevant aspects of the analysis, such as reconciliation provisions.

8. Reorganization Treatment of MCA Transactions

Again, in a reorganization, the first question is whether the MCA transaction is a true sale or a loan. For certain debtors in bankruptcy, characterization as a true sale may be advantageous as some debtors do not generate account receivables. For example, a debtor whose revenue is based on same-day sales, such as from a restaurant or bar, may elect for forego and surrender a single day's receipts and instead reorganization on the estate's generation of revenues in the future. Unsurprisingly, in these circumstances, the MCA company typically advocates to be treated as a loan obligation rather than true sale.

If treated as a loan (or a default secured by collateral), the MCA transaction treatment in reorganization aligns with the treatment of other secured creditors.

However, such MCA transactions are generally junior to other secured lenders and, as a result, may have little or no collateral to support a secured claim. In this scenario, some or all the MCA transactions can be stripped or crammed down from estate's interests in assets. Section 506, alone, is insufficient to reduce or eliminate these security interests. *Bank of Am., N.A. v. Caulkett*, 575 U.S. 790 (2015); *Dewsnup v. Timm*, 502 U.S. 410 (1992). In order to effectuate reduction or elimination of the security interest, confirmation is required, with the concurrent invocation of sections 1129(b)(2), 1191(c)(1), 1225(a)(5), and 1322(b)(2)), as applicable. While this can be done as part of the plan in chapter 12 and 13, it is less clear whether this can be done in a chapter 11 or subchapter V plan. *See* Fed. R. Bankr. P. 3012(b) ("a request to determine the amount of a secured claim may be made by motion, in a claim objection, or in a plan filed in a chapter 12 or chapter 13 case"). While this language does not expressly prohibit the inclusion of a determination motion in a chapter 11 or subchapter V plan, it does not expressly authorize it either. For that reason, it may be advisable to determine the amounts of secured claims early in a case, so that such issues can be determined in advance or separately from confirmation a plan.

For MCA transactions with collateral value, repayment terms are subject to considerable negotiation. Notwithstanding the lack of a finite term of "repayment," MCA companies frequently argue that the transactions are intended to be short-term obligations and that extended repayment through a reorganization is inappropriate.

9. **Conclusions**

The MCA industry continues to confront challenges. In January 2025, the State of New York reached a settlement with Yellowstone Capital to resolve allegations that Yellowstone's alleged MCA transactions were, in fact, disguised predatory loans. With a total $1.065 billion dollar judgment (including $534 million in cancellation of indebtedness and $16.1 in restitution payments), the settlement is the largest consumer settlement obtained by the New York attorney general's office and highlights the risks in MCA transactions.

As MCA transactions approach a thirty-year history, much remains uncertain. Court decisions, state regulation, and market competition have continued to change the MCA industry. As regulations and courts grapple with MCA transactions, MCA companies have continued to adapt; in some cases, MCA companies have moved to states without usury laws (such as Utah) or modified to conform with regulations (such as in California and New York). In addition, the increased acceptance of MCA transaction had resulted with larger, more established financial institutions offering MCA products, but some are exiting the market. MCA companies have also partnered with existing businesses, such as DoorDash and Amazon, to provide "working capital" secured against future receivables through those platforms.

Rapid changes in the industry and a wide range of applicable terms and practices mean each MCA transaction is unique; each MCA transaction should be carefully scrutinized to the determine the appropriate treatment in a bankruptcy case.

NOTES

fundkite

Congratulations, On Your Preliminary Offer!

Dear [redacted]

This preliminary offer is based on a preliminary review and is not guaranty or commitment that FUNDKITE will consummate a transaction. Complete contracts and documentation described herein must be provided for underwriting review before FUNDKITE will enter into a transaction. Any misrepresentation in the application submitted to FUNDKITE or adverse change may void this preliminary offer. This preliminary offer is subject to change or cancellation if requested transaction no longer meets applicable requirements.

Please take your time to go over the below details and complete your documents.

YOUR FUNDING DETAILS

Amount Paid to You (Purchase Price): **$103,100.00**

Service Fees: **$4,309.00**

Disbursement Amount: **$98,791.00**

Purchased Amount: **$142,278.00**

Remittance Percentage: **10%**

Initial Estimated Delivery Amount (Daily): **$846.89**

CREDIT AUTHORIZATION TO FUNDKITE AND RELATED ENTITIES

[redacted] (hereinafter "you" "your" and "yours") You understand that by signing this notice, you are providing "written instructions" under the Fair Credit Reporting Act to AKF Inc. dba FundKite ("FUNDKITE"), thereby authorizing FUNDKITE to obtain information from your personal consumer credit report and business credit profile and/or other information from TransUnion, Experian, Equifax, Thompson Reuters Clear and/or LexisNexis. You hereby authorize FUNDKITE to obtain such information to confirm your identity to avoid fraudulent transactions in your name, determine prequalification for a commercial transaction or any other lawful purpose covered under the Fair Credit Reporting Act.

Principal Owner:

Print Name: [redacted]

Signature: [redacted]

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REVENUE PURCHASE AGREEMENT

PURCHASE AND SALE OF FUTURE RECEIPTS (the "Agreement")

Dated MARCH 31, 2023, Between AKF Inc, DBA FundKite, located at 88 Pine Street, th Floor, New York NY 10005 hereafter known as ("BUYER"), the ("SELLER") listed below and each guarantor identified below (each a "Guarantor")

("THE SELLER")
MERCHANT INFORMATION

Seller's Legal Name: [redacted] DBA: [redacted]

Physical Address: [redacted]

Mailing Address: [redacted]

Primary Telephone: [redacted] Business Website: [redacted]

Type of entity: Limited Liability Company State of Incorporation: OR

Tax Id Number: [redacted]9508 Date Business Started: 11/17/2014

Name of Primary Authorized Signer: [redacted] Position or Title: MANAGING MEMBER

Email for Owner: [redacted]

Purchase Price: $103,100.00
(The agreed upon Purchase Price for the Receipts sold by SELLER to BUYER)

Service Fees: $4,309.00
(See Appendix A for breakdown of fees)

Disbursement Amount: $98,791.00
(The dollar amount BUYER will pay to SELLER after deducting Service Fees)

Purchased Amount: $142,278.00
(The dollar value of the Receipts being sold and delivered to BUYER from SELLER)

Remittance Percentage: 10%
(The percentage of Receipts SELLER agrees to remit to BUYER each weekday, Monday through Friday

Initial Estimated Delivery Amount (Daily): $846.89
(The dollar amount to be debited each weekday, Monday through Friday from the SELLER's bank account as described below, subject to reconciliation)

Reconciliation Frequency: Monthly
*Reconciliation may result in an adjustment to the Initial Estimated Delivery Amount

Designated Bank Account (the "Designated Account")

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Name of Bank: ROGUE CREDIT UNION ABA Transit/Routing #: 323274775 Checking Account # :855553883

Upon the terms and subject to the conditions set forth in this Agreement, [redacted] hereby sells, assigns and transfers to AKF Inc. DBA Fundkite ("FUNDKITE" and "BUYER") in consideration for the funds provided (the "PURCHASE PRICE"), all of Seller's future sales, accounts, contract rights and other obligations and entitlements arising from or relating to the payment of monies from Seller's customers and/or third-party payers and the proceeds thereof including, but not limited to all payments made by cash, check, electronic transfer or other form of monetary payment in the course of the Seller's business (the "Receipts"), in the amount specified above (the "Purchased Amount") to be delivered by the percentage of Receipts specified above (the "Remittance Percentage") until the Purchased Amount has been delivered by SELLER to BUYER. (SELLER and BUYER shall collectively be referred hereinafter to as the "PARTIES").

SELLER shall deliver the Remittance Percentage of Receipts to BUYER, until such time as BUYER receives full delivery of the Purchased Amount and any outstanding fees in accordance with Appendix A hereto. SELLER hereby authorizes BUYER to ACH Debit the initial estimated and adjusted delivery amounts from the Designated Account stated above (each a "Delivery Date") and will provide BUYER with access codes and monthly bank statements thereto. SELLER will be held responsible for any fees incurred by BUYER resulting from a rejected ACH attempt or an Event of Default, all such fees are outlined in Appendix A. BUYER is not responsible for any overdrafts or rejected transactions that may result from BUYER ACH debiting the specified remittances under the terms of this Agreement.

SELLER has elected to have BUYER debit the Initial Estimated Delivery Amount Daily , therefore SELLER shall deliver Receipts each weekday, Monday through Friday . The Initial Estimated Delivery Amount is intended to represent the Remittance Percentage of SELLER's actual Receipts prior to the date of this Agreement.

A list of all fees applicable under this Agreement is outlined in Appendix A. SELLER agrees to pay all fees as described therein.

I. TERMS OF ENROLLMENT IN PROGRAM

1.1 SELLER Deposit Account. SELLER shall deposit all Receipts into the Designated Account with a bank acceptable to BUYER. SELLER shall provide BUYER and/or its authorized agent with all of the information, authorization, and passwords reasonable and necessary for verifying SELLER's receivables, Receipts, and deposits into the Designated Account. SELLER authorizes BUYER and/or its agent to withdraw the Remittance Percentage or Initial Estimated/Adjusted Delivery Amount from the Designated Account. The authorization shall be irrevocable without the written consent of the BUYER. For the duration of this Agreement, SELLER shall have the use and enjoyment of Receipts above the Remittance Percentage to be delivered to BUYER. Additionally, the Remittance Percentage of Receipts are to be held in trust in the Designated Account for the benefit of BUYER and SELLER shall have no legal or equitable interest in said Receipts. Upon an Event of Default, the Remittance Percentage shall equal 100% of all Receipts.

1.2 Non-Recourse Sale of Future Receipts (THIS IS NOT A LOAN). SELLER is selling a portion of Receipts to BUYER at a discount, not borrowing money from BUYER. There is no interest rate or payment schedule and no time period during which the Purchased Amount must be collected by BUYER. BUYER is taking the risk that Receipts may be remitted more slowly than BUYER may have anticipated or projected because SELLER's business has slowed down, or the full Purchased Amount may never be remitted because SELLER's business filed a Chapter 7 liquidation or otherwise ceased operations in the ordinary course of business. BUYER is buying the Purchased Amount of Receipts knowing the risks that SELLER's business, despite SELLER's reasonable efforts, may slow down or fail, and BUYER assumes these risks based on SELLER's representations, warranties, and covenants in this Agreement that are designed to give BUYER a reasonable and fair opportunity to receive the benefit of its bargain. By this Agreement, SELLER transfers to BUYER full and complete ownership of the Purchased Amount of Receipts and SELLER retains no legal or equitable interest therein. SELLER will treat the Purchase Price and Purchased Amount in a manner consistent with a sale in its accounting

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records and tax returns. BUYER is entitled to audit SELLER's accounting records upon reasonable notice in order to verify compliance. SELLER waives any rights of privacy, confidentiality or taxpayer privilege in any such litigation or arbitration in which SELLER asserts that this transaction is anything other than a purchase and sale of future Receipts.

1.3 Reconciliation. For the convenience of the parties, the initial amount to be withdrawn from the Designated Account on each Delivery Date will be equal to the Initial Estimated Delivery Amount. Buyer has calculated the Initial Estimated Delivery Amount based on Seller's actual Receipts prior to the date of this Agreement, determined by Buyer based on a review of Banking Records provided by Seller. "Banking Records" may include bank statements, accounts receivables reports, credit card receipts, and view-only access to business bank accounts.

Buyer will review Seller's Banking Records for each Review Period that occurs during the course of this Agreement so long as such records are provided to Buyer. Buyer will request that Seller's Banking Records be provided each month. If Seller fails or refuses to provide Banking Records in response to Buyer's request, Buyer shall not be obligated to conduct such a review. For this purpose, the "Review Period" is one month, beginning on the first of the month and ending on the last day of the month. Buyer will calculate Seller's actual Receipts based solely upon a review of the Banking Records made available to Buyer for the applicable Review Period. Absent manifest error, Buyer's calculation of Seller's actual Receipts for any Review Period shall be conclusive. Buyer's calculation of Seller's actual Receipts will take place on or around the 12th calendar day following the end of the Review Period (the "Calculation Date").

The parties agree to adjust the Initial Estimated Delivery Amount so that subsequent withdrawals from the Designated Account are equal to the Remittance Percentage of the actual Receipts collected by Seller during a prior Review Period, as determined by Buyer on the Calculation Date. Each such adjustment is referred to herein as an "Adjusted Delivery Amount."

On each Delivery Date following a Calculation Date, the amount withdrawn from the Designated Account shall be equal to the Adjusted Delivery Amount. If on any Calculation Date, the Buyer is unable to determine Seller's actual Receipts for the applicable Review Period, the parties agree that the Adjusted Delivery Amount shall be based on the actual Receipts from the most recent Review Period for which Buyer was able to determine Seller's actual Receipts.

Seller hereby agrees to provide Buyer with such Banking Records as Buyer may reasonably require to calculate Seller's actual Receipts, including authorization to have "view-only" access to all business bank accounts to accommodate the reconciliations. Seller shall maintain this view-only access at all times and shall provide Buyer with any updated password, login, and account information Buyer may require for this purpose.

1.4 Processing Trial and BUYER'S Acceptance of Agreement. Prior to paying the Disbursement Amount to SELLER, BUYER shall have the right to instruct the credit/debit card processor used by SELLER for conducting its business to conduct a processing trial (a "Processing Trial") to determine whether settlement amounts of Receipts will be processed, reported and paid as contemplated under this Agreement. SELLER agrees that BUYER will make its final decision, in its sole and absolute discretion and with or without regard for the results of the Processing Trial, whether to purchase the Purchased Amount of Receipts after completing the Processing Trial or opting not to conduct a Processing Trial, and any underwriting conducted by BUYER. If BUYER elects to purchase the Purchased Amount of Receipts, BUYER will pay the Disbursement Amount to SELLER, and SELLER's obligations hereunder to deliver the Purchased Amount shall commence immediately. The obligation of BUYER under this Agreement will not be effective unless and until BUYER has completed its review of the SELLER and has accepted this Agreement by delivering the Disbursement Amount.

1.5 Financial Condition. SELLER authorizes BUYER and its agents to investigate their financial responsibility and history, and will provide to BUYER any financial or bank statements, tax returns, credit card statements and accounts receivable reports, and view-only access to any business bank account maintained by SELLER, as BUYER deems necessary prior to or at any time after execution of this Agreement. A photocopy of this authorization will be deemed as acceptable for release of financial information. BUYER is authorized to require Seller to provide updated information and

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financial profiles from time to time as it deems appropriate.

1.6 Transactional History. SELLER authorizes BUYER to obtain SELLER's banking or processing transactions and activity to verify information provided by Seller in connection with the performance of this program.

1.7 Indemnification. SELLER indemnifies and hold harmless BUYER, Processor, any and each of SELLER's, and any Account Debtors, their officers, directors, attorneys, assigns, agents and shareholders against all loses, damages, claims, liabilities and expenses (including reasonable attorney's fees) incurred, resulting from (a) all claims asserted by BUYER and its agents for amounts owed to BUYER from SELLER and (b) actions taken by Processor, SELLER's Banks and Account Debtors in reliance upon any information or instructions provided by BUYER and (c) litigation with SELLER and Guarantor(s). SELLER agrees to indemnify and hold harmless BUYER its officers, directors, attorneys, assigns, agents and shareholders against all losses, damages, claims, liabilities, and expenses (including reasonable attorney's fees) that they may have of any kind arising out of or related to the Agreement and enforcement of BUYER's remedies thereunder.

1.8 No Liability. In no event will BUYER and its agents, attorneys, assigns or affiliates be liable for any claims asserted by SELLER or Guarantor(s) under any legal theory for lost profits, lost revenue, lost business opportunities, exemplary, punitive, special, incidental, indirect or consequential damages, each of which is knowingly and voluntarily waived by SELLER or Guarantor(s). In the event these claims are nonetheless raised, SELLER and Guarantor(s) will be jointly liable for all of BUYER's attorney's fees and expenses resulting therefrom.

1.9 Reliance on Terms. Notwithstanding the fact that Processor, SELLER's bank, Guarantor(s)'s bank and Account Debtors, and their affiliates, are not parties to this Agreement, Sections 1.1, 1.2, 1.3, 1.4, 1.5 1.6, 1.7, 1.8, 1.9, 1.10, 1.13, 1.14, 2.3, 2.5, 2.6, and 2.7 of this Agreement are also for the benefit of BUYER, SELLER's bank and Guarantor(s)'s bank, Account Debtors and Processor, and each of their respective officers, directors, attorneys, assigns, agents and shareholders, and these parties may rely upon these terms and raise them as a defense in any action.

1.10 Disclosure of Information. SELLER, Guarantor(s) and each person signing this Agreement on behalf of SELLER and/or as Owner or Guarantor(s), in respect of himself or herself personally authorizes BUYER to disclose information concerning SELLER, Guarantor(s)'s and each Owner's credit standing (including credit bureau reports that BUYER obtains) and business conduct to agents, affiliate subsidiaries, and credit reporting bureaus. SELLER and each Owner and Guarantor(s) hereby waive to the maximum extent permitted by law any claim for damages against BUYER or any of its affiliates relating to any (i) investigation undertaken by or on behalf of BUYER as permitted by this Agreement or (ii) disclosure of information as permitted by this Agreement.

1.11 Publicity. SELLER and each Owner authorize BUYER to use its, his or her name in a listing of clients and in advertising and marketing materials.

1.12 D/B/A's. SELLER, Guarantor(s), and each Owner acknowledges that BUYER may be using "doing business as" or "d/b/a" names or authorized agents in connection with various matters relating to the transaction between BUYER and SELLER, including the filing of UCC-1 financing statements and other notices or filing.

1.13 Bank Holidays and Other Bank Closures. BUYER will debit the Initial Estimated/Adjusted Delivery Amount only on each weekday on which SELLER's bank is open and able to process ACH transactions.

1.14 ACH Authorization. If an ACH transaction is rejected by SELLER's financial institution for any reason other than a stop payment order placed by SELLER with its financial institution, including without limitation insufficient funds, SELLER agrees that BUYER may resubmit up to two times any ACH transaction that is dishonored. SELLER's bank may charge SELLER fees for unsuccessful ACH entries. SELLER agrees that BUYER has no liability to SELLER for such fees. In the event BUYER makes an error in processing any payment or credit, SELLER authorizes BUYER to initiate ACH entries to or from the Designated Account or bank account to correct the error. SELLER acknowledges that the origination of ACH entries to and from the Designated Account or bank account must comply with applicable law and applicable network rules. SELLER agrees to be bound by the Rules and Operating Guidelines of NACHA. SELLER will not dispute any ACH transaction initiated pursuant to this Authorization, provided the transaction corresponds to the terms of this

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Authorization. SELLER requests the financial institution that holds the Designated Account and bank account to honor all ACH entries initiated in accordance with this Authorization.

II. REPRESENTATIONS, WARRANTIES, AND COVENANTS

SELLER represents warrants and covenants that as of this date and, unless expressly stated otherwise, during the course of this Agreement:

2.1 Accounts Receivables and Financial Information. SELLER's accounts receivables and payable reports, bank and financial statements, copies of which have been furnished to BUYER, and future statements which will be furnished hereafter at the discretion of BUYER, fairly represent the performance and financial condition of SELLER at the dates the statements are provided. All performance and financial information provided to BUYER by SELLER and any Guarantor(s) is truthful, complete and accurate as of the date of this Agreement. BUYER may request Banking Records at any time during the performance of this Agreement and the SELLER shall provide them to BUYER within 5 business days. SELLER's failure to do so is a material breach of this Agreement.

2.2 Government Approvals. SELLER is in compliance and shall comply with all laws and has valid permits, authorizations and licenses to own operate and lease its properties and to conduct the business in which it is presently engaged.

2.3 Authorization. SELLER, and the persons(s) signing this Agreement on behalf of SELLER and Guarantor(s), have full power and authority to incur and perform the obligations under this Agreement, all of which have been duly authorized.

2.4 Maintenance of Designated Account. SELLER will not voluntarily change, alter, close or divert Receipts from SELLER’s Designated Account, or take any other voluntarily action that has any adverse effect upon Seller’s obligations under this Agreement without BUYER’s prior written consent. Any such change, interruption or diversion of Receipts shall be a material breach of this Agreement.

2.5 Electronic Check Processing Agreement. SELLER will not change its payment processor and terminals, or change its financial institution or bank account(s).

2.6 Change of Name, Location or Type of Business. SELLER will not conduct SELLER's business, or any similar business, under any name other than as disclosed to the Processor and BUYER or change the type of business it operates or any of its places of business without prior written consent from BUYER. Such change made without the prior written consent of BUYER shall be a material breach of this Agreement.

2.7 Daily Batch Out. SELLER will batch out receipts with the Processor on a daily basis and shall deposit all proceeds of batches to the Designated Account on a daily basis.

2.8 Estoppel Certificate. SELLER will at any time, and from time to time, upon at least one (1) day's prior notice from BUYER to SELLER execute, acknowledge and deliver to BUYER and/or to any other person, firm or corporation specified to BUYER a statement certifying that this Agreement is unmodified and in full force and effect (or, if there have been modifications, the same is in full force and effect as modified and stating the modifications) and stating the dates on which the Purchased Amount or any portion thereof has been delivered.

2.9 No Bankruptcy or Assignment. As of the date of this Agreement, SELLER does not contemplate and has not filed any petition for bankruptcy protection or assignment for the benefit of creditors, and there has been no involuntary petition or receivership brought or pending against SELLER. SELLER further warrants that as of the date of this Agreement, Seller does not anticipate filing any such bankruptcy petition and has no knowledge of or reason to believe any creditor has any cause to file an involuntary petition or receivership as against SELLER.

2.10 Working Capital Funding. At any time either contemporaneous with or after the execution of this Agreement,

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SELLER shall not, unless permitted in writing by BUYER, enter into any arrangement, agreement, or a loan that relates to or encumbers Seller's Receipts or future revenue with any party other than BUYER.

2.11 Unencumbered Receipts. SELLER warrants that, unless otherwise disclosed in writing to BUYER prior to the date of this Agreement, it has good, complete and marketable title to all of its Receipts free and clear of any and all liabilities, liens, claims, changes, restriction, conditions, options, rights, mortgages, security, interests, equities, pledges and encumbrances of any kind or nature whatsoever or any other rights or interests that may be inconsistent with the transactions contemplated with, or adverse to the interests of BUYER.

2.12 Business Purposes. SELLER is a valid business in good standing under the laws of the jurisdictions in which it is organized and/or operates, and SELLER is entering into this Agreement for business purposes and not for consumer, personal, family or household purposes.

2.13 Defaults Under Other Contracts. SELLER's execution of and/or performance under this Agreement will not cause or create an event of default by SELLER under any contract with another person or entity.

2.14 Bank Account. SELLER represents and warrants that (i) any bank account disclosed by SELLER (including but not limited to the Designated Account) to BUYER is SELLER's bank account; (ii) the person executing this Authorization on behalf of SELLER is an authorized signer on the bank account and has the power and authority to authorize BUYER to initiate ACH transactions to and from the bank account; and (iii) the bank account is a legitimate, open, and active bank account used solely for business purposes and not for personal, family or household purposes.

III. EVENTS OF DEFAULT AND REMEDIES

3.1 Events of Default. If Seller violates any term or covenant in this Agreement, it shall constitute an "Event of Default" hereunder, including but not limited to the following:

a) Any representation or warranty by SELLER in this Agreement proves to have been incorrect, false or misleading in any material respect when made;
b) SELLER refuses to deliver the Remittance Percentage of its Receipts as required by this Agreement;
c) SELLER refuses to provide reasonable and necessary access to SELLER's Banking Records;
d) SELLER voluntarily transfers, assigns or sells its Receipts, without prior written consent of BUYER
e) SELLER voluntarily transfers, assigns or sells all or substantially all of SELLER's assets, without prior written consent of BUYER;
f) SELLER voluntarily transfers, assigns or sells, all or any portion of, its shares or membership interests in the business without the prior written consent of BUYER.
g) SELLER fails to continue operations in the ordinary course of business with the intent to avoid delivering the Receipts to BUYER;
h) SELLER uses multiple depository accounts without prior written consent of BUYER;
i) SELLER changes its Designated Account or payment card processor without prior written consent of BUYER;
j) BUYER is unable, at any time, to successfully debit the Designated Account due to any "block" placed on BUYER's debits by or at the behest of SELLER;
k) SELLER voluntarily interrupts or diverts Receipts from SELLER's Designated Account with the intent to avoid delivering Receipts to BUYER;

3.2 Remedies. If any Event of Default occurs and is not waived pursuant to Section 4.4 hereof, the Remittance Percentageshall equal 100% and the full uncollected Purchased Amount of all Receipts plus all fees and charges (including reasonable attorney's fees, costs and default fees) due under this Agreement will become due and payable in full. BUYER may proceed to protect and enforce its rights or remedies by suit in equity or by action at law or both, whether for the specific performance of any event, agreement or other provision contained herein, or to enforce the discharge of SELLER's obligations or any other legal or equitable right or remedy. Subject to Arbitration, as provided in

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Section 4.14 of this Agreement, all rights, powers, and remedies of BUYER in connection with this Agreement may be exercised at any time by BUYER after the occurrence of an Event of Default, are cumulative and not exclusive, and shall be in addition to any other rights, powers or remedies provided by law or equity.

3.3 Costs. SELLER and Guarantor(s) shall pay to BUYER all reasonable costs associated with (a) any Event of Default, and (b) the enforcement of BUYER's remedies, including but not limited to court costs and attorneys' fees.

3.4 Required Notifications. SELLER is required to give BUYER three (3) days prior written notice of intent to change the Designated Account with updated account information attached to the notice. SELLER is required to give BUYER ten (10) days' written notice of the intent to sell, assign or transfer all or substantially all of the SELLER's assets or stock and shall provide BUYER in writing the name, address, phone number, email address and facsimile number of the proposed assignee, transferee or buyer's legal representative or owner.

3.5 Security Interest. The parties agree and understand this purchase and sale transaction is governed by Article 9 of the Uniform Commercial Code (the "UCC") and BUYER has a security interest in the Receipts purchased. Pursuant to UCC Article 9, BUYER has a security interest in all (a) SELLER's present and future Accounts, and General Intangibles, as such terms are defined in the UCC, now owned or hereafter owned or acquired by SELLER; and (b) all proceeds, as that term is defined in Article 9 of the UCC (a and b collectively, the "Collateral"). The security interests created by this transaction and evidenced by this Agreement shall secure all of the BUYER's entitlements under this or any other agreement now existing or later entered into between SELLER and BUYER or an affiliate of BUYER. SELLER authorizes BUYER to file one or more UCC-1 forms consistent with the UCC in order to give notice that the Purchased Amount of Future Receipts is the sole property of BUYER. BUYER may notify Account Debtors and/or other persons obligated on the Receipts or Accounts, of SELLER's sale of the Receipts and may instruct them to make payment or otherwise render performance to or for the benefit of BUYER. SELLER authorizes BUYER to debit the Designated Account and all other business bank accounts of SELLER for all costs incurred by BUYER associated with the filing, amendment or termination of any UCC filings.

3.6 Negative Pledge. SELLER agrees not to create, incur, or assume, directly or indirectly, any lien on or with respect to any of the Collateral (as defined in section 3.5 above), as applicable.

IV. MISCELLANEOUS.

4.1 Modifications. No modification, amendment, waiver or consent of any provision of this Agreement shall be effective unless the same shall be in writing and signed by BUYER.

4.2 Assignment. BUYER may assign, transfer or sell its right to receive the Purchased Amount or delegate its duties hereunder, either in whole or in part. The parties have entered into this Agreement in the State of New York and the Parties further agree that
BUYER is the absolute owner of Receipts in consideration of the funds provided. Fundkite may act as the lead purchaser for itself and other co-investors making FUNDKITE on behalf of itself and all co-investors collectively "FUNDKITE" and "BUYER".

4.3 Notices. All notices as required by Section 3.4 hereunder shall be delivered by certified mail; return receipt requested to the respective parties to this Agreement at the addresses set forth in this Agreement and shall become effective only upon receipt. All other notices, requests, consent, demands, and other communications may be made in writing sent by regular mail and/or electronic mail to SELLER at dianneschofield@yahoo.com and to BUYER at customerservice@fundkite.com.

4.4 Waiver of Remedies. No failure on the part of BUYER to exercise and no delay in exercising any right under this Agreement shall operate as a waiver thereof, nor shall any single or partial exercise of any other right under this Agreement preclude any other or further exercise thereof or the exercise of any other right. Subject to Arbitration, as provided in section 4.14 of this Agreement, the remedies provided hereunder are cumulative and not exclusive to any

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remedies provided by law or equity.

4.5 Phone Recordings and Contact. SELLER and each Guarantor(s) agree that any call between them and BUYER and its owners, managers, employees and agents may be recorded and/or monitored. Furthermore, SELLER and Guarantor(s) acknowledge and agree that: (i) they have an established business relationship with BUYER, its managers, employees and agents (collectively, the "BUYER Parties") and that SELLER and Guarantor(s) may be contacted by any of the BUYER Parties from time-to-time regarding SELLER's performance of its obligations under this Agreement or regarding other business transactions; (ii) they will not claim that such communications and contacts are unsolicited or inconvenient; and (iii) any such contact may be made by any of the BUYER Parties in person or at any phone number (including mobile phone number), email addresses, or facsimile number belonging to SELLER and Guarantor(s)'s office, or its owners, managers, officers, or employees.

4.6 Binding Effect; This Agreement shall be binding upon and inure to the benefit of SELLER, BUYER, and their respective successors and assigns, except that SELLER shall not have the right to assign its rights hereunder or any interest herein without the prior written consent of BUYER which consent may be withheld in BUYER's sole discretion. BUYER reserves the right to assign this Agreement with or without prior written notice to SELLER.

4.7 Governing Law, Venue, and Jurisdiction. Except as set forth in the Arbitration section, this Agreement shall be governed by or constructed in accordance with the laws of the state of New York, without regard to any applicable principles of conflicts of law. Any suit, action, or proceeding arising out of any disputes between the SELLER, Guarantor(s) and the BUYER, its affiliates agents, attorneys and assigns herein, or arising out of the Agreement hereunder, or the interpretation, performance or breach hereof, shall if BUYER so elects, be instituted in any court sitting in New York State, (the "Acceptable Forums"). SELLER and each Guarantor(s) agree that the Acceptable Forums are convenient to it/them and submit to the jurisdiction of the Acceptable Forums and waive any and all objections to jurisdiction or venue. Should such proceeding be initiated in any other forum, SELLER and each Guarantor(s) waive any right to oppose any motion or application made by BUYER to transfer and/or dismiss such proceeding.

4.8 Survival of Representation, etc. All representations, warranties and covenants herein shall survive the full execution and delivery of this Agreement and shall continue in full force until all obligations under this Agreement shall have been satisfied in full.

4.9 Severability. In case any of the provisions in this Agreement is found to be invalid, illegal or unenforceable in any respect, the validity, legality and enforceability of any other provision contained herein shall not in any way be affected or impaired. Any provision hereof prohibited by law shall be ineffective only to the extent of such prohibition without invalidating the remaining provisions of this Agreement.

4.10 Entire Agreement. This Agreement and any Guaranty embody the entire agreement between SELLER and BUYER and Guarantor(s) and supersede all prior agreements and understanding relating to the subject matter hereof.

4.11 JURY TRIAL WAIVER. THE PARTIES HERETO WAIVE TRIAL BY JURY IN ANY COURT IN ANY SUIT, ACTION OR PROCEEDING ON ANY MATTER ARISING IN CONNECTION WITH OR IN ANY WAY RELATED TO THE TRANSACTIONS OF WHICH THIS AGREEMENT IS A PART, OR THE ENFORCEMENT THEREOF. THE PARTIES HERETO ACKNOWLEDGE THAT EACH PARTY AGREES TO THIS WAIVER KNOWINGLY, WILLINGLY AND VOLUNTARILY AND WITHOUT DURESS, AND ONLY AFTER EXTENSIVE CONSIDERATION OF THE RAMIFICATIONS OF THIS WAIVER WITH THEIR ATTORNEYS.

4.12 CLASS ACTION WAIVER. THE PARTIES HERETO WAIVE ANY RIGHT TO ASSERT ANY CLAIMS AGAINST THE OTHER PARTY AS A REPRESENTATIVE OR MEMBER IN ANY CLASS OR REPRESENTATIVE ACTION, EXCEPT WHERE SUCH WAIVER IS PROHIBITED BY LAW AGAINST PUBLIC POLICY. TO THE EXTENT ANY PARTY IS PERMITTED BY LAW TO PROCEED WITH A CLASS OR REPRESENTATIVE ACTION AGAINST THE OTHER, THE PARTIES HEREBY AGREE THAT: (1) THE PREVAILING PARTY SHALL NOT BE ENTITLED TO RECOVER ATTORNEYS' FEES OR COSTS ASSOCIATED WITH PURSUING THE CLASS OR REPRESENTATIVE ACTION (NOTWITHSTANDING ANY OTHER PROVISION IN THIS AGREEMENT); AND (2) THE PARTY WHO INITIATES OR PARTICIPATES AS A MEMBER OF THE CLASS WILL NOT SUBMIT A CLAIM OR OTHERWISE PARTICIPATE IN ANY

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RECOVERY SECURED THROUGH THE CLASS OR REPRESENTATIVE ACTION.

4.13 SERVICE OF PROCESS. SELLER HEREBY IRREVOCABLY AND UNCONDITIONALLY WAIVES PERSONAL SERVICE OF LEGAL PROCESS AND ANY OBJECTION TO THE ABSENCE OF PERSONAL SERVICE OF PROCESS AND HEREBY AGREES TO ACCEPT SERVICE OF LEGAL PROCESS BY (I) ELECTRONIC MAIL SENT TO SELLER'S EMAIL ADDRESS PROVIDED TO BUYER BY SELLER ("LAST KNOWN EMAIL ADDRESS OF SELLER"), (II) UNITED STATES POSTAL SERVICES FIRST CLASS OR CERTIFIED MAIL SENT TO SELLER'S MAILING ADDRESS PROVIDED TO BUYER BY SELLER ("LAST KNOWN ADDRESS OF SELLER"), OR (III) BY ANY OTHER MEANS PERMITTED BY NEW YORK LAW. SELLER UNDERSTANDS AND AGREES THAT AN ACTION, LAWSUIT, OR CONTROVERSY MAY BE TAKEN UP AND CONSIDERED BY A COURT WITHOUT ANY FURTHER NOTICE. SERVICE OF PROCESS SHALL BE EFFECTIVE UPON SENDING / MAILING OF SERVICE OF PROCESS BY BUYER ("SERVICE DATE"). SELLER SHALL NOTIFY BUYER OF ANY CHANGE TO ITS LAST KNOWN EMAIL ADDRESS OR ITS LAST KNOWN ADDRESS FOR SERVICE. UNLESS BUYER IS NOTIFIED OF A CHANGE, BUYER'S LAST KNOWN EMAIL ADDRESS OR ITS LAST KNOWN ADDRESS SHALL BE PRESUMED TO BE ACCURATE AND VALID FOR THE PURPOSES OF SERVICE OF PROCESS AND NOTICES. THIS PROVISION SHALL SUPERSEDE ANY NOTICE REQUIREMENTS IN THE CONTRACT WITH RESPECT TO SERVICE OF PROCESS. SELLER WILL HAVE THIRTY (30) CALENDAR DAYS FROM THE SERVICE DATE OF THE SERVICE OF PROCESS HEREUNDER IN WHICH TO RESPOND. FURTHERMORE, SELLER EXPRESSLY CONSENTS THAT ANY AND ALL NOTICE(S), DEMAND(S), OR OTHER COMMUNICATION(S) UNDER AND PURSUANT TO THIS AGREEMENT SHALL BE DELIVERED IN ACCORDANCE WITH THE PROVISIONS OF THIS AGREEMENT.

4.14 ARBITRATION. IF BUYER, SELLER OR ANY GUARANTOR(S) REQUESTS, THE OTHER PARTIES AGREE TO ARBITRATE ALL DISPUTES AND CLAIMS ARISING OUT OF OR RELATING TO THIS AGREEMENT. IF BUYER, SELLER OR ANY GUARANTOR(S) SEEKS TO HAVE A DISPUTE SETTLED BY ARBITRATION, THAT PARTY MUST FIRST SEND TO ALL OTHER PARTIES, BY CERTIFIED MAIL, A WRITTEN NOTICE OF INTENT TO ARBITRATE. IF BUYER, SELLER OR ANY GUARANTOR(S) DO NOT REACH AN AGREEMENT TO RESOLVE THE CLAIM WITHIN 30 DAYS AFTER THE NOTICE IS RECEIVED, BUYER, SELLER OR ANY GUARANTOR(S) MAY COMMENCE AN ARBITRATION PROCEEDING WITH MEDIATION AND CIVIL ARBITRATION, INC. D/B/A RAPIDRULING ("RAPID") OR, IN CASE RAPID IS UNAVAILABLE AS ARBITRATOR AT THE TIME WHEN THE INTENT TO ARBITRATE ARISES, THE PARTIES HERETO MAY COMMENCE AN ARBITRATION PROCEEDING WITH JAMS, FORMERLY KNOWN AS JUDICIAL ARBITRATION AND MEDIATION SERVICES, INC. ("JAMS"), OR, ALTERNATIVELY, THE PARTY INTENDING TO ARBITRATE A DISPUTE BETWEEN THE PARTIES HERETO MAY SEEK COURT'S APPOINTMENT OF AN ARBITRATOR TO ARBITRATE A DISPUTE BETWEEN THE PARTIES HERETO. BUYER WILL PROMPTLY REIMBURSE SELLER OR THE GUARANTOR(S) FOR ANY ARBITRATION FILING FEE, HOWEVER, IN THE EVENT THAT BOTH SELLER AND THE GUARANTOR(S) MUST PAY FILING FEES, BUYER WILL ONLY REIMBURSE SELLER'S ARBITRATION FILING FEE AND, EXCEPT AS PROVIDED IN THE NEXT SENTENCE, BUYER WILL PAY ALL ADMINISTRATION AND ARBITRATOR FEES. IF THE ARBITRATOR FINDS THAT EITHER THE SUBSTANCE OF THE CLAIM RAISED BY SELLER OR THE GUARANTOR(S) OR THE RELIEF SOUGHT BY SELLER OR THE GUARANTOR(S) IS IMPROPER OR NOT WARRANTED, AS MEASURED BY THE STANDARDS SET FORTH IN FEDERAL RULE OF PROCEDURE 11(B), THEN BUYER WILL PAY THESE FEES ONLY IF REQUIRED BY RAPID OR JAMS RULES. SELLER AND THE GUARANTOR(S) AGREE THAT, BY ENTERING INTO THIS AGREEMENT, THEY ARE WAIVING THE RIGHT TO TRIAL BY JURY. BUYER, SELLER OR ANY GUARANTOR(S) MAY BRING CLAIMS AGAINST ANY OTHER PARTY ONLY IN THEIR INDIVIDUAL CAPACITY, AND NOT AS A PLAINTIFF OR CLASS MEMBER IN ANY PURPORTED CLASS OR REPRESENTATIVE PROCEEDING. FURTHER, BUYER, SELLER AND ANY GUARANTOR(S) AGREE THAT THE ARBITRATOR MAY NOT CONSOLIDATE PROCEEDINGS FOR MORE THAN ONE PERSON'S CLAIMS, AND MAY NOT OTHERWISE PRESIDE OVER ANY FORM OF A REPRESENTATIVE OR CLASS PROCEEDING, AND THAT IF THIS SPECIFIC PROVISION DEALING WITH THE PROHIBITION ON CONSOLIDATED, CLASS OR AGGREGATED CLAIMS IS FOUND UNENFORCEABLE, THEN THE ENTIRETY OF THIS ARBITRATION CLAUSE SHALL BE NULL AND VOID. THIS AGREEMENT TO ARBITRATE IS GOVERNED BY THE FEDERAL ARBITRATION ACT AND NOT BY ANY STATE LAW REGULATING THE ARBITRATION OF DISPUTES. THIS AGREEMENT IS FINAL AND BINDING EXCEPT TO THE EXTENT THAT AN APPEAL MAY BE MADE UNDER THE FAA. ANY ARBITRATION DECISION RENDERED PURSUANT TO THIS ARBITRATION AGREEMENT MAY BE ENFORCED IN ANY COURT WITH JURISDICTION. THE TERMS "DISPUTES" AND "CLAIMS" SHALL HAVE THE

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BROADEST POSSIBLE MEANING.

4.15 RIGHT TO OPT OUT OF ARBITRATION. SELLER AND GUARANTOR(S)(S) MAY OPT OUT OF THIS ARBITRATION CLAUSE. TO OPT OUT OF THIS ARBITRATION CLAUSE, SELLER AND EACH GUARANTOR(S) MUST SEND BUYER A NOTICE THAT THE SELLER AND EACH GUARANTOR(S) DOES NOT WANT THIS ARBITRATION CLAUSE TO APPLY TO THIS AGREEMENT. FOR ANY OPT OUT TO BE EFFECTIVE, SELLER AND EACH GUARANTOR(S) MUST SEND AN OPT OUT NOTICE TO THE FOLLOWING ADDRESS BY REGISTERED MAIL, WITHIN 14 DAYS AFTER THE DATE OF THIS AGREEMENT:

ARBITRATION OPT OUT,
FundKite, 88 Pine St, 24th Floor New York NY 10005.

4.16 Facsimile Acceptance. Facsimile signatures shall be deemed acceptable for all purposes.

4.17 Electronic Signatures. Electronic (digital) signatures and "DocuSign" signatures shall be deemed acceptable for all purposes.

4.18 Counterparts. This Agreement may be executed in any number of counterparts, each of which shall be deemed to be an original, but all such counterparts shall together constitute one and the same Agreement. Electronic signatures complying with the New York Electronic Signatures and Records Act (N.Y. State Tech. §§ 301-309), as amended from time to time, or other applicable law will be deemed original signatures for purposes of this Agreement. Transmission by telecopy, electronic mail or other transmission method of an executed counterpart of this Agreement will constitute due and sufficient delivery of such counterpart.

(signature pages to follow)

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THE "TERMS OF ENROLLMENT IN PROGRAM", APPENDIX “A” AND “GUARANTY OF PERFORMANCE” ARE HEREBY INCORPORATED IN AND MADE A PART OF THIS AGREEMENT.

Agreement of SELLER: By signing below SELLER agrees to the terms and conditions contained in this Agreement, including those terms and conditions on the preceding and following pages, and further agrees that this transaction is for business purposes and not for personal, family, or household purposes, and Seller will use all funds received from Buyer to operate or grow its business.

SELLER: [redacted]

[redacted]

Agreed to by: Signature

it's **MANAGING MEMBER** (Title)

Agreement of Each Owner Guarantor(s) and Affiliated Business Guarantor(s): Each Owner, Guarantor and Affiliated Business Guarantor signing below agrees to the terms of this Agreement, including those terms and conditions on the preceding and following pages, and further agrees that this transaction is for business purposes and not for personal, family, or household purposes, and Seller will use all funds received from Buyer to operate or grow its business.

Sign as Owner:

Print Name: [redacted]

[redacted]

Signature

Individual Guarantors
Guarantor

Print Name: [redacted]

Social Security Number: [redacted]

Driver's License: [redacted] State Issued: **Oregon**

[redacted]

Signature

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Affiliated Business Guarantors

Guarantor: [redacted]

[redacted]

By Signature

Print Name of Signor: [redacted] Its: **Owner**, (Official Position)

Address: [redacted]

Tax Id #: [redacted] **9508** State of Incorporation: **Oregon**

Guarantor: [redacted]

[redacted]

By Signature

Print Name of Signor: [redacted] Its: **Owner**, (Official Position)

Address: [redacted]

Tax Id #: [redacted] **9508** State of Incorporation: **Oregon**

Guarantor: **THE SALTY DAWG HIGHWAY 101 PORT ORFORD**

[redacted]

By Signature

Print Name of Signor: [redacted] Its: **Owner**, (Official Position)

Address: [redacted]

Tax Id #: [redacted] **9508** State of Incorporation: **Oregon**

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Affiliated Business Guarantors (continued)

Guarantor: [redacted]

By Signature

Print Name of Signor: [redacted] Its: **Owner**, (Official Position)

Address: **16261 HWY 101 S BROOKINGS OR 97415**

Tax Id #: **47-2339508** State of Incorporation: **Oregon**

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GUARANTY OF PERFORMANCE

A. Buyer has purchased Future Receipts of Seller, pursuant to that REVENUE PURCHASE AGREEMENT Purchase and Sale of Future Receipts (the "Agreement") dated, incorporated herein.

B. The undersigned Guarantor(s) hereby are parties to the Agreement and each agrees to irrevocably, absolutely and unconditionally guarantee to BUYER, SELLER's prompt and complete performance of the following "Guaranteed Obligations":

1. SELLER's obligation not to enter into any arrangement, agreement, or a loan that relates to or encumbers Seller's Receipts of future revenue with any party other than BYUER, unless permitted in writing by BUYER;

2. SELLER's representations, covenants and warranties shall be truthful, accurate and complete and shall not be misleading in any material respect when made;
3. SELLER's obligation to provide Banking Records to BUYER in accordance with the Agreement;
4. SELLER's obligation to not voluntarily transfer or sell all or substantially all of its assets, shares and/or membership interests without prior written consent of BUYER;
5. SELLER's obligation to not change, alter or terminate its Designated Account or payment card processor without prior written consent of BUYER;
6. SELLER's obligation to deliver Receipts as required by the Agreement and subject to SELLER's right to a reconciliation, without interruption by way of "stop payment" or any "block" on BUYER's debits

Indemnification. Guarantor indemnifies and hold harmless BUYER against all loses, damages, claims, liabilities and expenses (including reasonable attorney's fees) incurred, resulting from SELLER's failure to perform any of the Guaranteed Obligations.

Guarantor(s) Waivers. In the event that the SELLER fails to perform any of the Guaranteed Obligations, BUYER may enforce its rights under this Guaranty against any and all Guarantor(s) without first seeking to obtain performance from SELLER or any other Guarantor(s). BUYER is not required to notify Guarantor(s) of any of the following events and Guarantor(s) will not be released from its obligations under this Guaranty if it is not notified of: (i) SELLER's default, or failure to perform any obligations under the Agreement; (ii) BUYER's acceptance of the Agreement or this Guaranty; and (iii) any renewal, extension or other modification of the Agreement or Seller's other obligations to BUYER. In addition, BUYER may take any of the following actions without releasing Guarantor(s) from any of its obligations under this Guaranty: (i) renew, extend or otherwise modify the Agreement or SELLER's other obligations to BUYER; and (ii) release SELLER from its obligations to BUYER. Until SELLER's obligations to BUYER under the Agreement are satisfied in full, Guarantor(s) shall not seek reimbursement from SELLER or any other Guarantor(s) for any amounts paid by it under this Guaranty.

Guarantor(s) permanently waives and shall not seek to exercise any of the following rights that it may have against the SELLER, any other Guarantor(s), or any collateral provided by SELLER or any other Guarantor(s), for any amounts paid by it, or acts performed by it, under this agreement: (i) subrogation; (ii)reimbursement; (iii)performance; (iv) indemnification; or (v) contribution. In the event that BUYER must return any amount paid by or on behalf of SELLER or any other Guarantor(s) including but not limited to, a proceeding filed under the United States Bankruptcy Code or any similar law, Guarantor(s)'s obligations under this agreement shall include any such amounts.

Acknowledgment of Purchase. Guarantor(s) acknowledges and agrees that the Purchase Price paid by BUYER to SELLER in exchange for the Purchased Amount of Receipts is a purchase of the Purchased Amount of Receipts and is not intended to be treated as a loan or financial accommodation from BUYER to SELLER. Guarantor(s) specifically acknowledges that BUYER is not a lender, bank or credit card processor, and that BUYER has not offered any loans to SELLER. Guarantor(s) acknowledges the Receipts Purchase Price paid to SELLER is good and valuable consideration for the sale of the Purchased Amount of Receipts.

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Joint and Several Liability. The obligations hereunder of the persons or entities constituting Guarantor(s) under this Agreement are joint and several.

JURY TRIAL WAIVER. THE PARTIES HERETO WAIVE TRIAL BY JURY IN ANY COURT IN ANY SUIT, ACTION OR PROCEEDING ON ANY MATTER ARISING IN CONNECTION WITH OR IN ANY WAY RELATED TO THE TRANSACTIONS OF WHICH THIS AGREEMENT IS A PART OR THE ENFORCEMENT THEREOF. THE PARTIES HERETO ACKNOWLEDGE THAT EACH PARTY AGREES TO THIS WAIVER KNOWINGLY, WILLINGLY AND VOLUNTARILY AND WITHOUT DURESS, AND ONLY AFTER EXTENSIVE CONSIDERATION OF THE RAMIFICATIONS OF THIS WAIVER WITH THEIR ATTORNEYS.

CLASS ACTION WAIVER. THE PARTIES HERETO WAIVE ANY RIGHT TO ASSERT ANY CLAIMS AGAINST THE OTHER PARTY AS A REPRESENTATIVE OR MEMBER IN ANY CLASS OR REPRESENTATIVE ACTION, EXCEPT WHERE SUCH WAIVER IS PROHIBITED BY LAW AGAINST PUBLIC POLICY. TO THE EXTENT ANY PARTY IS PERMITTED BY LAW OR COURT OF LAW TO PROCEED WITH A CLASS OR REPRESENTATIVE ACTION AGAINST THE OTHER, THE PARTIES HEREBY AGREE THAT: (1) THE PREVAILING PARTY SHALL NOT BE ENTITLED TO RECOVER ATTORNEYS' FEES OR COSTS ASSOCIATED WITH PURSUING THE CLASS OR REPRESENTATIVE ACTION (NOTWITHSTANDING ANY OTHER PROVISION IN THIS AGREEMENT); AND (2) THE PARTY WHO INITIATES OR PARTICIPATES AS A MEMBER OF THE CLASS WILL NOT SUBMIT A CLAIM OR OTHERWISE PARTICIPATE IN ANY RECOVERY SECURED THROUGH THE CLASS OR REPRESENTATIVE ACTION.

ARBITRATION. IF BUYER, SELLER OR ANY GUARANTOR(S) REQUESTS, THE OTHER PARTIES AGREE TO ARBITRATE ALL DISPUTES AND CLAIMS ARISING OUT OF OR RELATING TO THIS AGREEMENT. IF BUYER, SELLER OR ANY GUARANTOR(S) SEEKS TO HAVE A DISPUTE SETTLED BY ARBITRATION, THAT PARTY MUST FIRST SEND TO ALL OTHER PARTIES, BY CERTIFIED MAIL, A WRITTEN NOTICE OF INTENT TO ARBITRATE. IF BUYER, SELLER OR ANY GUARANTOR(S) DO NOT REACH AN AGREEMENT TO RESOLVE THE CLAIM WITHIN 30 DAYS AFTER THE NOTICE IS RECEIVED, BUYER, SELLER OR ANY GUARANTOR(S) MAY COMMENCE AN ARBITRATION PROCEEDING WITH MEDIATION AND CIVIL ARBITRATION, INC. D/B/A RAPIDRULING ("RAPID") OR, IN CASE RAPID IS UNAVAILABLE AS ARBITRATOR AT THE TIME WHEN THE INTENT TO ARBITRATE ARISES, THE PARTIES HERETO MAY COMMENCE AN ARBITRATION PROCEEDING WITH JAMS, FORMERLY KNOWN AS JUDICIAL ARBITRATION AND MEDIATION SERVICES, INC. ("JAMS"), OR, ALTERNATIVELY, THE PARTY INTENDING TO ARBITRATE A DISPUTE BETWEEN THE PARTIES HERETO MAY SEEK COURT'S APPOINTMENT OF AN ARBITRATOR TO ARBITRATE A DISPUTE BETWEEN THE PARTIES HERETO. BUYER WILL PROMPTLY REIMBURSE SELLER OR THE GUARANTOR(S) FOR ANY ARBITRATION FILING FEE, HOWEVER, IN THE EVENT THAT BOTH SELLER AND THE GUARANTOR(S) MUST PAY FILING FEES, BUYER WILL ONLY REIMBURSE SELLER'S ARBITRATION FILING FEE AND, EXCEPT AS PROVIDED IN THE NEXT SENTENCE, BUYER WILL PAY ALL ADMINISTRATION AND ARBITRATOR FEES. IF THE ARBITRATOR FINDS THAT EITHER THE SUBSTANCE OF THE CLAIM RAISED BY SELLER OR THE GUARANTOR(S) OR THE RELIEF SOUGHT BY SELLER OR THE GUARANTOR(S) IS IMPROPER OR NOT WARRANTED, AS MEASURED BY THE STANDARDS SET FORTH IN FEDERAL RULE OF PROCEDURE 11(B), THEN BUYER WILL PAY THESE FEES ONLY IF REQUIRED BY RAPID OR JAMS RULES. SELLER AND THE GUARANTOR(S) AGREE THAT, BY ENTERING INTO THIS AGREEMENT, THEY ARE WAIVING THE RIGHT TO TRIAL BY JURY. BUYER, SELLER OR ANY GUARANTOR(S) MAY BRING CLAIMS AGAINST ANY OTHER PARTY ONLY IN THEIR INDIVIDUAL CAPACITY, AND NOT AS A PLAINTIFF OR CLASS MEMBER IN ANY PURPORTED CLASS OR REPRESENTATIVE PROCEEDING. FURTHER, BUYER, SELLER AND ANY GUARANTOR(S) AGREE THAT THE ARBITRATOR MAY NOT CONSOLIDATE PROCEEDINGS FOR MORE THAN ONE PERSON'S CLAIMS, AND MAY NOT OTHERWISE PRESIDE OVER ANY FORM OF A REPRESENTATIVE OR CLASS PROCEEDING, AND THAT IF THIS SPECIFIC PROVISION DEALING WITH THE PROHIBITION ON CONSOLIDATED, CLASS OR AGGREGATED CLAIMS IS FOUND UNENFORCEABLE, THEN THE ENTIRETY OF THIS ARBITRATION CLAUSE SHALL BE NULL AND VOID. THIS AGREEMENT TO ARBITRATE IS GOVERNED BY THE FEDERAL ARBITRATION ACT AND NOT BY ANY STATE LAW REGULATING THE ARBITRATION OF DISPUTES. THIS AGREEMENT IS FINAL AND BINDING EXCEPT TO THE EXTENT THAT AN APPEAL MAY BE MADE UNDER THE FAA. ANY ARBITRATION DECISION RENDERED PURSUANT TO THIS ARBITRATION AGREEMENT MAY BE ENFORCED IN ANY COURT WITH JURISDICTION. THE TERMS "DISPUTES" AND "CLAIMS" SHALL HAVE THE BROADEST POSSIBLE MEANING.

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RIGHT TO OPT OUT OF ARBITRATION. SELLER AND GUARANTOR(S) MAY OPT OUT OF THIS ARBITRATION CLAUSE. TO OPT OUT OF THIS ARBITRATION CLAUSE, SELLER AND EACH GUARANTOR(S) MUST SEND BUYER A NOTICE THAT THE SELLER AND EACH GUARANTOR(S) DOES NOT WANT THIS CLAUSE TO APPLY TO THIS AGREEMENT. FOR ANY OPT OUT TO BE EFFECTIVE, SELLER AND EACH GUARANTOR(S) MUST SEND AN OPT OUT NOTICE TO THE FOLLOWING ADDRESS BY REGISTERED MAIL, WITHIN FOURTEEN 14 DAYS AFTER THE DATE OF THIS AGREEMENT:

ARBITRATION OPT OUT,
FundKite, 88 Pine Street, 24th Floor Street New York NY 10005.

SERVICE OF PROCESS. EACH GUARANTOR(S) HEREBY IRREVOCABLY AND UNCONDITIONALLY WAIVES PERSONAL SERVICE OF LEGAL PROCESS AND ANY OBJECTION TO THE ABSENCE OF PERSONAL SERVICE OF PROCESS AND HEREBY AGREES TO ACCEPT SERVICE OF LEGAL PROCESS BY (I) ELECTRONIC MAIL SENT TO GUARANTOR'S EMAIL ADDRESS PROVIDED TO BUYER BY GUARANTOR ("LAST KNOWN EMAIL ADDRESS OF GUARANTOR"), (II) UNITED STATES POSTAL SERVICES CERTIFIED MAIL SENT TO GUARANTOR'S MAILING ADDRESS PROVIDED TO BUYER BY GUARANTOR ("LAST KNOWN ADDRESS OF GUARANTOR"), OR (III) BY ANY OTHER MEANS PERMITTED BY NEW YORK LAW. GUARANTOR UNDERSTANDS AND AGREES THAT AN ACTION, LAWSUIT, OR CONTROVERSY MAY BE TAKEN UP AND CONSIDERED BY A COURT WITHOUT ANY FURTHER NOTICE. SERVICE OF PROCESS SHALL BE EFFECTIVE UPON SENDING / MAILING OF SERVICE OF PROCESS BY BUYER ("SERVICE DATE"). GUARANTOR SHALL NOTIFY BUYER OF ANY CHANGE TO ITS LAST KNOWN EMAIL ADDRESS OR ITS LAST KNOWN ADDRESS FOR SERVICE. UNLESS BUYER IS NOTIFIED OF A CHANGE, BUYER'S LAST KNOWN EMAIL ADDRESS OR ITS LAST KNOWN ADDRESS SHALL BE PRESUMED TO BE ACCURATE AND VALID FOR THE PURPOSES OF SERVICE OF PROCESS AND NOTICES. THIS PROVISION SHALL SUPERSEDE ANY NOTICE REQUIREMENTS IN THE CONTRACT WITH RESPECT TO SERVICE OF PROCESS. EACH GUARANTOR(S) WILL HAVE THIRTY (30) CALENDAR DAYS FROM THE SERVICE DATE OF THE SERVICE OF PROCESS HEREUNDER IN WHICH TO RESPOND. FURTHERMORE, EACH GUARANTOR(S) EXPRESSLY CONSENTS THAT ANY AND ALL NOTICE(S), DEMAND(S), REQUEST(S) OR OTHER COMMUNICATION(S) UNDER AND PURSUANT TO THIS AGREEMENT SHALL BE DELIVERED IN ACCORDANCE WITH THE PROVISIONS OF THIS AGREEMENT.

Guarantor(s) Acknowledgement. Guarantor(s) acknowledges that: (i) He/She understands the seriousness of provisions of this Agreement; (ii) He/She has had a full opportunity to consult with counsel of his/her choice; and (iii) He/She has consulted with counsel of its choice or has decided not to avail himself/herself of that opportunity.

(signature pages to follow)

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THE TERMS, DEFINITIONS, CONDITIONS AND INFORMATION SET FORTH IN THE "REVENUE PURCHASE AGREEMENT PURCHASE AND SALE OF FUTURE RECEIPTS" AND "TERMS OF ENROLLMENT IN PROGRAM" ARE HEREBY INCORPORATED IN AND MADE A PART OF THIS PERFORMANCE GUARANTY.

Individual Guarantors
Guarantor

Print Name: [redacted]

Social Security Number: [redacted]6

Driver's License: [redacted] State Issued: **Oregon**

[redacted]

Signature

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Affiliated Business Guarantors

Guarantor: [redacted]

[redacted]

By Signature

Print Name of Signor: [redacted] Its: **Owner**, (Official Position)

Address: [redacted]

Tax Id #: [redacted] **9508** State of Incorporation: **Oregon**

Guarantor: [redacted]

[redacted]

By Signature

Print Name of Signor: [redacted] Its: **Owner**, (Official Position)

Address: [redacted]

Tax Id #: [redacted] **9508** State of Incorporation: **Oregon**

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Affiliated Business Guarantors (continued)

Guarantor: [redacted]

[redacted]

By Signature

Print Name of Signor: [redacted] Its: **Owner**, (Official Position)

Address: [redacted]

Tax Id #: [redacted]**9508** State of Incorporation:**Oregon**

Guarantor: [redacted]

[redacted]

By Signature

Print Name of Signor: [redacted] Its: **Owner**, (Official Position)

Address: [redacted]

Tax Id #: [redacted]**9508** State of Incorporation:**Oregon**

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APPENDIX A: THE FEE STRUCTURE

A. **Service Fees**

- **FUNDKITE FEE** - $3,093.00 The Underwriting Fee is deducted from the Purchase Price.
- **ACH Program Fee** - $1,031.00 The ACH Program Fee is deducted from the Purchase Price.
- **UCC Fee** - $150.00. The UCC Fee is deducted from the Purchase Price.
- **WIRE FEE** - $35.00. The Wire Fee is deducted from the Purchase Price.

B. **NSF Fee** - $35.00. The NSF Fee is due each time the BUYER'S debit ACH of the Account is rejected for insufficient funds. And will be debited from the SELLER'S account on the next available business day or added to the balance.

C. **Rejected ACH Fee**- $100.00. The Rejected ACH Fee is due if SELLER directs the bank to reject BUYER'S debit ACH, and will be debited from the SELLER'S account on the next available business day or added to the balance.

D. **Default Fee** - In case of default, a default fee in the amount of 25% of the total amount of Purchased Receipts outstanding. The Default Fee is due when an Event of Default occurs.

Agreement of Seller

[redacted]

Agreed to by: Signature

it's **MANAGING MEMBER** (Title)

AKF Inc DBA FundKite © 2023 All Rights Reserved

NOTES

[redacted]

FILED: [redacted]
OREGON SECRETARY OF STATE

UCC LIEN NO. [redacted]

UCC FINANCING STATEMENT

FOLLOW INSTRUCTIONS

A. NAME & PHONE OF CONTACT AT FILER (optional)
Corporation Service Company 1-800-858-5294

B. E-MAIL CONTACT AT FILER (optional)
SPRFiling@cscinfo.com

C. SEND ACKNOWLEDGMENT TO: (Name and Address)
1422 68623
Corporation Service Company
1127 Broadway St.
Salem, OR 97301

Filed In: Oregon (S.O.S.)

THE ABOVE SPACE IS FOR FILING OFFICE USE ONLY

1. DEBTOR'S NAME: Provide only one Debtor name (1a or 1b) (use exact, full name; do not omit, modify, or abbreviate any part of the Debtor's name); if any part of the Individual Debtor's name will not fit in line 1b, leave all of item 1 blank, check here ☐ and provide the Individual Debtor information in item 10 of the Financing Statement Addendum (Form UCC1Ad)

1a. ORGANIZATION'S NAME [redacted]

OR

1b. INDIVIDUAL'S SURNAME	FIRST PERSONAL NAME	ADDITIONAL NAME(S)/INITIAL(S)	SUFFIX

1c. MAILING ADDRESS	CITY	STATE	POSTAL CODE	COUNTRY
[redacted]	[redacted]	OR	[redacted]	USA

2. DEBTOR'S NAME: Provide only one Debtor name (2a or 2b) (use exact, full name; do not omit, modify, or abbreviate any part of the Debtor's name); if any part of the Individual Debtor's name will not fit in line 2b, leave all of item 2 blank, check here ☐ and provide the Individual Debtor information in item 10 of the Financing Statement Addendum (Form UCC1Ad)

2a. ORGANIZATION'S NAME

OR

2b. INDIVIDUAL'S SURNAME	FIRST PERSONAL NAME	ADDITIONAL NAME(S)/INITIAL(S)	SUFFIX
[redacted]			

2c. MAILING ADDRESS	CITY	STATE	POSTAL CODE	COUNTRY
[redacted]	[redacted]			USA

3. SECURED PARTY'S NAME (or NAME of ASSIGNEE of ASSIGNOR SECURED PARTY): Provide only one Secured Party name (3a or 3b)

3a. ORGANIZATION'S NAME Corporation Service Company, as Representative

OR

3b. INDIVIDUAL'S SURNAME	FIRST PERSONAL NAME	ADDITIONAL NAME(S)/INITIAL(S)	SUFFIX

3c. MAILING ADDRESS	CITY	STATE	POSTAL CODE	COUNTRY
P.O. Box 2576 uccsprep@cscinfo.com	Springfield	IL	62708	USA

4. COLLATERAL: This financing statement covers the following collateral:
UCC-1 Collateral Language: The collateral includes the following property of Debtor wherever found and whether now owned or hereafter acquired by Debtor: (a) all accounts, chattel paper, cash, deposit accounts, documents, equipment, general intangibles, instruments, and inventory, or investment property, as those terms are defined in Article 9 of the UCC, excluding any of Debtor's assets that are obligations owed by consumers to Debtor; (b) all proceeds, as that term is defined in Article 9 of the UCC; (c) all funds at any time in the Debtor's accounts, regardless of the source of such funds; (d) present and future Electronic Check Transactions; and (e) any amount which may be due to Secured Party under a certain Security Agreement and Payment Rights Purchase and Sale Agreement, including but not limited to all rights to receive any payments or credits.
The collateral secures a sale of a specified amount of Debtor's future payment rights to Secured Party, the terms of which prohibit Debtor from transferring the future payments rights that Secured Party has purchased to any person or entity other than Secured Party, or granting any security interest in the future payment rights that Secured Party has purchased from Debtor to any person or entity other than Secured Party. Any subsequent lienor may be tortuously

5. Check only if applicable and check only one box: Collateral is ☐ held in a Trust (see UCC1Ad, item 17 and Instructions) ☐ being administered by a Decedent's Personal Representative

6a. Check only if applicable and check only one box: ☐ Public-Finance Transaction ☐ Manufactured-Home Transaction ☐ A Debtor is a Transmitting Utility

6b. Check only if applicable and check only one box: ☐ Agricultural Lien ☐ Non-UCC Filing

7. ALTERNATIVE DESIGNATION (if applicable): ☐ Lessee/Lessor ☐ Consignee/Consignor ☐ Seller/Buyer ☐ Bailee/Bailor ☐ Licensee/Licensor

8. OPTIONAL FILER REFERENCE DATA:
1422 68623

FILING OFFICE COPY — UCC FINANCING STATEMENT (Form UCC1) (Rev. 04/20/11)

Corporation Service Company
2711 Centerville Rd., Ste. 400
Wilmington, DE 19808

Case [redacted] Claim 16 Part 3 Filed 05/16/18

UCC FINANCING STATEMENT ADDENDUM

FOLLOW INSTRUCTIONS

9. NAME OF FIRST DEBTOR: Same as line 1a or 1b on Financing Statement; if line 1b was left blank because Individual Debtor name did not fit, check here ☐

9a. ORGANIZATION'S NAME

[redacted]

OR

9b. INDIVIDUAL'S SURNAME

FIRST PERSONAL NAME

ADDITIONAL NAME(S)/INITIAL(S) | SUFFIX

THE ABOVE SPACE IS FOR FILING OFFICE USE ONLY

10. DEBTOR'S NAME: Provide (10a or 10b) only one additional Debtor name or Debtor name that did not fit in line 1b or 2b of the Financing Statement (Form UCC1) (use exact, full name; do not omit, modify, or abbreviate any part of the Debtor's name) and enter the mailing address in line 10c

10a. ORGANIZATION'S NAME

OR

10b. INDIVIDUAL'S SURNAME

INDIVIDUAL'S FIRST PERSONAL NAME

INDIVIDUAL'S ADDITIONAL NAME(S)/INITIAL(S) | SUFFIX

10c. MAILING ADDRESS	CITY	STATE	POSTAL CODE	COUNTRY

11. ☐ ADDITIONAL SECURED PARTY'S NAME or ☐ ASSIGNOR SECURED PARTY'S NAME: Provide only one name (11a or 11b)

11a. ORGANIZATION'S NAME

OR

11b. INDIVIDUAL'S SURNAME	FIRST PERSONAL NAME	ADDITIONAL NAME(S)/INITIAL(S)	SUFFIX

11c. MAILING ADDRESS	CITY	STATE	POSTAL CODE	COUNTRY

12. ADDITIONAL SPACE FOR ITEM 4 (Collateral):
interfering with Secured Party's rights.

13. ☐ This FINANCING STATEMENT is to be filed [for record] (or recorded) in the REAL ESTATE RECORDS (if applicable)

14. This FINANCING STATEMENT:
☐ covers timber to be cut ☐ covers as-extracted collateral ☐ is filed as a fixture filing

15. Name and address of a RECORD OWNER of real estate described in item 16 (if Debtor does not have a record interest):

16. Description of real estate:

17. MISCELLANEOUS:

FILING OFFICE COPY — UCC FINANCING STATEMENT ADDENDUM (Form UCC1Ad) (Rev. 04/20/11)

Corporation Service Company
2711 Centerville Rd, Ste. 400
Wilmington, DE 19808

Case [redacted] Claim 16 Part 3 Filed 05/16/18

Chapter 10

Ninth Circuit Case Law Update

The Honorable Whitman Holt
U.S. Bankruptcy Court, Eastern District of Washington
Yakima, Washington

Dominique Scalia
DBS Law
Seattle, Washington

Ava Schoen
Tonkon Torp LLP
Portland, Oregon

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Government may assert sovereign immunity as defense to the merits of claims brought under § 544(b) where the defense would be available under applicable law outside of the bankruptcy context

United States v. Miller, 604 U.S. ___ (2025)

The Supreme Court resolved a circuit split over whether § 106(a)—which waives the government's sovereign immunity with respect to claims under § 544 and other sections of the Code—waives the government's sovereign immunity with respect to state-law claims that provide the "applicable law" underlying claims brought under § 544(b).

Utah-based transportation company All Resorts Group ended up in bankruptcy after two of its shareholders misappropriated company funds to pay their own personal expenses, including $145,000 to the Internal Revenue Service for their personal income taxes. The trustee attempted to avoid the tax payments by filing a claim under § 544(b), citing Utah fraudulent transfer laws as the "applicable law" underlying the claim. On cross-motions for summary judgment, the government argued that the trustee could not meet the "actual creditor" requirement contained in § 544(b), because a claim brought by any creditor under Utah law would be barred by sovereign immunity.

The trustee argued that § 106(a) waived sovereign immunity "with respect to" § 544, and that the waiver thus applied equally to the cause of action itself and to all other "subjects that concern or regard" the provisions listed in § 106(a), including the "applicable law" that provides the elements of the cause of action.

The bankruptcy court rejected the government's argument and entered judgment for the trustee, and the District Court and Tenth Circuit both affirmed the bankruptcy court's decision.

The Supreme Court overruled the Tenth Circuit, holding that sovereign immunity was available to the government as a meritorious defense to state law claims nested within causes of action brought under § 544(b). The Court held that § 106(a) does nothing to alter the elements of any cause of action, whether under § 544 or any other section of the code to which § 106(a) applies; thus, while the government cannot assert sovereign immunity as a jurisdictional defense to a claim under § 544, it can nonetheless assert it as a merits defense against a state-law cause of action that provides the elements thereof.

The Supreme Court noted that sovereign immunity waivers are "merely jurisdictional" in nature, and while they allow courts to hear cases against the government, they do not generally create new substantive rights. In keeping with that rule, the Court stated that § 106(a) grants bankruptcy courts the power to hear cases against the government under specified Code sections, but that by its own terms it does not "create any substantive claim for relief or cause of action not otherwise existing …." 11 U.S.C. § 106(a)(5). The Court also cited §70e of the Bankruptcy Act of 1898, from which § 544(b) was derived, which the Court stated was well understood to provide trustees with no greater rights than creditors had under state law. Thus, because the government could invoke sovereign immunity as a defense to a claim brought under Utah's fraudulent transfer law

outside the context of a bankruptcy proceeding, the Court reasoned, the same defense is available within the bankruptcy context.

The Court found more compelling the trustee's argument that the government's reading of § 106(a) would render pointless the inclusion of § 544 in the waiver of sovereign immunity; as the Court characterized the trustee's argument, "it simply grants federal courts jurisdiction over a set of inherently unwinnable claims." Ultimately the Court was unpersuaded, however, because the inclusion of § 544 would still allow for claims against the government under § 544(a) (which has no "actual creditor" requirement), or against state governments. The Court also noted that every section listed in § 106(a) was listed in its entirety, without any demarcation of specific subsections.

Justice Gorsuch filed a brief dissent to Justice Jackson's majority opinion, reasoning that the elements of the Utah statute were satisfied under the agreed facts of the case, making the transfers "voidable" under the "applicable law." Justice Gorsuch stated that § 106(a) bars the government from raising any sovereign immunity defense in the trustee's lawsuit. He disagreed with the majority that this reading of § 106(a) would alter the elements of the § 544(b) claim, stating that Congress had simply chosen to waive sovereign immunity in one context but not the other.

Under the logical relationship test, courts must consider the equitability of recoupment in each individual case.

Cooper v. Social Security Administration, ___ F.4th ___, 2025 WL 866003 (9th Cir. Mar. 20, 2025)

The 9th Circuit held that recoupment is impermissible when the Social Security Administration seeks to recoup pre-petition overpayments from a debtor-beneficiary who engaged in no malfeasance. In doing so, the 9th Circuit joined the 3rd Circuit in a split with the 1st and 8th Circuits.

Darrin Lenald Cooper suffered a disabling injury at work in 2007 and eventually filed for bankruptcy. He applied for and received workers' compensation. Twelve years later he applied for Social Security Disability Insurance benefits ("SSDI"). In his application he disclosed that he received workers' compensation, but the Social Security Administration ("SSA") improperly processed his forms, and indicated that he did not receive those benefits. Accordingly, he received higher SSDI payments than if SSA had properly processed his forms. Cooper later filed a no-asset Chapter 7 bankruptcy. Neither he nor the SSA knew that he had been overpaid SSDI benefits, so he did not schedule the overpayment as a debt, nor list the SSA as a creditor. Cooper received a discharge and continued to receive SSDI.

The SSA learned of the overpayment and sought to recover it despite the discharge. It relied on the doctrine of "equitable recoupment," which provides an exception to the discharge injunction. Recoupment must arise from the same transaction or occurrence as a plaintiff's claim, and is asserted strictly for the purpose of abatement or reduction of such claim. This distinguishes it

from a setoff, which is about mutual debts, but not from the same claim. To determine if a claim arises from the same transaction or occurrence, the 9th Circuit uses the "logical relationship test." The test asks whether the relevant rights being asserted against the debtor are sufficiently logically connect to the debtor's countervailing obligations such that both may be fairly said to constitute part of the same transaction. Here, the SSA argued that the continuing SSDI payments were logically connected to the past overpayments, and therefore the pre-petition overpayment justified a reduction of future payments until the overpayment was recovered.

The bankruptcy case was reopened, and the bankruptcy court ruled in the SSA's favor. It held that the pre-petition overpayments were logically linked to post-petition entitlements because the SSA must consider an applicant's entire work history, so the SSA must consider work history that pre-and post-dates a petition. The BAP affirmed, holding that under 9th Circuit precedent, it was precluded from considering the equities of the case when applying the logical relationship test.

The 9th Circuit reversed and clarified that the logical relationship test demands consideration of equitability, including the purpose of the Bankruptcy Code, in each individual case. For support it looked to *In re Gardens Regional Hospital and Medical Center, Inc.*, 975 F.3d 926 (9th Cir. 2020). There, a California agency sought to recoup from a hospital in Chapter 11 bankruptcy by discounting the state's payments to the hospital through the state's Medicaid program. The 9th Circuit allowed some, but not all discounts. The agency could not discount future payments to the hospital to reimburse patient services, however, because California's Medicaid scheme involves circular payments where hospitals pay into a common fund and receive payments from that fund, those payments could be discounted. There was a logical connection between the future payments and the circular scheme, but no connection between the future payments and patient services.

As applied to Cooper, the 9th Circuit focused on the fact that the SSA overpaid him because of its own error. The court repeatedly cautioned that recoupment should only be applied in bankruptcy cases where it would be inequitable for the debtor to enjoy the benefits of that transaction with meeting its obligations. Cooper had disclosed that he was receiving worker's compensation benefits. His no-asset Chapter 7 bankruptcy discharged even his unscheduled debts. His SSDI payments were ordinary and necessary living expenses. In these circumstances, allowing recoupment would defeat the purpose of the Bankruptcy Code, to provide a fresh start to honest but unfortunate debtors. Because the court could consider the equities and they favored Cooper, the 9th Circuit reversed and remanded.

Federal receivership courts can extinguish third-party state causes of action against non-receivership entities that "substantially overlap" with the receiver's claims when approving global settlement.

S.E.C. v. Peterson, 129 F.4th 599 (9th Cir. 2025)

This appeal presented three questions (1) whether a district court that has equitably appointed a receiver may issue a bar order extinguishing claims against non-receivership entities, (2) whether such an order violates the Anti-Injunction Act, 28 U.S.C. § 2283, and (3) whether a bar order issued in this case was unfair. The 9th Circuit held that the district court had authority, the Anti-Injunction Act did not preclude the bar orders, and the challenged bar order was not unfair.

ANI Development, LLC ("ANI") was operated as a Ponzi scheme. It ostensibly provided short-term, high-interest loans to businesses seeking California liquor licenses. It attracted investors who believed that their investments were held in escrow accounts by Chicago Title Company ("Chicago Title"). ANI did not in fact supply loans to liquor license applicants, nor were there escrow accounts with Chicago Title. Instead, ANI had a single holding account with Chicago Title, which ANI's owner used as a personal slush fund, and to funnel profits to earlier investors. ANI also used funds to bribe Chicago Title officials, who forged paperwork to make it appear as though the funds were held in separate escrow accounts.

Eventually the scheme collapsed and several lawsuits followed. First, the SEC brought a civil enforcement action. The district court appointed a receiver over ANI and stayed all litigation against it. In response, ANI's defrauded investors brought claims in state court against third-parties that aided in the Ponzi scheme, including Chicago Title. Chicago Title settled with over 300 defrauded investors and paid over $163 million. Chicago Title did not settle with Kim Peterson and his related entities (collectively, "Peterson"), who was a net-winner and had recruited investors to the Ponzi scheme. That case continued.

Meanwhile, back in federal court, the district court authorized the receiver to sue Chicago Title, and for Chicago Title to sue the receivership estate. The receiver and Chicago Title reached a global settlement, which included orders barring any further litigation against Chicago Title or a law firm "Nossaman"[1] stemming from the Ponzi scheme. That extinguished Peterson's state court claims against Chicago Title, so Peterson appealed.

Peterson made three arguments. *First*, he argued that the district court lacked authority to issue the bar order, but the 9th Circuit disagreed. The 9th Circuit provided two reasons: the receiver's claims and Peterson's claims against Chicago Title "substantially overlapped" and the bar order was necessary to protect the ANI receivership's assets. Looking to three cases from the 5th Circuit,[2] the 9th Circuit held that district courts have authority to prevent litigation that interferes

[1] These consolidated appeals challenge both the order barring claims against Chicago Title and the order barring claims against Nossaman. The challenge to the Chicago Title order was brought by Peterson. The Nossaman challenge was brought by Ovation Fund Management II. Because the 9th Circuit applied the same logic to both appeals, this summary only addresses the Chicago Title bar order for the sake of brevity.

[2] Zacarias v. Stanford International Bank, Ltd., 945 F.3d 883 (5th Cir. 2019); SEC v. Stanford International Bank, Ltd., 927 F.3d 830 (5th Cir. 2019); Rotstain v. Mendez, 986 F.3d 931 (5th Cir. 2021).

with a receiver's efforts to recover losses, if the litigation arises from the same fraudulent conduct. Here, Chicago Title's misconduct allowed ANI to continue its Ponzi scheme for longer. That increased its liability for fraud. The receiver sought to recover its losses in the form of that increased liability. Similarly, Peterson sought to recover its losses because of Chicago Title's role in the Ponzi scheme. Because both parties' claims stem from the same conduct by Chicago Title, they "substantially overlapped." And because they substantially overlapped, the district court had authority to issue the bar order.

Second, Peterson argued that the Anti-Injunction Act precluded the bar order, and the 9th Circuit found Peterson' argument without merit. The Anti-Injunction Act provides that a "court of the United States may not grant an injunction to stay proceedings in a State court except . . . where necessary in aid of its jurisdiction or to protect or effectuate its judgments." The 9th Circuit again approvingly cited the 5th Circuit's *Zacarias* case, which held that an order barring state proceedings that threatened receivership property was in aid of the federal court's jurisdiction over that property.

Third, Peterson argued that the bar order against Chicago Title was unfair, and the 9th Circuit rejected Peterson's argument again. Peterson argued that he could not share in the receiver's settlement with Chicago Title because, as a net Ponzi-scheme winner, he could not recover through a claim in the receivership estate; nor could he get relief directly from Chicago Title. But the 9th Circuit ruled that the reason Peterson would not receive payment was significant (and in doing so returned to the 5th Circuit's jurisprudence). It explained that the reason Peterson would get nothing from the receivership estate was because he was entitled to nothing through the Ponzi formula that applied to all creditors. Peterson was neither exempt from it, nor categorically excluded from submitting a claim; he was just entitled to nothing. In that circumstance, a district court does not abuse its discretion in issuing a bar order.

Voluntary retirement contributions are not disposable income for Chapter 13.

In re Saldana, 122 F.4th 333 (9th Cir. 2024)

In a split opinion, the 9th Circuit held that voluntary contributions to employer-managed retirement plans are not disposable income of the employee under Chapter 13 of the Bankruptcy Code.

Jorden Marie Saldana filed for a Chapter 13 bankruptcy. As an above-average earner, she applied various exclusions, deductions, and allowances to calculate her disposable income. Her plan included no payments to unsecured creditors. The trustee challenged her disposable income calculation. Relying on *In re Parks*, 475 B.R. 703 (9th Cir. B.A.P. 2012), the bankruptcy court held that Ms. Saldana's voluntary contributions to her employer-managed retirement account should be included in her disposable income. That change meant her unsecured creditors would receive around a 30% return. Ms. Saldana appealed. The bankruptcy court's ruling was upheld by the district court and bankruptcy appellate panel. The 9th Circuit reversed.

The majority saw this as a simple issue. Section 1325 provides the calculation for a debtor's disposable income. Section 541(b) states that any amount withheld, or received, by an employer from the wages of employees for payment as contributions to qualifying retirement plans "shall not constitute disposable income as defined in section 1325(b)(2)." Thus the 9th Circuit concluded that the plain language is clear and a debtor can exclude any amount of their voluntary retirement contributions to employer-managed plans from their disposable income.

The 9th Circuit also reasoned that its interpretation was consistent with the canons of statutory construction. Prior to the Bankruptcy Abuse Prevention and Consumer Protection Act, passed in 2005, courts routinely held that voluntary retirement contributions were disposable income. Congress amended the Bankruptcy Code to encourage reorganization under Chapter 13 and discourage Chapter 7 bankruptcies. The 2005 amendments added the Section 541(b) language excluding retirement contributions from disposable income. Because courts presume a significant change in statutory language has meaning, the 9th Circuit concluded that Congress intended to change the status quo, and so it changed the treatment of retirement contributions in Chapter 13.

In dicta the court goes on to explain why three alternative interpretations are wrong. In one reading, disposable income includes all voluntary retirement contributions, but such an interpretation is wrong because it renders the 2005 amendment meaningless. In another reading, voluntary contributions are not disposable income, so long as the debtor was making payments prior to declaring bankruptcy. But that has no textual support. Finally, a third reading espoused that the average from the last six months of voluntary contributions would be excluded from disposable income. The 9th Circuit again rejected this for lacking textual support.

Judge Callahan dissented. She argued that the language was not plain. As support, she pointed to the fact that over twenty years since the 2005 amendments, courts have adopted four different interpretations. She would have adopted the logic of *In re Parks* and held that pre-petition retirement contributions are not estate property, but post-petition contributions are.

Chapter 13 Debtor May Dismiss Chapter 13 Petition Without Proving Chapter 13 Eligibility

In re Powell, 119 F.4th 597 (9th Cir. 2024)

This case presented the question of whether the absolute right of a Chapter 13 debtor to dismiss their petition under *In re Nichols*, 10 F.4th 956 (9th Cir. 2021), is conditioned on the bankruptcy court determining that the debtor is in fact eligible for Chapter 13 relief. The 9th Circuit said no.

Jason Powell filed a petition under Chapter 13 of the Bankruptcy Code, and his former employer, TICO Construction Company, Inc. ("TICO"), filed a claim. Later Powell voluntarily dismissed his Chapter 13 case and TICO opposed. The bankruptcy court interpreted *In re Nichols* to give Powell an absolute right to voluntarily dismiss his Chapter 13 bankruptcy case, so it granted the motion. TICO appealed. The BAP and 9th Circuit both affirmed.

The 9th Circuit began with four elements under Section 1307(b) for a voluntary dismissal: (1) a request, (2) by a debtor, (3) who has a Chapter 13 case, (4) that has not been converted to another enumerated chapter under Title 11. TICO conceded that those four elements were satisfied, and that the 9th Circuit previously held that the right to dismiss under Section 1307(b) survives even if the debtor filed the Chapter 13 petition in bad faith. However TICO continued that only debtors who are entitled to relief under Section 109(e) have an absolute right to dismiss the petition under Section 1307(b). So when a Chapter 13 debtor seeks to dismiss their case, the bankruptcy court must determine if the debtor is in fact entitled to relief under Section 109(e). If ineligible, the case cannot be dismissed unless it is in the best interests of the estate and creditors.

The court explained the flaws in TICO's position. It took issue with the definition of "debtor" and requirement to resolve eligibility. "Debtor" is not defined under Section 1307(b), but it is defined in Section 101(13). A debtor is "a person or municipality concerning which a case under this title has been commenced." The Bankruptcy Code does not define debtor as someone who meets chapter-specific eligibility requirements.

The court thus rejected TICO's strained argument that the Section 101(13) definition's use of the word "commence" necessarily incorporates Section 301(a), which uses the phrase "may be a debtor"—the same phrase used in Section 109(e) defining Chapter 13 eligibility—leading TICO to conclude that Sections 101(13), 109(e), and 301(a) must all be tied together such that Section 101(13)'s definition of debtor is limited to those who may be a debtor under Chapter 13. But the 9th Circuit pointed out that Section 101(13) defines "debtor" for the entire title, so it does not make sense that the definition would incorporate only a reference to a single chapter.

The eligibility determination was similarly rejected. That is because under Section 301(a), a case is commenced when a petition is filed, not when eligibility is determined. And the filing entity's certification of eligibility presumptively establishes that the entity may be a debtor under the designated chapter. In support of this, the court noted that when a debtor is later determined to be ineligible for relief under their designated chapter, it does not render void all proceedings occurring to that point. Because there is a presumption of eligibility until proven ineligible, an entity that has filed a Chapter 13 petition retains the absolute right to dismiss the petition.

Judge Collins dissented. He argued that the benefits of Chapter 13 should inure only to those who are actually eligible for Chapter 13 relief. Section 109(e) determines Chapter 13 eligibility. If a creditor challenges a debtor's exercise of a Chapter 13 power, then a bankruptcy court must confirm Chapter 13 eligibility before allowing the debtor's action.

Chapter 15 Stays Are Effective When Recognized By An American Court, Not When Petition Filed

International Petroleum Products & Additives Company, Inc. v. Black Gold S.A.R.L., 115 F.4th 1202 (9th Cir. 2024)

This case presented two questions (1) does a stay under Section 1520 apply retroactively when an order denying a petition is later overturned on appeal, and (2) does a stay under Section 1520

encompass alter ego claims against a foreign debtor company's sole owner? The answer to both is no.

The facts and procedural history of this case are long and entertaining. International Petroleum Products and Additives Company ("IPAC") had a sales agreement with Black Gold S.A.R.L. ("Black Gold"), a limited liability company headquartered in the Principality of Monaco. The sales agreement involved various non-disclosure and non-compete agreements, which Black Gold blatantly violated. Mr. Napoleoni left Black Gold to found PXL Chemicals BV ("PXL") a company based in the Netherlands. He started PXL with "a confidential password-protected Excel spreadsheet 'detailing the identity, vendor, price, and relative composition for each component in each of IPAC's products,' as well as 'large amounts of other IPAC Confidential Information relating to IPAC sales in pricing.'" IPAC later discovered the breaches and sued Black Gold. At the arbitration hearing, when Mr. Napoleoni was asked how PXL so quickly produced a product so similar to IPAC's, he said he "had [IPAC's information] available, and yeah. That's it."

The arbitration panel found in favor IPAC, but IPAC had trouble collecting from Black Gold. IPAC registered its judgment in the Northern District of California and entered post-judgment asset discovery. Black Gold completely stonewalled and ignored court orders to compel production. Two years after IPAC won in arbitration, Black Gold filed for bankruptcy in Monaco and filed for recognition of those proceedings under Chapter 15 of the Bankruptcy Code. The bankruptcy court denied the Chapter 15 petition, which Black Gold appealed.

Notably, Black Gold did not move for a stay of the district court post-judgment proceedings pending appeal of its denied Chapter 15 petition, so IPAC continued its collection efforts. IPAC moved to amend its judgment to include Mr. Napoleoni and his wife as judgment debtors on the theory that they were Black Gold's alter ego. The district court granted adverse inferences against the Napoleonis for their discovery misconduct, and granted the motion to include them as judgment debtors.

Meanwhile the appeal of Black Gold's denied Chapter 15 petition progressed. The BAP reversed the bankruptcy court's denial of the Chapter 15 petition. Despite agreeing that the Monaco proceedings were a sham, that was insufficient to deny a petition that otherwise satisfied the pleading requirements of Chapter 15 (which it did). IPAC did not appeal the BAP's decision, which became final. The reversal triggered the automatic bankruptcy stay, but the 9th Circuit limited it. It ordered that the stay applied to proceedings against Black Gold, and not against the Napoleonis individually, who had been added as judgment debtors to IPAC's arbitration award.

On remand to the district court in the post-judgment proceedings, the Napoleonis argued that the alter ego claim was subject to the automatic stay. The district court rejected the argument, and the case found itself on appeal before the 9th Circuit directly from the district court.

Automatic stays under Chapter 15 take effect only after entry of an order granting recognition of a foreign bankruptcy proceeding. The Court held that the answer to when the stay takes effect—and whether it is retroactive—"is as straightforward as the question is novel." Because the bankruptcy court's order did not "grant[] recognition" of the foreign bankruptcy proceedings, the

stay did not take effect. It was only the later in time reversal that granted recognition and started the stay. The 9th Circuit also refused to give retroactive application of the stay because the Napoleonis failed to seek a stay under Rule 8007. A Rule 8007 stay requires the court to balance the interests of all parties, not just the losing below, and could be conditioned on the losing party posting a bond or other security. No bond or security was placed, so the 9th Circuit refused to retroactively impose a stay when the Napoleonis failed to seek one prospectively.

On the issue of whether the alter ego claim belonged to the estate, the 9th Circuit held that the Napoleonis had failed to comply with Federal Rule of Civil Procedure 44.1 and so were precluded from raising its argument. Rule 44.1 requires a party who intends to rely on a foreign country's law to give notice of that intention. The court reasoned that whether the claim belonged to the estate was a matter of state law and here, that state was Monaco and Monesgasque law. The Napoleonis failed to give Rule 44.1 notice, so they could not argue that under Monegasque law the alter ego claim belonged to the estate. Instead, the court applied California law, which provides that an alter ego claim remains with a creditor unless there is an injury alleged to the corporation itself.

Finally, the Napoleonis argued that if they are the alter ego of Black Gold, then Black Gold is their alter ego as well. And because there is an automatic stay against Black Gold, that should apply to them too. The 9th Circuit refused to adopt the Fourth Circuit's "unusual situation" exception and held that this was not the correct procedural posture to rule on it because it was raised in the first instance on appeal.

Depletion Of Estate Property Is Injury-In-Fact To Trustee

In re O'Gorman, 115 F.4th 1047 (9th Cir. 2024)

This case presented the question of whether a bankruptcy trustee had standing to assert fraudulent transfer actions when no creditor was harmed by the transfer. The 9th Circuit concluded that the depletion of assets of the estate constituted an injury-in-fact to the trustee.

Debbie Reid O'Gorman owned a 30-acre plot of land that she lived on, valued at $2.5 million. It was subject to a mortgage and second deed of trust. O'Gorman paid the mortgage, but the holder of the second deed of trust, Grant Reynolds, who was O'Gorman's former attorney, threatened foreclosure. William Utnehmer, another attorney, approached O'Gorman with a scheme to prevent foreclosure. Utnehmer's plan was to create three trusts ("transferees"). The transferees were structured so ultimately O'Gorman would be paid $235,000 and then the remaining proceeds of the sale of the land would be split 80-20, with 80% inuring to Utnehmer and 20% to O'Gorman. O'Gorman agreed to the plan and transferred the land to the transferees for no consideration, and to prevent Reynolds from foreclosing. O'Gorman fired Utnehmer before the land was sold and filed a Chapter 7 petition.

The Chapter 7 trustee filed an adversary action against the transferees to avoid the transfer of the land. The trustee moved for summary judgment, supported by a declaration from O'Gorman stating that it was her understanding that the transfer would prevent or delay Reynolds from

foreclosing on his deed of trust and that was her only reason for following Utnehmer's advice. The transferees opposed summary judgment arguing that there was insufficient evidence of actual intent to hinder, delay, or defraud Reynolds, and the summary judgment motion was otherwise premature because the parties had not conducted a Rule 26(f) conference. They did not submit an affidavit contesting any facts put forth by the trustee. The bankruptcy court granted the motion for summary judgment and denied the continuance until after a Rule 26(f) conference because the transferees had not submitted an affidavit. They appealed.

The transferees first argued that the trustee lacked standing because no creditors were harmed by the transfer. The transfer included a $235,000 priority distribution to O'Gorman in the event of a sale, the Chapter 7 creditor's claims were less than $235,000, so upon sale of the land there would be sufficient funds to pay all creditors in full—and no creditor would be harmed. Thus, no injury-in-fact. But the 9th Circuit disagreed. It framed the fraudulent transfer as harming the estate by depleting its assets, and held that a trustee suffers an injury-in-fact when the estate is harmed.

Next, the 9th Circuit addressed whether an injury to a creditor is an element of a Section 548 claim. Noting that it had not ruled in the issue before, the 9th Circuit joined the 4th Circuit and 8th Circuit in concluded no harm is necessary because the statute permits a trustee to avoid "any" fraudulent transfer of the debtor's property.

Finally, in the longest analysis section of the opinion, the court concluded that summary judgment was appropriate. The gravamen of the section is that O'Gorman's declaration was unrebutted direct evidence of actual intent to hinder and delay Reynolds' foreclosure efforts and if the transferees wished to contest it, they could have submitted an affidavit in opposition. They failed to do so, so the material facts were uncontested and judgment was appropriate as a matter of law.

The Schedules Do Not Necessarily Control When Chapter 11 Debtor Makes Contradictory Statements To Creditors During the Period To Object To Exemptions

In re Masingale, 108 F.4th 1195 (9th Cir. 2024)

At the time that Rosana and Monte Masingale filed for Chapter 11 bankruptcy the maximum homestead exception that they could claim was $45,950. Their house was valued around $165,000. On their schedules, they claimed a homestead exemption for "100% of FMV." Before the 30-day window for creditors to object ended, the Masingales filed a disclosure statement and proposed Chapter 11 Plan. There, they claimed that their homestead exemption did not exceed the statutory limit. The question presented by this case was whether creditors could rely on the Masingales' statements, or if the schedules were operative. The 9th Circuit concluded that creditors could rely on the statements outside the schedules.

In the Chapter 11 proceedings, no creditors objected to the homestead exemption. Over a year later, the United States Trustee moved to convert the case to a Chapter 7 liquidation. Because it

had been over a year, the creditors and the Chapter 7 trustee could not raise new objections to the homestead exemption.

Rosana Masingale[3] subsequently tried to sell her home for $400,000 without giving any proceeds to the bankruptcy estate. She argued that because she claimed "100% of FMV" as the value of her exemption on the schedules and no creditor objected to the exemption, her entire interest in the home was withdrawn from the estate.

Masingale and the Trustee filed cross motions—Masingale to compel the Trustee to abandon the property, and the Trustee for authority to sell the home. The bankruptcy court granted the Trustee's motion and denied Masingale's, holding that she was entitled only to the statutory cap on her homestead exemption. The Trustee sold the property for $422,000. Masingale appealed.

The 9th Circuit Bankruptcy Appellate Panel reversed in a published opinion. It ruled that the "100% of FMV" on the schedules were dispositive and that such a ruling was compelled by *Taylor v. Freeland & Fronz*, 503 U.S. 638 (1992), and *Schwab v. Reilly*, 560 U.S. 770 (2010). The BAP went on to criticize Masingale and her counsel for the "frivolous" claim for exemption and suggested sanctions as a remedy, but because no creditor objected to the exemption, Masingale was not limited to the statutory cap.

The 9th Circuit reversed. It began by drawing principles from *Taylor*—where the exemption warranted an objection because it signaled the debtor's intention to withdraw the asset from the bankruptcy estate—and *Schwab*—where it did not. The *Schwab* Court opined that language such as "100% of FMV" may be sufficient to put creditors on notice that the debtor intends to remove an asset from the bankruptcy estate.

The court did not rule on whether the "100% of FMV" claim on the schedules raised the "warning flag" that creditors had a "make-it-or-lose-it objection." That was because it looked outside the schedules to the statements that the Masingales made to creditors during the 30-day period to object. The 9th Circuit reasoned it was appropriate to look outside the schedules because the Masingales had fiduciary duties to their creditors; and, while trying to win support for the confirmation of the Chapter 11 Plan, they had told creditors that they would not claim above the statutory cap.

The Court also outright rejected Masingale's proposed *per se* rule. She had argued that when there are potentially conflicting statements by a debtor, the schedules should always control. The Court reasoned that such a rule would incentivize frivolous exemption claims and require objections. Such a rule would reduce efficiency in the bankruptcy process, so the Court refused to adopt it.

[3] Monte Masingale passed away while the proceedings were ongoing.

"Tax-First" Method Required To Allocate Proceeds Between Taxes And Penalties When A Sale Does Not Generate Sufficient Proceeds To Pay Entire Tax Lien And Penalty Portion Has Been Avoided

In re Leite, 112 F.4th 1246 (9th Cir. 2024)

This appeal presented the question of how to allocate sale proceeds among the IRS and bankruptcy estate after the tax penalty portion of a tax lien is avoided under Section 724(a) and the trustee stands in the shoes of the IRS for lien priority under Section 551. The 9th Circuit was confronted with two competing methodologies: the "pro rata" method, and the "tax-first" method. The 9th Circuit adopted the "tax-first" method and concluded that the unavoidable taxes and interest must be paid in full before the sale proceeds could be used to pay the trustee for the avoidable portion of the tax lien.

The 9th Circuit began with the statutory framework. It noted that courts interpret the Bankruptcy Code with a presumption that the Code does not change preexisting pre-Code practice. Section 724(a) and Section 551 both expressly deviate from pre-Code practice. Section 724(a) deviates because it makes some claims for penalties "voidable not void" in order to permit the penalty lien to revive if a Chapter 7 bankruptcy is converted to a Chapter 11 bankruptcy. Section 551 "preserves" the estate by allowing a trustee to stand in the shoes of lienholder whose lien has been avoided under seven statutes, including Section 724(a).

It then rejected the pro rata method. Section 724(a) allows for a partial avoidance of a tax lien. A trustee may avoid the penalty portions only, but may not avoid the compensatory tax provisions of tax liens. Section 551 preserves only what Section 724(a) avoids, the non-compensatory penalties.

This limitation on Section 551 creates three problems with the pro rata method. First, it preserves part of the unavoidable tax lien because it reduces the actual amount recovered from the unavoidable tax lien. Second, it runs counter to policy. Section 724(a) is to protect unsecured creditors from the debtor's wrongdoing. But the pro rata method instead prioritizes unsecured creditors by placing them on the same level as the unavoidable portion of the tax lien. Third, it conflicts with priorities set out in the Bankruptcy Code. Generally, the Bankruptcy Code prioritizes secured creditors over unsecured creditors and taxes over penalties. But the pro rata method reduces recovery for the IRS's secured tax lien for compensatory unpaid taxes.

The last important section of the opinion provides further explanation for the distinction between taxes and penalties, and the different treatment that they receive under the Bankruptcy Code, as reflected in subordination under Section 726(a)(4). Thus when a trustee avoids a tax penalty, the trustee stands in the shoes of the IRS insofar as the trustee is ahead of junior secured creditors, but remains subordinated behind the IRS's unavoidable portion of the tax lien.

Proving the objective criteria of a Ponzi scheme satisfies the *mens rea* requirement for fraudulent intent

In re EPD Investment Company, LLC, 114 F.4th 1148 (9th Cir. 2024)

This case presented the question of whether a *mens rea* jury instruction is required in fraudulent transfer cases alleging the operation of a Ponzi scheme. The 9th Circuit held that the instruction was not required.

The appeal arose in a unique posture. EPD Investment Company, LLC ("EPD")'s creditors successfully forced it into a Chapter 7 bankruptcy. Ann Kirkland served as trustee to one creditor, Bright Conscience Trust ("BC Trust"). She was married to John Kirkland. This case began when the trustee filed an adversary proceeding against John seeking to avoid fraudulent transfers made by EPD to John. However, because John was not a party to the bankruptcy nor did he file a proof of claim, the fraudulent transfer case against John went before a jury in the district court.

The jury returned a verdict in favor of John. It found that he received reasonably equivalent value for his payments from EPD, and received them in good faith. However, it also found that EPD was operated by the Chapter 7 debtor as a Ponzi scheme. Because that finding would have a preclusive effect on BC Trust's proofs of claim in the Chapter 7 bankruptcy, Ann Kirkland appealed from a verdict in her husband's favor. She sought vacatur of the jury finding that EPD was a Ponzi scheme.

The 9th Circuit first concluded that Ms. Kirkland and her trust had standing. The trustee argued that she did not because she was not a party to John's trial. However, because the bankruptcy court held that all findings from the jury would be binding on the bankruptcy proceedings—including that EPD was operated as a Ponzi scheme—the findings were binding on BC Trust, so its trustee had standing.

Ann challenged the jury instructions for two reasons. First, she contended that the court erred when it did not include a *mens rea* jury instruction. Second, she argued that the court erred in instructing the jury that lenders are investors for the purposes of a Ponzi scheme.

The court concluded that no *mens rea* instruction was necessary. In fraudulent transfer cases, if a trustee proves that the debtor operated a Ponzi scheme, then the trustee is entitled to an irrebuttable presumption that the debtor transferred money with actual fraudulent intent under 11 U.S.C. § 548. That is because a Ponzi scheme, by definition, is giving investors the impression that a legitimate profit-making business opportunity exists where in fact no such opportunity existed. The court extended this logic to proving *mens rea*. In operating a Ponzi scheme there can be no intent but fraudulent intent, thus proving the objective criteria of a Ponzi scheme also satisfies proving the *mens rea* requirement of the perpetrator.

Next, she argued that the district court erred in including "lenders" as a possible category of victims of a Ponzi scheme. Her logic was that only "investor" could be injured by a Ponzi scheme because an investor expects a business generating a profit, and would not invest in a Ponzi scheme if they knew there was no profit-generating business that they are invested in.

Conversely, a "lender" provides a loan, which has fixed terms of repayment and does not depend on the existence of a profit-generating business.

The court did not buy it. It noted that Charles Ponzi and his eponymous Ponzi scheme was based on short-term loans to defraud lenders. Ann presented two additional arguments, one challenging the sufficiency of the evidence, and the second on the admission of expert testimony. Neither was availing, so the court affirmed.

The panel drew a dissent from Judge Clifton. Judge Clifton argued that the majority's logic was circular because a Ponzi scheme is a form of fraud, proving fraud requiring proving fraudulent intent, so proving a Ponzi scheme cannot prove fraudulent intent, because fraudulent intent is an element of a Ponzi scheme.

Employment Claims Based On Single Course Of Continuing Conduct That Begins Pre-Petition And Continues Post-Petition Is A Claim Belonging To The Bankruptcy Estate.

Bercy v. City of Phoenix, 103 F.4th 591 (9th Cir. 2024)

The case presents the question of who can bring a hostile work environment claim arising from a course of discriminatory conduct that began pre-petition, and continued post-petition. The Court concluded that the claim belonged to the bankruptcy estate so only the Trustee could bring the case.

Bercy worked for the City of Phoenix. During that time, a co-worker allegedly made offensive and bigoted remarks about Bercy's race and ethnicity. Bercy filed a Chapter 7 bankruptcy petition seeking relief from her debt, in part so that she could leave her job. As part of her Chapter 7 petition, she stated that she had no claims against third parties, including employment disputes or rights to sue. The bankruptcy court discharged her debts.

Bercy then filed suit against the City of Pheonix. During discovery the City learned about the bankruptcy case and moved for summary judgment asserting that Bercy's claim belonged to the bankruptcy estate. The trustee moved to reopen the bankruptcy case, and agreed to a settlement with the City, pending the district court's dismissal of the hostile work environment claim with prejudice. The district court granted the motion for summary judgment. Bercy appealed, arguing that she was personally entitled to pursue damages for the post-petition conduct.

The court rejected Bercy's argument and affirmed. Relying on Title VII case law, the court concluded that the individual acts creating a hostile work environment are not individually actionable. Rather, they collectively create the hostile work environment. Because the conduct creating the hostile work environment began pre-petition, Bercy's cause of action accrued before the bankruptcy proceedings, so the claim belonged to the bankruptcy estate under 11 U.S.C. § 541(a)(6).

The court also distinguished Bercy's primary case, *O'Loghlin v. County of Orange*, 229 F.3d 871 (9th Cir. 2000). The court explained that the *O'Loghlin* case involved whether a creditor's claim

was discharged as a debt, rather than whether a debtor's claim was included in the estate as property.

District court cannot enter a stay without considering prejudice to the parties.

In re PG&E Corporation Securities Litigation, 100 F.4th 1076 (9th Cir. 2024)

This case presented the question of whether the district court abused its discretion when it *sua sponte* issued a stay without considering prejudice to the parties. The 9th Circuit held that it did.

The case originated with the northern California wildfires of 2017 and 2018. Plaintiffs filed two nearly identical complaints against two sets of defendants—PG&E Corporation and Pacific Gas & Electric Company—and its agents—current and former officers, directors, and bond underwriters. PG&E had declared bankruptcy, so the claims against it were referred to bankruptcy court whereas the complaint against the individual defendants remained in the district court.

The bankruptcy court moved fast. Between January 2020 and April 2021, it set up several processes for handling the claims against PG&E, which resulted in over 7,000 securities claims being filed and about 1,600 of those claims settling. Relevant to this case, not all claims against the individual defendants could be resolved in the bankruptcy court; and the first stage of the bankruptcy proceedings was expected to take four to seven years before moving to the second stage.

The district court moved slow. Between January 2020 and April 2021, the district court did not rule on a fully briefed motion to dismiss the claims against the individual defendants. In April 2021, in seeming reliance on plaintiffs' statements about the overlapping nature of the district court case and bankruptcy case, the court *sua sponte* issued a notice of intention to stay the proceedings. The plaintiffs opposed. Eighteen months later, the court issued the stay while the fully briefed motion to dismiss was still pending. Plaintiffs filed an interlocutory appeal challenging the stay.

The 9th Circuit first addressed whether it had jurisdiction over the interlocutory appeal. Applying the *Moses H. Cone* doctrine from *Moses H. Cone Memorial Hospital v. Mercury Construction Corp.*, 460 U.S. 1 (1983), it concluded that it did. That doctrine gives appellate jurisdiction over stay orders if it effectively places a plaintiff out of court. The court held that the first phase of the bankruptcy could take as long as seven more years, which effectively put the plaintiffs out of court.

Having concluded it had jurisdiction, the 9th Circuit considered the merits of the district court's stay order. The order cited only judicial economy as the reason for the stay. The 9th Circuit agreed that the stay promoted judicial economy. In so doing it rejected the plaintiffs' argument that the bankruptcy proceedings would not assist the district court because they would not be binding. Instead, the court reasoned that the district court would receive considerable assistance in resolving the issues presented in the case if they were first addressed by the bankruptcy court.

The 9th Circuit vacated the stay, however, because the district court did not weigh the hardships that the stay may cause. Neither the district court nor the individual defendants articulated a single prejudice that they would suffer from having to litigate the case, whereas the plaintiffs identified many hardships, including the fading of memory and other spoilation of evidence. Because these issues were not addressed by the stay order, the district court abused its discretion in granting it.

A state does not waive sovereign immunity when it files an unsuccessful involuntary bankruptcy petition.

In re Blixseth, 112 F.4th 837 (9th Cir. 2024)

This case presented two questions: whether a state waives sovereign immunity when it petitions for involuntary bankruptcy, and whether 11 U.S.C. §§ 106 and 303(i) abrogate sovereign immunity.

This case began when the State of Montana Department of Revenue, Idaho State Tax Commission, and California Franchise Tax Board filed an involuntary bankruptcy petition against Timothy Blixseth under 11 U.S.C. § 303(b)(1). Blixseth settled with Idaho and California, who withdrew as petitioning creditors. The bankruptcy court granted Blixseth summary judgment finding that Montana's claim was the subject of a bona fide dispute as to the amount of liability, Montana lacked standing to pursue the claim in bankruptcy court, and the petition could not be sustained based on the existence of only one remaining petitioning creditor (who joined before Idaho and California settled). Montana appealed, but that was ultimately affirmed and the involuntary petition was dismissed.

During a hearing in the bankruptcy court, the court indicated its opinion that Montana had waived sovereign immunity by submitting to the jurisdiction of the court, to which counsel for Montana replied "I believe that's correct, Your Honor."

Blixseth brought an adversary proceeding against Montana seeking attorneys' fees and costs, proximate and punitive damages, and sanctions against counsel under Section 303(i). Montana moved to dismiss asserting sovereign immunity. The bankruptcy court denied the motion for three reasons. First, because Montana voluntarily invoked the bankruptcy court's jurisdiction by filing the involuntary petition, it waived sovereign immunity. Second, counsel's statement to the court clearly and unequivocally waived sovereign immunity. Third, and finally, the claim under Section 303(i) was ancillary to the bankruptcy's *in rem* jurisdiction such that it abrogated sovereign immunity.

The 9th Circuit Bankruptcy Appellate Panel denied the appeal citing a lack of jurisdiction over the interlocutory appeal. The 9th Circuit reversed that holding as an incorrect application of Supreme Court and Circuit precedent and turned to the merits.

The court first concluded that Montana had not voluntarily invoked the jurisdiction of the bankruptcy court by filing an involuntary petition. The court began by noting that Montana had

never filed a proof of claim, and therefore *Gardner v. New Jersey*, 329 U.S. 565 (1947), which held that a state waives sovereign immunity when it files a proof of claim, was not implicated. Thus, the waiver could arise only if the counterclaim was predicated on the same transaction or occurrence as the Montana's involuntary petition. The court held, as a matter of law, that a Section 303(i) claim is not the equivalent to a compulsory counterclaim because a Section 303(i) claim cannot arise out of the same factual predicate for involuntary petition. The simple reason being that filing an involuntary petition is itself an element of a Section 303(i) claim. The court also distinguished 303(i) claims from Rule 11 sanctions because the former is a fee shifting provision and the latter is not.

Next, in a single paragraph, the court held that Montana's counsel's statement to the bankruptcy court was not unequivocally expressed and therefore did not constitute a waiver of sovereign immunity.

Finally, the 9th Circuit concluded that the bankruptcy court's ancillary jurisdiction under *Central Valley Community College v. Katz*, 546 U.S. 356 (2006), did not abrogate sovereign immunity. In *Katz*, the Court recognized that states agreed to a limited waiver of sovereign immunity when ratifying the Bankruptcy Clause of the Constitution. This waiver was limited to subordination of sovereign immunity to the extent necessary to effectuate the *in rem* jurisdiction of a bankruptcy court. Specifically, the waiver is limited to "the exercise of exclusive jurisdiction over all of the debtor's property, the equitable distribution of that property among the debtor's creditors, and the ultimate discharge that gives a debtor a 'fresh start' by releasing him, or her, or it from further liability for old debts." The remedial nature of Section 303(i) claims do not implicate control over the estate or its equitable distribution. Additionally, a Section 303(i) claim does not concern property of the *res* of the bankruptcy estate because, after an unsuccessful involuntary petition, no *res* was created.

After determining that Montana had sovereign immunity, the circuit court reversed the bankruptcy court and remanded with instructions to dismiss the adversary proceeding. Blixseth has recently filed a petition for a writ of certiorari with the Supreme Court.

Malicious prosecution claims based on bankruptcy proceedings are completely preempted by federal law and within the exclusive jurisdiction of the bankruptcy court.

Cogan v. Trabucco, 114 F.4th 1054 (9th Cir. 2024)

This case presented the question of whether the *Rooker-Feldman* doctrine barred a state civil action for malicious prosecution of a claim in a bankruptcy proceeding. The 9th Circuit held that the Bankruptcy Code created exclusive federal jurisdiction for malicious prosecution claims arising from bankruptcy proceedings, so the state court lacked subject matter jurisdiction, and the *Rooker-Feldman* doctrine was inapplicable.

The parties here are Arnaldo Trabucco, a surgeon and Chapter 7 debtor, and Jeffrey Cogan, an attorney who represented a creditor in the Chapter 7 bankruptcy. Separately, the family members of a patient that Trabucco performed surgery on, who later passed away, sued Trabucco

for medical malpractice in an Arizona state court. Cogan came to represent that family in the Arizona case, as well as the bankruptcy proceedings.

In the bankruptcy case, Cogan filed an adversary complaint seeking a determination that Trabucco's liability to the family was nondischargeable under 11 U.S.C. § 523(a)(2)(A) and (a)(6). That included the allegation that Trabucco committed willful and malicious injury to his patient during surgery, and that he later made false statement to the family. The adversary complaint was ultimately dismissed with prejudice upon stipulation that the state court proceeding could continue without any claims about malicious or intentional conduct.

Trabucco then filed a complaint against Cogan and the family for malicious prosecution, abuse of process, and intentional infliction of emotional distress. After the medical malpractice claim was dismissed, and the bankruptcy discharge issued, the only remaining litigation was Trabucco's complaint.

Trabucco won an $8,000,000 judgment against Cogan and Cogan appealed. The Arizona appeals court affirmed Cogan's liability for the malicious prosecution claim, reversed as to the other claims, and remanded for a new trial on malicious prosecution damages only. Trabucco appealed to the Arizona Supreme Court. There, Cogan filed a motion to dismiss the case for lack of subject matter jurisdiction. He argued that the state courts lacked jurisdiction because the underlying conduct involved a federal bankruptcy proceeding. The Arizona Supreme Court denied the petition for review and the motion to dismiss. Before the new trial on damages in state court, Cogan filed a complaint in the district court to collaterally attack the state court judgment against him.

While the collateral attack was pending, Trabucco and Cogan settled the malicious prosecution case. Relevant here, it reimposed $8,000,000 but on terms where Trabucco could never effectively collect it. Then, Trabucco moved to dismiss the collateral attack action because it was barred by the *Rooker-Feldman* doctrine. The case was dismissed. Cogan appealed to the 9th Circuit.

For background on the *Rooker-Feldman* doctrine, the doctrine prevents district courts from reviewing final civil judgments of state courts. The reasoning announced by the Supreme Court was that district court are limited to original jurisdiction, and reviewing a state court judgment would be an exercise of appellate power. The Supreme Court is the only federal court with appellate jurisdiction over state court judgments.

First, the 9th Circuit determined that the case was not moot. It held that there was a difference between an invalid judgment because the state court lacked subject matter jurisdiction, and an unenforceable judgment because of a settlement agreement. The settlement agreement did not moot the dispute over the parties' underlying substantive rights. If Cogan prevailed in the federal case, then the state court's substantive determinations would be rendered void and Cogan's liability to Trabucco will be eliminated. Conversely, if Trabucco prevailed, then the state court's liability findings against Cogan would be preserved and his ensuing liability would be fixed and payable in accordance with the settlement's terms. In other words, the case was not

moot because if Cogan prevailed, the judgment would be void, which is different than if Trabucco prevailed, the judgment would exist (despite being unenforceable).

Cogan contended that Trabucco's malicious prosecution action was within the exclusive jurisdiction of the federal courts; that any judgment in that case was therefore subject to collateral attack in federal court; and therefore, *Rooker-Feldman* did not apply.

Previously, in *MSR Exploration, Ltd. v. Meridian Oil, Inc.*, 74 F.3d 910 (9th Cir. 1996), the court held that state malicious prosecution actions for events taking place within bankruptcy court proceedings are completely preempted by federal law. Because of the highly complex bankruptcy laws, the court concluded that Congress intended to insulate bankruptcy proceedings from even the slightest incursion or disruption from state courts. The specter of state malicious prosecution action may have a chilling effect on bankruptcy proceedings, such as by deterring a creditor from filing a proof of claim. That led the court to hold that Congress intended to remove such an action from the subject matter jurisdiction of the state courts. Because claims for malicious prosecution arising from bankruptcy claims are exclusive federal jurisdiction, the state court issued a judgment without jurisdiction, and that could be reviewed in a federal district court.

NOTES