Watch Out for the Putative "In-Kind" Exemption!

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About the Author

Lisa Gretchko, a shareholder at Howard & Howard Attorneys PC, concentrates her practice on creditors' rights and commercial litigation, and she has represented nearly every constituency in bankruptcy cases in Michigan and several bankruptcy courts around the country. She lectures extensively on creditors' rights issues.

In these troubled economic times, business bankruptcy lawyers increasingly find themselves involved in personal bankruptcy cases. As real estate development companies fail, the once-wealthy real estate developer might wind up in a chapter 7 or 11.[1] Or, perhaps your business client obtained a guaranty from the president of a company before shipping goods, and the guarantor has filed bankruptcy. No matter *how* the business bankruptcy attorney winds up involved in a personal bankruptcy case, it is important to know *what* to look for.


Lisa Sommers Gretchko

Most business bankruptcy attorneys thumb through the debtor's schedules and statement of affairs to see whether their client's claim is listed in the correct amount, or listed as disputed, contingent or unliquidated. For some creditors' attorneys, the analysis of the debtor's schedules ends there. However, the creditor's counsel *also* needs to look at the debtor's Schedule C of claimed exemptions. After all, it can be rather embarrassing to explain to your creditor client *why* the debtor has managed to skate through a personal bankruptcy with valuable assets exempt from creditors' claims.

In my most recent foray into a personal bankruptcy case, the debtor's Schedule C showed that he was attempting to exempt his interests in three businesses. The debtor owned interests in three privately held entities, and his Schedule C of "property claimed as exempt" alleged that the "market value" of his interest in each business was $1,000. That *same* Schedule C also listed the "value of the exemption" for the interest in each business at $1,000. Most of the other creditors thought that the debtor was just trying to exempt $1,000 of his interest in each business entity—and they weren't troubled by such small exemptions. However, a handful of creditors were concerned that the debtor's recitation of an *identical* market value and exemption value of his interests in these businesses meant that the debtor was really trying to exempt the *entire* value of the his stock in *each* of the businesses. What if the businesses were profitable so that the market value of his stock was worth far more than $1,000? (In fact, one of the businesses touted a new medical breakthrough.) Could the debtor be trying to exempt a valuable asset from the bankruptcy estate?

A term of art defines this maneuver: It is called the "in-kind exemption," because the debtor is trying to assert an exemption of an entire asset (not just the exemptible portion thereof). Despite the monetary limits in Bankruptcy Code §522(d), and in many state exemption schemes, debtors who purport to assert an in-kind exemption are attempting to effectively "pull a fast one" by trying to exempt assets *in their entirety*, while disregarding the statutory dollar limits for the exemption.

Creditors must watch for *any* sign that the debtor is trying to claim an in-kind exemption. The most obvious "red flags" are if debtor's Schedule C (1) lists the market value and the exempt value at identical figures or (2) lists the market value of the asset as "$1.00," "unknown" or "contingent" and the claimed exemption as "100 percent," "contingent," unknown," etc. However, debtors (and their counsel) can be very creative. Because the deadline for objections to the debtor's claim of exemptions expires so quickly (30 days after the conclusion of the §341 meeting of creditors or within 30 days after a subsequent amendment to the Schedule C; *see* Fed. R. Bankr. P. 4003(b)), creditors need to be alert to this issue so that they can make sure that a *timely* objection to exemption gets filed—whether by the trustee or by creditor(s).

In my recent case, several creditors timely filed objections to the debtor's claimed exemptions. We argued that *if* the identity of the market value and the claimed exemption constituted the debtor's attempt to exempt all of his interests in the businesses (regardless of the value of each business interest), then the exemption must be denied because it runs afoul of the exemption statute. The court agreed and ruled that *even though* the debtor's Schedule C recited identical market and exemption values, the "exemption value" governed and the debtor would only be able to exempt $1,000 from the value of each of his business interests. In other words, if the debtor's interest in each of his businesses sold for $100,000, then the debtor would still only receive the first $1,000 in proceeds, but the remaining $99,000 would be nonexempt property of the bankruptcy estate. In so ruling, the judge in my case expressly rejected the concept of an in-kind exemption.

Creditors who fail to pay attention to the in-kind exemption issue might not be so lucky. In November 2007, the Sixth Circuit Bankruptcy Appellate Panel (BAP) issued a decision that will embolden more debtors to try to claim an in-kind exemption. *In re Anderson*, 377 B.R. 865 (B.A.P. 6th Cir. 2007). In *Anderson*, the debtors (a husband and wife) owned a one-half interest in a cabin. Two nondebtors owned the other one-half interest in the cabin. The debtors' Schedule C listed their interest in the cabin as having a market value of $15,000 and an exemption value of $15,000. The bankruptcy trustee did not object to the debtors' claimed exemption of their interest in the cabin.

Approximately one year into the bankruptcy case, the trustee filed an adversary proceeding against the nondebtor co-owners of the cabin, seeking authority (under 11 U.S.C.

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[1] Often, the debt ceilings in chapter 13 render the real estate developer ineligible to be a chapter 13 debtor.

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§363(h)) to sell both the estate's interest in the cabin and the nondebtors' interest in the cabin. The trustee reached a settlement in the adversary proceeding and filed a motion seeking bankruptcy court approval of that settlement.

The bankruptcy court, *sua sponte*, raised the issue of whether the bankruptcy estate had *any* interest in the cabin to convey. Because the debtors' Schedule C listed $15,000 as *both* the market value and the exemption value of the cabin, the bankruptcy court held that the entire cabin was exempt and that the bankruptcy estate had no interest in the cabin. Consequently, the bankruptcy court denied the trustee's motion to approve the settlement, holding that the bankruptcy estate had no interest in the cabin because the debtors exempted it and the trustee failed to timely object to that claimed exemption.

The trustee appealed. The issue on appeal was whether the chapter 7 trustee's failure to timely object to the debtors' claimed exemption of their interest in the cabin removed the exempt property *in its entirety* from the bankruptcy estate when the debtors' Schedule C used identical market and exemption values. The BAP summarized the parties' arguments in *Anderson* as follows:

> [T]he Defendants argue, and the bankruptcy court agreed, that when a debtor schedules an exemption with identical market and exemption values, as in this case, the debtor is clearly indicating the intention to exempt the property in full, regardless of its actual value. In contrast, the Trustee contends that the debtor's mere listing of identical market and exemption values is insufficient to manifest the required intent. According to the Trustee, listing identical values simply indicates that the debtor desires to exempt an interest in property up to the specific dollar amount shown. Therefore, maintains the Trustee, if a debtor wants to exempt a piece of property in its entirety, he or she must list its market value as unknown and its exempted value as 100%, or make some similar notation evidencing such an intent.

377 B.R. at 875.

In analyzing the arguments, the *Anderson* BAP noted that there is a split of authority among the bankruptcy courts. Some bankruptcy courts hold that when a debtor states a valid statutory basis for the exemption and claims a specific dollar amount within the statutory limit for the exemption, then neither the trustee nor any creditor is required to object to the claimed exemption, the debtor is bound by the amount claimed as exempt, and cannot then claim that the entire asset is somehow exempt. *See, e.g., In re Heflin*, 215 B.R. 530, 533-534 (Bankr. W.D. Mich. 1997). Other bankruptcy courts hold that "if the debtor's intent to exempt the property in full is clear, then that intent will control in the absence of an objection. Claiming an exemption sufficient to exempt all the available...value in a property should be deemed to indicate the debtor's intent to exempt the property in full." *See, e.g., In re Jones*, 357 B.R. 888, 897 (Bankr. M.D. Ga. 2005).

There also appears to be a split among the circuit courts that have considered the issue—although those disparate circuit court rulings might turn on the specific facts of each case. For example, in *In re Green*, 31 F. 3d 1098 (11th Cir. 1994), the Eleventh Circuit affirmed the district court's ruling that the debtor was entitled to exempt all of the proceeds of a litigation settlement that was listed on that debtor's Schedule C with a contingent value of $1.00. (In *Green*, however, the trustee *conceded* that the $1.00 value on the Schedule C was a *contingent* value—so the court held that the trustee was on notice that he should object to the claimed exemption if he wanted to preserve any of the lawsuit's potential value for the estate.) In *In re Wick*, 276 F.3d 412 (8th Cir. 2002), the debtor's Schedule C used 11 U.S.C. §522(d)(5) to exempt stock options—with the exempt value stated as "unknown." The *Wick* court held that the debtor only intended to partially exempt the options to extent of the remaining exemption allowed by law.

The BAP's ruling in *Anderson* is not good for creditors. The *Anderson* BAP adopted the Eleventh Circuit's reasoning in *Green* and rejected the more creditor-oriented precedent of *Wick*. In *Anderson*, the BAP held that the entire value of the cabin was exempt, reasoning: "As the bankruptcy court correctly noted, there is nothing on the form Schedule C that alerts a debtor that the required way to assert an in-kind exemption is to list the value unknown and the exemption as 100 percent." 377 B.R. at 875. As if to dash any hope that the BAP's decision in *Anderson* might be limited to its particular facts, the BAP's holding continued:

> Moreover, we are persuaded generally that a debtor's listing of an exemption in an amount sufficient to exempt all of the available (*i.e.*, unencumbered) value in the property indicates his or her intent to exempt the property in full.

377 B.R. at 876.

The good news for creditors is that within three months after *Anderson* was decided, it came under sharp criticism in *In re Corimer*, 2008 WL 436965 (Bankr. E.D. Mich. 2008). In *Corimer*, the debtors' Schedule C listed certain jointly owned stock with a market value of "$1.00" and a claimed exemption (under 11 U.S.C. §522(d)(5)) of "$1.00." Judge Gregg held that "this did not result in a presumed in-kind exemption which removed the stock from the estate. The *Anderson* BAP decision, being unsound as a matter of law, does not require the stock to be removed from this bankruptcy estate." Indeed, *Corimer* leads off with the following critique: "If [the] *Anderson* BAP is broadly construed, its results may be far reaching, and drastically modify the federal exemption design, resulting in some debtors figuratively and fortuitously sliding down a rainbow to be gifted a pot of unwarranted bankruptcy largesse." *Corimer* held that interpreting Code §522(d)(5) as an in-kind exemption does not give enough weight to the statutory mandate "not to exceed in value." (Presumably, the same would hold true for the other parts of §522(d) (and applicable state exemption statutes) with dollar ceilings.) *Corimer* makes short shrift of *Anderson*'s comment that Schedule C fails to tell a debtor *how* to assert an in-kind exemption, noting that "*procedures* required by the Bankruptcy Rules and the Official Forms cannot, and should not, be utilized to modify the

substantive law mandated by the Bankruptcy Code." Indeed, *Corimer* accuses the *Anderson* court of imposing a "judge-invented mechanical formula" from which it can be *presumed* that the debtor intended to claim an in-kind exemption of an entire asset (irrespective of the statutory exemption ceiling).

The in-kind exemption issue in *Anderson*, *Corimer* and the other cases cited above arose because there was no timely objection to the individual debtor's claimed exemption. The lesson of these cases is obvious: Creditors must err on the side of caution in a personal bankruptcy case and assure that a timely objection to claimed exemptions is filed *whenever* the debtor's Schedule C evidences any intent to exempt an entire asset—irrespective of applicable statutory exemption ceilings. Creditors need to watch for *any* "red flags" that portend the individual debtor's attempt to claim an in-kind exemption in any personal bankruptcy case, such as the debtor's Schedule C listing (1) identical figures for the market value and the claimed exemption, (2) the market value or claimed exemption as "$1.00" or "contingent" or "unknown," (3) the claimed exemption as "100 percent" and (4) the claimed exemption value in excess of the statutory exemption ceiling. Once an objection is filed, the court will conduct a hearing, thus obviating the need for the court to resort to any "formula" (such as the *Anderson* BAP formula) to determine what the debtor intended to claim as exempt. At any hearing on objections to exemptions, creditors can argue for the enforcement of the dollar limits in applicable exemption statutes. Although the bankruptcy trustee (and perhaps the U.S. Trustee) should object to any attempted in-kind exemption, sometimes they are reluctant to incur the expense attendant to filing objections to claimed exemptions. Consequently, creditors must watch for the putative in-kind exemption and make sure that a timely objection is filed (even if the creditor files it!) in order to avoid being last in line. ■