Lead Case No. 22-60050 (consolidated with No. 22-60053)

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

In re: MONTE L. MASINGALE (Deceased)
and ROSANA D. MASINGALE,

Debtors.

JOHN D. MUNDING, Chapter 7 Trustee,

Appellant,

v.

ROSANA D. MASINGALE; STATE OF WASHINGTON,

Appellees.

STATE OF WASHINGTON,

Appellant,

v.

ROSANA D. MASINGALE; et al.,

Appellees.

On Appeal from the United States Bankruptcy Appellate Panel
for the Ninth Circuit
No. 22-1016
The Honorable Robert J. Faris, Julia W. Brand, and William J. Lafferty III

OPENING BRIEF OF APPELLANT STATE OF WASHINGTON

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I. INTRODUCTION

This case is about abuse of the bankruptcy system by debtors and their counsel. In 2015, knowing they were behind on their taxes and about to be sued by the State of Washington over a years-long pattern of sexual harassment affecting their employees, debtors Monte and Rosana Masingale filed for Chapter 11 bankruptcy. Bankruptcy gave the Masingales a significant benefit—the protection of the bankruptcy court from new lawsuits or conflicting litigation while they re-organized their affairs and addressed their debts. In their bankruptcy filings, the Masingales repeatedly promised to pay all of their creditors in full, and to limit all their exemptions to the caps provided by federal statute.

More than seven years later, Monte Masingale has passed away and Rosana Masingale and her lawyer are the only parties who have benefitted in any way from this bankruptcy. Despite binding promises to do so, Masingale has made no payments to any creditor, including the State. During the Chapter 11 reorganization proceeding, Masingale failed to disclose assets and missed so many administrative and reporting deadlines that the bankruptcy court eventually converted this case into a Chapter 7 liquidation proceeding.

Once the Chapter 7 proceeding began, creditors and the newly appointed Chapter 7 trustee learned that many of Masingale's listed assets turned out to be largely worthless—with one exception. A residential home in Greenacres, Washington, had appreciated significantly during the pendency of the bankruptcy, increasing in value from $165,430 to $422,000. That home, which Masingale designated as her homestead, is now the primary asset from which creditors, including the State, might ever be paid.

At the height of the Greenacres home's appreciated value, Masingale filed a motion seeking to take the entire asset, including all the appreciation, for herself. The bankruptcy court denied the request, ruling that the home should be sold to benefit creditors after paying Masingale $45,950, the value of the federal homestead exemption at the time she filed for bankruptcy in 2015. Masingale appealed, arguing that her inclusion of a single phrase in her bankruptcy schedules—"100% of FMV"—was sufficient to undo her previous promises to limit her exemptions, and worked to override the limit on homestead exemptions set by Congress.

The Bankruptcy Appellate Panel (BAP) agreed with Masingale, awarding her the full $422,000 home. *Masingale v. Munding* (*In re Masingale*), 644 B.R. 530, 539-41 (B.A.P. 9th Cir. 2022). In reaching that result, the BAP focused

almost exclusively on dicta discussing "100% of FMV" from *Schwab v. Reilly*, 560 U.S. 770 (2010), even though that language has never been applied to a case—like this one—that began as a Chapter 11 proceeding. *Id.* at 539-41. Through its ruling, the BAP allowed "100% of FMV" to become a Trojan Horse, capable of lurking in a bankruptcy case for years, only later springing to action and granting the debtor a windfall.

This Court should reverse. The BAP ignored all of Masingale's prior representations about the limits on her exemptions and the consideration she would pay in exchange for retaining her home, even though those representations have the force of contract, are res judicata, and fell within the federal statutory limit such that they required no objection at the time Masingale made them. And though correcting that error is enough to resolve this appeal, the Court should also reverse because the BAP's embrace of "100% of FMV" conflicts with Masingale's fiduciary duty to maximize the estate's value for creditors, breeds confusion and inefficiency in the exemption process, and rewards game-playing at the expense of congressional intent. Simply put, it is Congress—not a debtor wielding dicta—who determines the maximum value of bankruptcy exemptions. This Court should correct the BAP's erroneous opinion holding otherwise.

II. JURISDICTIONAL STATEMENT

The bankruptcy court had jurisdiction over the parties and the subject matter pursuant to 28 U.S.C. §§ 157(b)(2)(A), (B), (N), and (O) and § 1334. The BAP had, and the Court of Appeals has, jurisdiction pursuant to 28 U.S.C. § 158(d). The BAP Opinion being appealed from was entered on November 2, 2022. *Masingale*, 644 B.R. at 530. The State of Washington filed its Notice of Appeal on November 28, 2022, and the appeal is timely pursuant to Federal Rule of Appellate Procedure 4(a)(1)(a).

III. ISSUES PRESENTED

1. Does res judicata preclude the debtor from recalculating the value of a homestead exemption claim in a Chapter 7 proceeding, six years after the bankruptcy was filed under Chapter 11, when the new calculation conflicts with the terms of the confirmed Chapter 11 Plan and all of the debtor's prior statements about the value of the exemption?

2. Did the BAP err in permitting the debtor to claim a homestead exemption that exceeds the statutory limit in the Bankruptcy Code by nearly ten times, based solely on the fact that no creditor objected to the use of "100% of FMV" in the exemption schedule, but where the value of the homestead

exemption at the time the schedule was filed was clear from the contemporaneous papers and below the federal statutory maximum?

IV. STATUTORY AND REGULATORY AUTHORITIES

All relevant statutory and regulatory authorities appear in the Addendum to this brief.

V. STATEMENT OF THE CASE

A. Bankruptcy Background and Principles Governing Homestead Exemptions

Pursuant to Article I, Section 8 of the U.S. Constitution, Congress enacted uniform laws governing all bankruptcy cases. Codified at Title 11 of the United States Code, the Bankruptcy Code ("Code") establishes relief for debtors in one of two ways: either through an orderly liquidation or by permitting the debtor to reorganize its affairs to retire debt over time. In furtherance of these objectives, the Code sets out five different types of bankruptcy proceedings, each of which is commonly referred to by the chapter that describes it.

Of the five types of bankruptcy proceedings, four permit the debtor to continue business by means of a reorganization plan. 11 U.S.C. §§ 941; 1121, 1221, 1321. One, Chapter 7, is strictly a liquidation proceeding. 11 U.S.C. §§ 721-727. Chapter 7 and Chapter 11 are relevant to this appeal.

In Chapter 7 liquidation, a trustee takes over the debtor's assets, reduces them to cash, pays creditors secured by the assets, pays the debtor the value of certain property the Code permits them to claim as exempt, and distributes any remaining cash to unsecured creditors. 11 U.S.C. §§ 701, 704, 725, 726.

In contrast, Chapter 11 proceedings are reorganization proceedings in which trustees are not automatically appointed to administer the bankruptcy estate. Instead, the debtor is permitted to administer estate assets for the benefit of their creditors by exercising the same rights and powers, and performing all the functions and duties, of a trustee. 11 U.S.C. § 1107. Because the debtor does not automatically turn estate assets over to a trustee, a debtor in a Chapter 11 case is known as a "debtor in possession." 11 U.S.C. §§ 1101, 1115(b). The debtor has an exclusive, 120-day period in which to file a plan of reorganization. In order to fend off competing plans from other parties in interest, the debtor must solicit votes for, and obtain bankruptcy court confirmation of, a reorganization plan that follows particular requirements set forth in the Code. 11 U.S.C. §§ 1121, 1123, 1125, 1126, 1128, 1129. The provisions of a confirmed plan bind the debtor and its creditors without regard to whether a creditor has accepted the plan. 11 U.S.C. § 1141(a). An individual in Chapter 11 will not

receive a discharge unless and until all payments have been made under the plan. 11 U.S.C. § 1141(d)(5)(A).

In every case, filing of a bankruptcy petition creates an estate comprised of, among other things, all legal or equitable interests of the debtor in property as of the commencement of the case, together with "proceeds, product, offspring, rents, or profits of or from property of the estate[.]" 11 U.S.C. § 541(a)(1), (6). When an individual files under Chapter 11, property of the estate also includes "all property of the kind specified in section 541 that the debtor acquires after commencement of the case but before the case is closed, dismissed, or converted" to a Chapter 7 case. 11 U.S.C. § 1115(a)(1). All debtors must file a set of schedules detailing various aspects of their assets and liabilities. 11 U.S.C. § 521(a)(1); Fed. R. Bankr. P. 1007.

With respect to exemptions, 11 U.S.C. § 522(*l*) requires a debtor to file a list of property the debtor claims as exempt. Individual debtors may select between the federal exemption scheme or the exemption scheme of the state in which the debtor resides. 11 U.S.C. § 522(b). In turn, 11 U.S.C. § 522(d) lists twelve categories of property that a debtor may claim as exempt. The first category listed is the homestead exemption, and it is a limited one, permitting an exemption for: "[t]he debtor's aggregate interest, not to exceed $15,000 in value,

in real property or personal property that the debtor or a dependent of the debtor uses as a residence[.]" 11 U.S.C. § 522(d)(1).[1] The statute permits exemption of "the debtor's aggregate interest, not to exceed" the specified cap. *Id.* This is the exemption at issue in this case. 4-StateER-722, 625; 3-StateER-366.

B. The State's Tax and Civil Rights Investigations of the Masingales

For many years, Monte and Rosana Masingale ran two used-car dealerships known as Greenacres Motors with locations in Eastern Washington and Western Idaho. 4-StateER-706-07, 605. Beginning in 2015, the Masingales' business activities were subject to a pair of law enforcement actions by Washington State regulators.

First, the Washington State Department of Revenue determined that the Masingales and Greenacres Motors serially violated their obligations to pay sales tax on used car sales made through their businesses. In January 2015, the Washington State Department of Revenue notified the Masingales that from 2010 to 2015, the Masingales had underpaid sales tax by the sum of $404,481.00. 4-StateER-605.

[1] Pursuant to 11 U.S.C. § 104, the $15,000 cap is adjusted every three years to reflect the change in the Consumer Price Index.

Next, in June 2015, the Civil Rights Unit of the Washington State Attorney General's Office notified Monte Masingale and Greenacres Motors that they were being investigated for employment discrimination. 4-StateER-605, 640-41. The investigation revealed a years-long pattern of harassment by Monte Masingale against employees and job applicants at the car dealerships. *See Washington v. Masingale* (*In re Masingale*), Case No. 16-80001-FPC (Bankr. E.D. Wash. 2016); 3-StateER-573-96. The Civil Rights Unit alleged that Masingale routinely made unwelcome sexual comments and advances toward employees; engaged in unpermitted kissing, hugging, grabbing, and groping of female employees; and required (or attempted to require) female employees to engage in sex acts with Masingale as a condition of keeping their jobs. 3-StateER-575. After being notified that the Civil Rights Unit planned to bring suit for multiple violations of Washington law, including a demand for at least $240,000 to compensate Masingale's victims, the Masingales filed for bankruptcy. 4-StateER-605.

C. The Masingales' Bankruptcy Filing

On September 28, 2015, the Masingales filed Chapter 11 bankruptcy. 4-StateER-684-739. At that time, the Masingales' bankruptcy schedules listed total assets of $2,262,879.35 (4-StateER-712-21) and total liabilities of

$1,755,945.64 (4-StateER-712, 723-31), giving the estate a positive value of $506,933.71. The assets included the used car businesses and several real estate holdings. 4-StateER-712-21.

Through their Schedule C, titled "Property Claimed As Exempt," the Masingales designated their home in Greenacres, Washington as the property for which they would claim a homestead exemption. 4-StateER-722. The Masingales valued the home at $165,430, and it carried a mortgage of $130,724. 4-StateER-713. This gave the Masingales $34,706 in equity in the homestead. On their bankruptcy schedules, the Masingales selected federal law as the source of their exemptions. 4-StateER-722 (listing 11 U.S.C. § 522(d), the federal homestead exemption statute, as the source of each exemption). In 2015, the maximum homestead exemption under federal law for joint debtors was $45,950. 11 U.S.C. § 522(d)(1) & n.1. The equity of $34,706 in the Greenacres home was below that maximum amount. *Id.*

Also in Schedule C, under the column titled "Value of Claimed Exemption," the Masingales listed "100% of FMV" as the value of each of their assets, including the homestead. 4-StateER-722. The Masingales did not check the box on Schedule C that states, "Check if debtor claims a homestead exemption that exceeds $155,675." 4-StateER-722.

On November 25, 2015, a meeting of creditors occurred as required by 11 U.S.C. § 341. 4-StateER-683. Under Federal Rule of Bankruptcy Procedure 4003(b)(1), creditors and interested parties have 30 days after the meeting of creditors to file an objection to the list of property claimed as exempt. On December 16, 2015, after the meeting of creditors but before objections to exemptions were due, the Masingales filed their "Debtors' Disclosure Statement" (Disclosure Statement) and "Chapter 11 Plan of Reorganization" (Chapter 11 Plan). 4-StateER-599-682. In the portion of the Disclosure Statement that spoke to their homestead exemption, the Masingales provided specific dollar figures for the value of the property, the extent of encumbrances, the anticipated sale costs, and the net equity. 4-StateER-625. In the next column, the Masingales confirmed their understanding that the value of the homestead exemption fell within the federal statutory limits:

Item	Amount by which Exemption Exceeded
2. Debtors' Home. Value: $165,430. 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

4-StateER-625.

In addition, both the Disclosure Statement and Chapter 11 Plan stated that the Masingales intended to pay all creditors in full. Specifically, the Disclosure Statement said, "Debtors Plan provides for full payment to all allowed claims by the sale of property or in periodic installments or by the abandonment of property." 4-StateER-606. The Chapter 11 Plan stated "Debtors believe the payment and distribution under this Plan will benefit and pay all Creditors in full, which is more than Creditors would receive in a Chapter 7 liquidation. It does provide for full payment to allowed claims." 4-StateER-653.

The Chapter 11 Plan also included additional promises to creditors about the limits on the exemptions the Masingales were claiming. 4-StateER-670. The Chapter 11 Plan affirmed that, "Debtors' exemptions are not allowed to the extent they exceed the statutory limit, until full payment is made pursuant to this Plan." *Id.* Another term provided, "Debtors shall pay an amount to Creditors, which is greater than the amount by which the claimed exemptions exceed those allowable by statute." *Id.* The Chapter 11 Plan reiterated this again, stating, "As provided herein, Debtors' Plan does specifically provide and/or project that all Creditors will be paid in full. Debtors must pay for property to be retained in excess of allowable exemptions." *Id.*

On December 25, 2016, nine days after receiving the Masingales' Chapter 11 Plan and supporting documents, creditors' objections to the Masingales' schedule exemptions were due. No creditor filed an objection. The representations and guarantees in the Masingales' Chapter 11 Plan remained in force, including in the final versions of the Disclosure Statement and the Chapter 11 Plan that the Masingales subsequently submitted to the bankruptcy court for confirmation. 3-StateER-366, 539.

D. Plan Confirmation

The U.S. Trustee raised eight objections to the Masingales' Disclosure Statement and Chapter 11 Plan. 3-StateER-569-72. These objections primarily concerned the Masingales' intermingling of personal and business finances, Ms. Masingale's role in running these businesses, the Masingales' recent sale of property, and the Masingales' failure to make adequate disclosure of information concerning the claims by the State of Washington's Department of Revenue and Civil Rights Unit. *Id.*

In July 2016, Monte Masingale passed away, and Rosana Masingale continued the bankruptcy case as the debtor seeking confirmation of the

Chapter 11 Plan.[2] In response to the U.S. Trustee's objections, in March 2017, Masingale filed a "Proposed Amended Plan of Reorganization" (Amended Plan) and an "Amended Disclosure Statement." 3-StateER-455-562. By that point, the value of the State of Washington's two claims were no longer disputed by the bankruptcy estate. 3-StateER-461, 467. The bankruptcy estate acknowledged a $79,468.71 tax debt to the Department of Revenue and a $280,000 debt to the Civil Rights Unit. *Id.* In April 2017, the U.S. Trustee raised several objections to the Amended Disclosure Statement and Amended Plan. 3-StateER-441-54. The U.S. Trustee's objections focused on the Disclosure Statement's failure to disclose Masingale's extensive history of administrative non-compliance during the course of the bankruptcy, including failure to disclose assets, late filing of monthly reports, and failure to explain missing cash and income. *Id.* Additionally, the U.S. Trustee noted that the Disclosure Statement did not address the impact of the death of Mr. Masingale on the Masingales' businesses, and objected to the Amended Plan's proposal to give priority treatment to the Civil Rights Unit's claim. 3-StateER-442-44. Masingale made further

[2] Going forward, this brief uses "Masingale" in the singular to reflect that Rosana Masingale is the only debtor now pursuing the bankruptcy case.

adjustments to address the U.S. Trustee's concerns, 3-StateER-328-97, 2-StateER-324-25, and the U.S. Trustee withdrew his objection. 2-StateER-323.

On August 23, 2017, the bankruptcy court entered an order confirming the Amended Plan (2-StateER-320-22), and specifically the March 2, 2017, version, which carried through Masingale's original promise of full payment to creditors and repeated promises to keep the value of all exemptions within the federal limits. *See* 3-StateER-539.

E. Conversion to Chapter 7

A little over a year later, in September 2018, the U.S. Trustee brought a motion titled "Motion to Dismiss or Convert Confirmed Chapter 11 Case for Non-Performance of Plan and Statutory Duties and Material Default Under the Plan." 2-StateER-318-19. The U.S. Trustee alleged that Masingale continually had failed to file financial reports as required by the federal and local bankruptcy rules. According to the U.S. Trustee, the failure to file reports was a default of the Plan under 11 U.S.C. §§ 1112(b)(4)(E), (K) and (N), and a violation of the confirmation order. 2-StateER-319. Leading up to this motion, the U.S. Trustee had filed three similar motions regarding Masingale's non-performance of statutory duties, including the failure to file required reports about the status of assets. 3-StateER-563-68. The U.S. Trustee argued that this series of breached

obligations warranted a conversion of the case from a Chapter 11 reorganization proceeding to a Chapter 7 liquidation proceeding. 2-StateER-318-19.

The State of Washington's Civil Rights Unit joined the U.S. Trustee's motion requesting conversion. The Civil Rights Unit argued that Masingale had failed to comply with the terms of the confirmed Chapter 11 Plan, which required payment to all creditors in full, and in particular the required installment payments to the Victims' Fund established through the sexual harassment lawsuit. 2-StateER-315-16.

A year after confirmation, Masingale had not made any of these required payments or sold any of the properties or assets that were supposed to go toward the Victims' Fund. 2-StateER-316. On November 19, 2018, the Court converted the bankruptcy to a Chapter 7 liquidation proceeding and appointed John Munding as the Chapter 7 Trustee. 2-StateER-299-300. By rule, upon conversion to Chapter 7, the exemptions claimed in the Chapter 11 proceeding carried over, and there was no new time period for creditors or Trustee Munding to object to any of Masingale's claimed exemptions. *See* Fed. R. Bankr. P. 1019(2)(B)(i) (objections to exemptions not allowed after conversion when more than one year has passed since Chapter 11 Plan confirmation).

Soon after conversion, Masingale's counsel filed a request for attorneys' fees and costs totaling $50,884.84. 2-StateER-244-98. By that point, the bankruptcy estate had already paid Masingale's counsel $230,334.14, representing the only entity to receive any payment from the estate during the three years of the bankruptcy, aside from one payment of $380.80 to a title insurance company. *See* Debtor's Analysis Regarding Dismissal or Conversion, 2-StateER-308. The Civil Rights Unit objected to the fee request on several grounds, including mathematical error, irregularities respecting payments to third parties, services not reasonably likely to benefit the estate, and missing information concerning cash on hand and unencumbered funds. 2-StateER-239-43, 307-09. The Court ultimately reduced the fee request to $17,780, concluding that a good portion of the services were not reasonably likely to benefit the estate (2-StateER-99-102) and that post-confirmation fees were not entitled to administrative priority. 2-StateER-102-04.

In January 2019, Trustee Munding issued a "Chapter 7 Trustee's Status Report and Financial Summary" that established the estate had $73,065.36 in funds. 2-StateER-235. Trustee Munding then proceeded to abandon what turned out to be worthless estate assets and liquidate the few remaining estate assets, netting another $65,440 for the estate. *See* 2-StateER-191-233, 96-97, 65-76.

By July 2019, the remaining asset in the estate was the Greenacres home, the homestead property at issue in this appeal.

F. Masingale's First Effort to Remove the Greenacres Home from the Bankruptcy Estate

On September 1, 2021, Masingale filed a motion to sell the Greenacres home and directly receive the net proceeds, without any of them going to the bankruptcy estate. 2-StateER-188-90. Trustee Munding objected, arguing that, upon conversion to a Chapter 7 bankruptcy, the Greenacres home became property of the bankruptcy estate; that Masingale's homestead exemption under 11 U.S.C. § 522(d)(1) was fixed at $49,950 for joint debtors; and that the bankruptcy estate was entitled to any intervening increase in the value of the home. 2-StateER-181-87. The State also objected to the sale motion and joined Trustee Munding's objection. 2-StateER-176-80. The State pointed out that, under Chapter 7, Masingale had no standing to sell estate property, that notice of sale on an emergency basis was unsupported and inadequate, and that Masingale improperly sought to switch from the federal to the state homestead exemptions. 2-StateER-177-80. Masingale withdrew the sale motion. 2-StateER-175.[3]

[3] The day after withdrawing the motion to sell, Masingale recorded a mortgage lien on the Greenacres home in favor of her attorney in the amount of

G. Masingale's Second Effort to Remove the Greenacres Home from the Bankruptcy Estate, and the Trustee's Cross-Motion to Sell

On October 21, 2021, Masingale filed a motion seeking to compel Trustee Munding to abandon the Greenacres home because there had been no objection to her claim that "100% of FMV" of the home's value was exempt. 2-StateER-156-74. She argued that she was entitled to the entire home with no value left for the bankruptcy estate. 2-StateER-172-73. *See also* 2-StateER-90. Trustee Munding objected, asserting the homestead exemption amount was fixed at the time of the bankruptcy filing, which under 11 U.S.C. § 522(d)(1) was $45,950 for joint debtors. 2-StateER-146, 149. Trustee Munding argued that any increase in the value of the home during the bankruptcy was to the benefit of the bankruptcy estate. 2-StateER-147-52. Due to appreciation in the real estate market since the bankruptcy had been filed, the Trustee stated he could sell the Greenacres home for $400,500 with a net value to the estate of at least $158,091. 2-StateER-154. The State objected to Masingale's motion on similar grounds,

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$53,225.90. 2-StateER-79. Masingale and her lawyer did not inform the bankruptcy court or the parties of this lien, but Trustee Munding discovered it during a title review. 2-StateER-80. Trustee Munding brought the matter to the attention of the court and the parties, after which Masingale's attorney released the mortgage. 2-StateER-63-64.

and additionally argued that any ambiguities in Masingale's exemptions must be construed against her. 2-StateER-135-42.

On November 8, 2021, Trustee Munding filed his own motion to sell the Greenacres home, arguing the sale would provide substantial funds to the bankruptcy estate after paying sales costs and Masingale's homestead exemption as allowed under 11 U.S.C. § 522(d)(1). 2-StateER-124-34. The State supported Trustee Munding's motion. 2-StateER-105-23.

H. Eastern District of Washington Bankruptcy Court Decision

On January 18, 2022, the U.S. Bankruptcy Court for the Eastern District of Washington denied Masingale's motion to direct Trustee Munding to abandon the Greenacres home. 2-StateER-95. At the same time, the bankruptcy court granted Trustee Munding's cross-motion to sell the home for a gross sale price of at least $400,500. *Id*.

In rejecting Masingale's argument that "100% of FMV" exempted the entire asset from the bankruptcy estate, the bankruptcy court made three determinations. First, the absence of an objection to the homestead exemption claim did not operate to remove the residence from the bankruptcy estate. 2-StateER-92-93. Second, Masingale's use of "100% of FMV" as the value of the homestead exemption claimed no more than $45,950, the exemption value

allowed by statute at the time of filing. 2-StateER-93-94. Third, the increased equity in the residence during the course of the bankruptcy belonged to the bankruptcy estate, not the debtor. 2-StateER-94.

Following the bankruptcy court's ruling, Trustee Munding sold the Greenacres home for $422,000. 2-StateER-84-87. There is now $357,022.94 in the bankruptcy estate. 2-StateER-47. Of that, $223,033.34 is derived from the sale of the Greenacres home, meaning the funds from the sale of the Greenacres home are the majority of the funds left to pay Trustee Munding's administrative fees and the creditors' claims. *Id*. Masingale appealed to the Bankruptcy Appellate Panel.

I. Bankruptcy Appellate Panel Decision and Subsequent Sanctions Proceedings

The BAP reversed the bankruptcy court. *Masingale*, 644 B.R. at 534. The BAP ruled that, because no party objected to the Masingale's 2015 designation of the home's value as "100% of FMV," Masingale was free to take the position in 2021 that she was entitled to all sale proceeds from the Greenacres home, including the appreciation during the seven years the bankruptcy had been pending. *Id.* at 538-44.

Although the BAP awarded Masingale the entire asset, it made clear that it was troubled by the result. The BAP explained that it "d[id] not condone the

conduct of the Masingales and their counsel," and was not intending "to immunize them from all consequences for making a baseless claim of exemption." *Id.* at 544. The BAP then identified several bases on which Masingale and her attorney may be subject to sanctions on remand, including for "mak[ing] assertions that lack any colorable legal basis or . . . engag[ing] in improper or bad-faith conduct." *Id.* at 544. Eight days after the BAP issued its decision and remanded, the bankruptcy court ordered Masingale's counsel to show cause why sanctions, in the form of disgorgement of attorneys' fees charged over the course of the bankruptcy, should not be imposed. 2-StateER-61-62. Trustee Munding and the State timely appealed the BAP's decision, and the sanctions proceedings are stayed while this appeal proceeds. 2-StateER-31-42.

VI. SUMMARY OF ARGUMENT

Masingale is bound by the terms of the Chapter 11 Plan. The Plan is enforceable as a contract and is res judicata. When filing bankruptcy schedules in 2015, Masingale asserted a homestead exemption of "100% of FMV" and specified that the source of her exemption was "11 U.S.C. § 522(d)(1)." At the time of filing, the fair market value of the equity in the homestead totaled $34,706, and came within the homestead exemption of $45,950 allowed under

11 U.S.C. § 522(d)(1). During the time period to object to exemptions, Masingale filed a Chapter 11 Plan reiterating that, "Debtors' exemptions are not allowed, to the extent they exceed the statutory limit, until full payment is made pursuant to this Plan." 4-StateER-670.

Only years later, once the value of the residence had dramatically increased, did Masingale begin claiming that the "100% of FMV" actually means something different, and captures the *entire* value of the home, including intervening appreciation. The Chapter 11 Plan language, however, is a contract that binds Masingale, and precludes her change of position. Res judicata applies under longstanding precedent. The BAP erred in failing to hold Masingale to her binding representations, and correcting that error is sufficient to dispose of this appeal.

Even if Masingale were permitted to ignore her prior representations and litigate the value of her homestead exemption anew, the bankruptcy court correctly applied the law to these facts. This case began as a Chapter 11 bankruptcy, a particular type of bankruptcy that imposes special obligations on debtors. As a "debtor in possession" of the estate's assets, Masingale owed a fiduciary duty to *creditors* not to misuse or steal estate assets, which necessarily includes the duty to limit her exemptions to those permitted by the Bankruptcy

Code. Until Masingale's recent change in strategy, all of her filings indicated that she understood, and planned to comply with, those obligations. Indeed, in 2015, when the bankruptcy was filed, Masingale's bankruptcy schedules, Chapter 11 Plan, and Disclosure Statements *all* identified the homestead value as falling within the statutory cap. Because the value of the claimed exemption was clear from Masingale's filings and fell below the statutory limit, no objection to the exemption was required. *Schwab*, 560 U.S. at 789 (a party is not required to object within 30 days if there is no reason to object to the claimed exemption).

To reach a contrary result, the BAP relied nearly entirely on dicta from *Schwab* regarding the term "100% of FMV." *See Masingale*, 644 B.R. at 540-41 (citing *Schwab*, 560 U.S. at 792-93). This dicta has created confusion in the bankruptcy courts, and, as far as the State is aware, has never before been applied in a case that originated under Chapter 11—where the debtor has unique duties not present in Chapter 7 cases like *Schwab*. The Court should decline to embrace that dicta because doing so would lead to absurd results that are flatly inconsistent with the limits that Congress has imposed on homestead exemptions.

Finally, under 11 U.S.C. § 541(a)(6) and controlling case law, even if Masingale successfully could use "100% of FMV" to claim the full value of the home (as opposed to just the equity) at the time of filing, the bankruptcy estate is still entitled to the intervening appreciation. Under this Court's well-established precedent, the bankruptcy court correctly determined that the increase in equity since 2015 belongs to the bankruptcy estate. *Wilson v. Rigby*, 909 F.3d 306, 308 (9th Cir. 2018); *Gebhart v. Klein* (*In re Gebhart*), 621 F.3d 1206, 1211 (9th Cir. 2010). At minimum, the Court should reverse the BAP and remand so that the bankruptcy court may calculate the post-filing appreciation and award it to the estate for payment to creditors, including the State's tax agency and the sexual harassment victims.

VII. STANDARD OF REVIEW

The Court of Appeals reviews de novo decisions of the BAP. *Alsberg v. Robinson* (*In re Alsberg*), 68 F.3d 312, 314 (9th Cir. 1995); *Steelcase Inc. v. Johnston* (*In re Johnston*), 21 F.3d 323, 326 (9th Cir. 1994). This Court reviews the bankruptcy court's conclusions of law de novo. *Id.* In particular, the Court of Appeals reviews the scope of bankruptcy exemptions de novo. *Wilson*, 909 F.3d at 308. *See also Lieberman v. Hawkins* (*In re Lieberman*), 245 F.3d 1090, 1091 (9th Cir. 2001).

VIII. ARGUMENT

A. The Confirmed Chapter 11 Plan Forecloses Masingale's Late-Breaking Attempt to Inflate the Value of the Homestead

Masingale's confirmed Chapter 11 Plan addressed exemptions in detail and guaranteed full payment to creditors. 4-StateER-670; 3-StateER-539. It also expressly limited Masingale's homestead exemption to the federal statutory limit of $45,950, which is the maximum joint debtors may claim under 11 U.S.C. § 522(d)(1). Under established precedent, the Chapter 11 Plan language is binding on Masingale. The BAP erred by completely disregarding it.

1. During the Chapter 11 bankruptcy, the Masingales owed a fiduciary duty to the creditors, and the terms of their Chapter 11 Plan are a binding contract

During the Chapter 11 bankruptcy, with no trustee in place, Masingale was a "debtor in possession" of estate assets. Under the Bankruptcy Code, this required Masingale to serve as a fiduciary to her creditors: "[A] debtor in possession shall have all the rights . . . and powers, and shall perform all the functions and duties . . . of a trustee serving in a case under this chapter." 11 U.S.C. § 1107(a). As a fiduciary, Masingale had a duty to act in good faith and maximize the value of the estate available to pay creditors. *An-Tze Cheng v. K & S Diversified Invs., Inc.* (*In re An-Tze Cheng*), 308 B.R. 448, 455 (B.A.P. 9th Cir. 2004), *aff'd* 160 F. App'x. 644 (9th Cir. 2005); *see also Wilson*, 909

F.3d at 311 (a debtor in possession "must act in good faith"); *Devers v. Bank of Sheridan* (*In re Devers*), 759 F. 2d 751, 754 (9th Cir. 1985) ("A debtor-in-possession has the duty to protect and conserve property in his possession for the benefit of creditors.") (citing *Nw. Nat'l Bank of St. Paul v. Halux, Inc.* (*In re Halux Inc.*), 665 F.2d 213, 216 (8th Cir. 1981)). Masingale was also "obligated to protect and conserve property in [her] possession, as well as to provide voluntary and honest disclosure of financial information." *In re Sal Caruso Cheese, Inc.*, 107 B.R. 808, 817 (Bankr. N.D.N.Y. 1989). At a minimum, the duty of good faith prevents Masingale from taking assets that properly belong to the estate.

In addition to imposing fiduciary duties on the debtor in possession, Chapter 11 proceedings also trigger contract obligations for the parties. By statute, "the provisions of a confirmed plan bind the debtor . . . and any creditor." 11 U.S.C. § 1141(a). Thus, a Chapter 11 plan is a contract between the parties. *Hillis Motors, Inc. v. Hawaii Auto. Dealers Ass'n*, 997 F.2d 581, 588 (9th Cir. 1993). "A Chapter 11 plan is a contract between the debtor and its creditors in which general rules of contract interpretation apply." *Dolven v. Bartleson* (*In re Bartleson*), 253 B.R. 75, 84 (B.A.P. 9th Cir. 2000) (quoting *Aino v. Maruko, Inc.* (*In re Maruko, Inc.*), 200 B.R. 876, 881 (Bankr. S.D. Cal. 1996)). Bankruptcy

courts look to state law to interpret the provisions of a Chapter 11 plan. *Hillis Motors,* 997 F.2d at 588 (citing *Kamen v. Kemper Fin. Servs. Inc*., 500 U.S. 90, 97-99 (1991)).

Washington follows the "objective manifestation theory of contracts," which focuses on the objective manifestations of the agreement "rather than on the unexpressed subjective intent of the parties." *Hearst Commc'ns, Inc. v. Seattle Times Co.*, 115 P.3d 262, 267 (Wash. 2005). Under this rule, the subjective intent of a contracting party is irrelevant if intent can be determined by giving the actual words used "their ordinary, usual, and popular meaning." *Id.* Washington courts do "not interpret what was intended to be written but what was written." *Id.* (citing *J.W. Seavey Hop Corp. of Portland v. Pollock*, 147 P.2d 310, 316 (Wash. 1944)). In *Hearst*, the Washington Supreme Court clarified that courts consider extrinsic evidence only if needed to determine the meaning of specific words and terms. *Id.* (citing *Hollis v. Garwall, Inc.*, 974 P.2d 836, 843 (Wash. 1992)).

Here, the Chapter 11 Plan provides that "Debtors' exemptions are not allowed, to the extent they exceed the statutory limit, until full payment is made pursuant to this Plan." 4-StateER-670; 3-StateER-539. This language is unambiguous, and can mean only that Masingale is not claiming exemptions

above the federal statutory limit until all creditors are paid in full. The Court does not need extrinsic evidence to interpret these terms. The contract formed by the Chapter 11 Plan bound Masingale to the federal statutory exemptions until full payment to creditors is made. In other words, Masingale agreed to pay the bankruptcy estate the fair market value for any assets she retained in excess of the allowable exemptions. 4-StateER-670; 3-StateER-539. Masingale's effort to now claim the entire sale value of the homestead in spite of these promises constitutes a breach of the contract and should be rejected.

While the Chapter 11 Plan language is clear, even if the Court were to consider extrinsic evidence, Masingale's Disclosure Statement is the single most relevant document after the Chapter 11 Plan to ascertain the intent of the parties. *In re Penberthy*, 211 B.R. 391, 396 (Bankr. W.D. Wash. 1997). The multiple Disclosure Statements filed by Masingale *all* stated, "Debtors Plan provides for full payment to all allowed claims by the sale of property or in periodic installments or by the abandonment of property." 4-StateER-606; 3-StateER-464, 406, 342. Additionally, the Disclosure Statements contained the following evaluation of the Greenacres home:

> 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

4-StateER-625; 3-StateER-486, 428, 366. Therefore, at the time of Chapter 11 Plan confirmation in August 2017, Masingale represented that the homestead value of the Greenacres home was $18,163, well within the federal exemption limit of $45,950 permitted under the statute she chose—11 U.S.C. § 522(d)(1). The Disclosure Statement confirms Masingale's obligation to limit her exemption to the federal maximum.

Finally, even if there were any ambiguity in the Chapter 11 Plan language—and there is not—this ambiguity must be construed against Masingale, the drafter of the plan. *See United States v. Seckinger*, 397 U.S. 203, 210 (1970) (reciting "the general maxim that a contract should be construed most strongly against the drafter"). Again, bankruptcy courts look to state law in interpreting any plan ambiguity. *Hillis Motors*, 997 F.2d at 588. Washington law construes ambiguities against the drafter. *Spokane Airport Bd. v. Experimental Aircraft Ass'n*, 495 P.3d 800, 804 (Wash. 2021). Bankruptcy courts that have not expressly relied upon state law have also construed ambiguities against the drafter. *Miller v. U.S. Dep't of Treasury Internal Revenue Serv.* (*In re Miller*), 253 B.R. 455, 459 (Bankr. N.D. Cal. 2000). Therefore, under both state and federal law, Masingale cannot now re-write the contract to remove the homestead from the bankruptcy estate when the Chapter 11 Plan, which has the

force of a contract, confirmed that Masingale committed to pay creditors in full and limit her exemptions to the statutory maximum.

2. A Chapter 11 Plan is a final judgment and has res judicata effect after conversion

A Chapter 11 plan is not only a contract. It is "well-settled that a bankruptcy court's confirmation order is a binding, final order, accorded full *res judicata* effect[.]" *Heritage Hotel Ltd. P'ship I v. Valley Bank of Nev.* (*In re Heritage Hotel P'ship I*), 160 B.R. 374, 377 (B.A.P. 9th Cir. 1993). Even after conversion to a Chapter 7 proceeding, a Chapter 11 plan is a final judgment with res judicata effect as to the rights of the debtor and creditors addressed in the plan. *Laing v. Johnson* (*In re Laing*), 31 F.3d 1050, 1051 (10th Cir. 1994). In *Laing*, the Tenth Circuit precluded the debtor from discharging a debt in Chapter 7 after conversion, because the Chapter 11 plan spoke to the particular debt's dischargeability, and the Chapter 11 plan continued to be "a binding order." *Id.* at 1051. The court found that since the debtor and creditors were parties to the Chapter 11 proceeding and had the opportunity to object to the Chapter 11 plan, the plan was binding on them even after conversion. *Id.* at 1051. Similarly, in *Bank of Louisiana v. Pavlovich*, 952 F.2d 114, 117 (5th Cir. 1992), the Fifth Circuit held that the confirmed Chapter 11 plan was res judicata and precluded a creditor from changing the treatment of their claim after conversion to

Chapter 7. The court determined that debtor's pre-petition debt owed to the creditor was resolved in the Chapter 11 plan, and the creditor should have raised any issues concerning the treatment of their claim prior to Chapter 11 confirmation. *Id.* at 118 (rejecting creditor's "late-blooming attempt" to re-litigate issues settled during Chapter 11 proceeding).

In another case involving a debtor who did an about-face, *Knupfer v. Wolfberg* (*In re Wolfberg*), debtors proposed a Chapter 11 plan providing for sale of their residence to ensure a 100% payment to the unsecured creditors and did not claim a homestead exemption in their residence. 255 B.R. 879, 882-83 (B.A.P. 9th Cir. 2000), *aff'd*, 37 F. App'x 891 (9th Cir. 2002). After plan confirmation, a Chapter 11 trustee was appointed who the sold the residence. *Id.* at 880. Debtors then demanded their homestead exemption, and the trustee objected because debtors did not claim the exemption prior to Chapter 11 plan confirmation. *Id.* at 881. The bankruptcy court allowed the homestead exemption and the Chapter 11 trustee appealed. *Id.*

The BAP reversed, finding the debtors were not entitled to the homestead exemption because the Chapter 11 plan did not provide for one, and the confirmation order was "a binding, final order, accorded full res judicata effect." *Id.* at 882 (citing *Heritage Hotel P'ship 1,*160 B.R. at 377). In reaching this

decision, the BAP relied on 11 U.S.C. § 1141(a) and its directive that, "the provisions of [a Chapter 11] plan bind the debtor . . . and any creditor[.]" The *Knupfer* court also recited the familiar elements of res judicata:

> (1) a final judgment on the merits; (2) the judgment was rendered by a court of competent jurisdiction; (3) a second action involving the same parties [or their privies]; and (4) the same cause of action involved in both cases.

Id. at 881-82. The BAP determined that the plan confirmation order easily met the first two elements of res judicata. *Id.* As to the third element, although the trustee became a party after confirmation, the trustee represented the interests of the creditors and shared those same interests for purposes of satisfying the privity requirement. *Id.* at 882. Fourth, the BAP concluded the cause of action was the same because the debtors' "claim of exemption . . . falls within the same cause of action as the petition for relief and plan confirmation," since a debtor's claim of exemption removes assets available to pay creditors. *Id.* Having reviewed the four res judicata factors, the BAP found that creditors could rely upon debtors' representation that the home would be an asset available to fund the plan. *Id.* at 882. The BAP further held that, once confirmed, the plan was binding and the debtor could not assert any interest other than the exemptions contained in the plan. *Id.* at 884.

The same reasoning applies here. Even after conversion, Masingale is bound by the guarantees she included in the Chapter 11 Plan because the four elements of res judicata are met. There is a confirmed Chapter 11 Plan entered by the bankruptcy court, a court of competent jurisdiction. This action involves the parties to the confirmed Chapter 11 Plan, plus the addition of Trustee Munding, which does not alter privity under *Knupfer*. *See id*. at 882. And the claim of homestead exemption is the same statutory claim raised in the Chapter 11 Plan and now on appeal.

The result is that Masingale is bound by her promises to pay creditors' claims in full, and take only the federal statutory homestead amount until full payment is made. Specifically, Masingale's exemption is limited to—at most—$45,950, which is the maximum amount permitted under 11 U.S.C. § 522(d)(1), the exemption statute she explicitly designated in her schedules and Chapter 11 Plan. The Chapter 11 Plan was a contract and constituted a judgment with res judicata effect as to the terms of the Chapter 11 Plan. The BAP failed to acknowledge the contractual nature of the Chapter 11 Plan, the fiduciary duty Masingale owed to creditors when soliciting their votes in support of her Chapter 11 Plan, or the res judicata effect of the Chapter 11 proceedings. This Court's analysis need go no further, and the BAP order should be reversed.

B. Statutory Limits Set by Congress, and Not Gimmicks Like "100% of FMV," Determine the Maximum Value of the Homestead Exemption Masingale May Claim

Although contract principles and the operation of res judicata are sufficient to resolve this appeal, the bankruptcy court was also fully correct to conclude that, if Masingale is permitted to re-raise the value of the homestead exemption, that value is capped at $45,950. This is the maximum homestead permitted under the federal exemption scheme, which Masingale selected. Masingale did not (and cannot) alter those statutory limits using shorthand like "100% of FMV," and the BAP erred in holding otherwise.

1. The bankruptcy court faithfully applied statutory exemptions and controlling case law governing post-petition appreciation to the home, which at all times remained part of the estate

When a debtor files for bankruptcy, "all of the debtor's assets become property of the bankruptcy estate, subject to the debtor's right to reclaim certain property as 'exempt.'" *Schwab*, 560 U.S. at 774 (internal citation omitted). "The Bankruptcy Code specifies the types of property debtors may exempt, as well as the maximum value of the exemptions a debtor may claim." *Id*. (internal citations omitted). The Code limits exemptions because every asset a debtor is permitted to withdraw from the estate is an asset that is not available to repay creditors. In enacting 11 U.S.C. § 522(d), the statute which caps exemptions, "Congress

balanced the difficult choices that exemption limits impose on debtors with the economic harm that exemptions visit on creditors." *Schwab*, 560 U.S. at 791-92. The Supreme Court has been clear that courts may not "alter this balance." *Id.*

When a debtor claims an exemption and the exemption is allowed (either because no party objects or the court permits it over objection), what is removed from the estate is the value of the exemption, not the asset itself. *Gebhart*, 621 F.3d at 1210. As applicable in this case, the rule that a homestead exemption removes the debtor's *interest* in the residence from the bankruptcy estate, but not the residence *itself*, was established in this Circuit more than thirty years ago. *Bernard v. Coyne* (*In re Bernard*), 40 F.3d 1028, 1030 n.2 (9th Cir. 1994) (citing *Schwaber v. Reed* (*In re Reed*), 940 F.2d 1317, 1321 (9th Cir. 1991); *Hyman v. Plotkin* (*In re Hyman*), 967 F.2d 1316, 1319-20 (9th Cir. 1992)). This must be so, because under 11 U.S.C. § 541(a)(6), the estate is entitled to all post-petition appreciation in the value of property, even if a portion of the property has been claimed as exempt. The asset must remain in the estate in order for the value of post-petition appreciation to be available for distribution to creditors.

Moreover, a creditor is not required to object to a homestead exemption in order for the residence to remain part of bankruptcy estate. *Gebhart*, 621 F.3d at 1209. *Gebhart* involved two consolidated appeals in which the debtors' equity

in their homes at the time of filing was less than the statutory exemption, though over the course of their bankruptcies, the value of their equity increased such that the debtors had equity in excess of their homestead exemptions. *Id.* at 1208. After the home values appreciated, the bankruptcy trustees sought to force sales of homestead properties in order to recover the excess equity. *Id.* The debtors sought to retain the post-petition increase in the value of their homes, claiming, in part, that the trustees' failure to object to homestead exemptions meant the increased value belonged to the debtors. *Id.* at 1208.

The Ninth Circuit framed the issue as "whether the Trustee's failure to object to the homestead exemption claim within the period allowed by statute resulted in the homestead property being withdrawn from the bankruptcy estate at that point." *Id.* at 1209. The Court answered in the negative, holding that the homestead exemptions available to the debtors did not permit the exemption of entire properties, but rather, specific dollar amounts. *Id.* at 1210.

In determining the amount of the Masingales' homestead exemption, the bankruptcy court carefully applied the plain text of the Bankruptcy Code. First, the court easily ascertained their "aggregate interest" in the residence as required by 11 U.S.C. § 522(d) by consulting Masingale's schedules. "The Masingales' schedules (i) identified the value of their home as $165,430; (ii) listed their

mortgage debt as $130,724; and (iii) expressly selected the exemption authorized by 11 U.S.C. § 522(d)(1), which in 2015 allowed a homestead amount 'not to exceed $22,975' for each debtor or $45,950 for both debtors." 2-StateER-93-94. This left $34,706 in "aggregate interest" (aka equity) for the Masingales. *See* Historical Notes to Subsection (b) of § 522 at 1978 Act Revision Note, Pub. L. 95-598, Nov. 6, 1978, 92 Stat. 2586 ("Property may be exempted even if it is subject to a lien, but only the unencumbered portion of the property is to be counted in computing the 'value' of the property for the purpose of exemption."). The bankruptcy court accurately calculated Masingale's unencumbered interest in the Greenacres home.

Next, the bankruptcy court correctly awarded the post-petition increase in the residence's value to the estate, rather than to Masingale. 2-StateER-94. The value of a bankruptcy exemption is fixed at the time the bankruptcy petition is filed. *Wilson*, 909 F.3d at 308 (citing *White v. Stump*, 266 U.S. 310, 313 (1924)); *Wolfe v. Jacobson* (*In re Jacobson*), 676 F.3d 1193, 1199 (9th Cir. 2012)). This is known as the "snapshot rule." *Wolfe*, 676 F.3d at 1199. It is well-settled 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*, 621 F.3d at 1211. The snapshot rule froze Masingale's

interest in her homestead at the amount of the equity she had in 2015, which was $34,706. Finally, in an abundance of caution, and because the Chapter 7 Trustee appeared to consent, the bankruptcy court awarded Masingale the maximum amount permitted by the federal homestead statute: $45,950. 2-StateER-94, n.7.[4]

These rulings by the bankruptcy court—both in calculating the value of the homestead exemption and awarding post-appreciation value to the estate—were correct. The BAP reversed them, however, concluding that Masingale's use of "100% of FMV" worked to override the statutes and precedents above, and to remove the entire Greenacres home from the estate. *Masingale*, 644 B.R. at 541-42. This was so, according to the BAP, because no party objected to "100% of FMV" within 30 days of the meeting of creditors, the timeline provided by Federal Rule of Bankruptcy Procedure 4003(b) and applied in *Taylor v. Freeland & Kronz*, 503 U.S. 638 (1992). *Id.* at 538-39. Further, the BAP held that dicta in the Supreme Court's decision in *Schwab*, 560 U.S. at 539-44, forces courts to exempt a full asset with a scheduled value of "100% of FMV" unless a party objects. *Masingale*, 644 B.R. at 539-41. Because the BAP misapplied Supreme Court precedents, and additionally took the unwarranted

[4] The State has not appealed the bankruptcy court's decision to award to Masingale the full $45,950, rather than the lower $34,706 figure.

step of extending the *Schwab* dicta to the Chapter 11 context where it produces absurd results, this Court should reverse.

2. No objection to "100% of FMV" was required under *Taylor*

The inflexible 30-day objection deadline that Masingale urges—and that the BAP adopted—stems from the Supreme Court's decision in *Taylor v. Freeland & Kronz*. In *Taylor*, the debtor filed a voluntary Chapter 7 petition. 503 U.S. at 640. On her bankruptcy schedule, she claimed as exempt property the money she expected to win from an ongoing discrimination lawsuit, and listed the value in her schedules as "unknown." *Id.* Despite learning at the meeting of creditors that the potential recovery was an amount upwards of $100,000, well above the statutory dollar limit for the designated exemption, the trustee did not object to the claimed exemption. *Id.* at 640-41. After the debtor settled her lawsuit for $110,000 and paid her attorneys, the trustee demanded the attorneys turn over the fee payments, arguing the proceeds were property of the bankruptcy estate. *Id*. at 641. The Supreme Court rejected the trustee's effort to recoup the fee payments, citing Federal Rule of Bankruptcy Procedure 4003(b) and its grant of 30 days for creditors to object following the meeting of creditors. *Id.* at 642. Reasoning that the rule's negative implication is to prohibit creditors from objecting after the 30-day period expires, the Court held that the trustee

could not contest the exemption and could not recover the lawsuit's proceeds. *Id.* at 644.

Taylor does not apply here. Unlike *Taylor*, where the debtor listed the value of the discrimination lawsuit as "unknown," the parties to this proceeding had, during the objection window, a great deal of information about the precise valuation of the homestead exemption—a value calculated by the debtors themselves and signed under penalty of perjury. 4-StateER-678, 635. First, the Masingales' proposed Chapter 11 Plan and Disclosure Statement scrupulously limited exemptions to the statutory cap until full payment of *all* claims had been made. 4-StateER-670, 625; 3-StateER-539, 366. Second, the value of Masingale's equity in the home was set forth repeatedly, in Schedules A and C, the Chapter 11 Plan, and the Disclosure Statement. 4-StateER-713, 654, 625. In each place, the value of the home was listed at $165,430, and the encumbrance (the mortgage) was listed at $130,724. *Id.* This means that the value of Masingale's equity was easily calculable at $34,706, and obviously fell within the exemption limit of $45,950 permitted for joint debtors at the time of filing. Therefore, because 11 U.S.C. § 522(d)(1) limits any homestead exemption to Masingale's equity in the property, the use of "100% of FMV," could only have meant that Masingale was exempting the fair market value of the *equity* in the

Greenacres home. *See also Schwab*, 560 U.S. at 783 ("property claimed as exempt" is the debtor's "interest" in the property, "*not* . . . the [property] *per se*"). Masingale understood this, which is why she represented that "all" equity was "exempt pursuant to 11 U.S.C. § 522(d)(1)," with the "[a]mount by which [e]xemption [e]xceeded" the statutory cap equaling "$0.00." 4-StateER-625.

Under these circumstances, the rule from *Taylor*—that creditors must object to values like "unknown" that could constitute a value higher than the exemption limit—has no application. Masingale's exemption had a known, fixed value of $34,706, and fell within the exemption limit. The Chapter 11 Plan and Disclosure Statement confirmed Masingale was going to comply with the statutory exemption limits. Unlike in *Taylor*, here there was no evidence at the meeting of creditors, in the schedules, in the proposed Chapter 11 Plan, or anywhere else suggesting anything different. The creditors relied on what Masingale "repeatedly told [them]" about the value of the exemption. *Taylor*, 503 U.S. at 644. No objection was required under *Taylor*.

3. No objection to "100% of FMV" was required under *Schwab*

In addition to improperly requiring an objection under *Taylor*, the BAP also relied heavily on *Schwab* to hold that the notation "100% of FMV" exempted the full value of the property and "withdrew the property from the

bankruptcy estate." *Masingale*, 644 B.R. at 542. The BAP badly misconstrued *Schwab*, which actually supports the State.

In *Schwab*, the Supreme Court addressed a disagreement among the Circuit Courts about when a party must object to a claim of exemption under 11 U.S.C. § 522(*l*), the statute requiring debtors file a list of exemptions at the time they petition for bankruptcy. *Schwab*, 560 U.S. at 774. *Schwab* concerned a Chapter 7 debtor who itemized on her Schedule B—the list of assets—certain commercial kitchen equipment to which she assigned an estimated market value of $10,718. *Id.* at 755. Then, on Schedule C, she claimed two exempt interests in the equipment, which together totaled the same amount. *Id.*[5]

Although an appraisal revealed the equipment's total market value could be as much as $17,200, the trustee did not object to the claimed exemptions because the dollar value the debtor assigned to each fell within the limits of the exemptions she claimed. *Id*. at 775-76. The bankruptcy court denied the trustee's motion to auction the equipment to benefit the estate. *Id*. at 777. The trustee appealed to the district court, where he argued that neither the Bankruptcy Code nor Federal Rule of Bankruptcy Procedure 4003(b) required him to object to a

[5] That sum is less than the $12,075 combined total permitted under 11 U.S.C. §§ 522(d)(5) and (6).

claimed exemption where the amount the debtor declared as the value of her claimed exemption is an amount within the limits the Code prescribed. *Id*. The district court rejected the trustee's argument and the Third Circuit affirmed. *Id*. The Court of Appeals relied on the Supreme Court's decision in *Taylor*, concluding that an unstated premise of *Taylor* was that a debtor who exempts the entire reported value of an asset intends to exempt the "full amount" of the asset, whatever it turns out to be. *Id.* at 777-78.

The Supreme Court reversed, concluding "the Court of Appeals' approach fails to account for the text of the relevant Code provisions and misinterprets our decision in *Taylor*." *Id.* at 778. The Court held, "[the trustee] had no duty to object to the property [debtor] Reilly claimed as exempt (two interests in her business equipment worth $1,850 and $8,868) because the stated value of each interest, and thus of the 'property claimed as exempt,' was within the limits the Code allows." *Id.* at 782. In its analysis, the Court took care to cabin the rule of *Taylor*, limiting it to circumstances where the "value claimed exempt is not within statutory limits," such as "the value ($ *unknown*) in *Taylor*." *Id*. at 790 (citation omitted). But where the debtor assigns the exemption a value, the Supreme Court held that it would "take [those] exemptions at face value." *Id*. at 790-91. Accepting debtors at their word is the best method to preserve "the

predictability the [Bankruptcy Code] is designed to provide." *Id*. at 790 & n.17. Because the debtor's exemptions, which were expressed in dollar values, were unobjectionable under the Bankruptcy Code, the trustee in *Schwab* had no duty to object. *Id.* at 790-791.

After reaching its decision, the Court suggested that, in a circumstance where a debtor may wish to exempt "the full market value of the asset or the asset itself," the use of "100% of FMV" might be one way to flag a debtor's desire to exempt the full market value of the asset, or the asset itself. *Id.* at 792-94. This suggestion, which appears in one paragraph at the end of the opinion, was not a part of the Court's ruling and was dicta. Nonetheless, the BAP relied heavily on this dicta, holding that "100% of FMV" made "clear" to creditors that Masingale was attempting to exempt the full value of the asset, and that, because no party objected to the exemption in 2015, Masingale was allowed to claim the full sale value of the home in 2021. *Masingale*, 644 B.R. at 541.

The BAP's reasoning requires creditors to ignore all of the representations Masingale made in her schedules, Chapter 11 Plan, and Disclosure Statement, and instead "interpret[] her claimed exemption as improper[.]" *Cf. Schwab*, 560 U.S. at 779. But this is precisely the mode of analysis the Supreme Court *rejected* in *Schwab*, because it overly complicates the duties of trustees in reviewing

bankruptcy schedules and prohibits them from "tak[ing] a debtor's claim at face value." *Id.* at 779. All schedules "must be read in light of the Bankruptcy Code . . . and must yield to those provisions in the event of conflict." *Id.* at 779 n.5. Here, all of Masingale's filings confirmed she was limiting her homestead exemption to the statutory cap under 11 U.S.C. § 522(d). 4-StateER-713, 722, 670, 625, 627-28. Creditors, including the State, were permitted to take Masingale at her word, and no objection was required.

Nor does *Scwhab*'s dicta about the possible use of "100% of FMV" change the result. First, as dicta, it is not binding and this Court need not follow it. "It is a rule of universal application that general expressions used in a court's opinion are to be taken in connection with the case under consideration." *Bramwell v. U.S. Fidelity & Guaranty Co.*, 269 U.S. 483, 489 (1926) (citation omitted). *See also Humphrey's Ex'r v. United States*, 295 U.S. 602, 627 (1935) (dicta may be followed to the extent persuasive, but does not "control the judgment in a subsequent suit") (citation omitted); *Kirtsaeng v. John Wiley & Sons, Inc.*, 568 U.S. 519, 548 (2013) (refusing to give dicta "legal weight" because it was just an "example," and was "unnecessary" to the prior holding).

And the *Schwab* dicta is not persuasive here, because it does not suggest that a statement of "100% of FMV" will *always* raise a red flag and require an

objection. Instead, the *Schwab* court conceded that a red flag might be "in the eye of the beholder," because courts and creditors are permitted to rely on what a debtor "declares," and the "Code itself breaks the tie between what might otherwise be two equally tenable views." *Schwab*, 560 U.S. at 780, 789 n.16.[6] Where, as here, the debtor made a raft of contemporaneous representations that the homestead exemption fell within the limit prescribed by Congress, there was no red flag. The BAP erred when it reflexively applied the *Schwab* dicta to hold that "100% of FMV" required an objection.

But that is not all—the BAP went significantly further, holding as "a matter of first impression" that Masginale's shorthand use of 100% of FMV "includes postpetition appreciation."[7] *Masingale*, 644 B.R. at 543. In reaching this conclusion, the BAP declined to apply the "snapshot rule," which "fixes [at the filing date] the point in time that defines the exemptions that a debtor is entitled to take." *Id.* (emphasis omitted). The BAP reasoned that the snapshot rule did not apply, because Masingale's use of 100% of FMV removed the entire

[6] And, as discussed earlier, because Masingale was the drafter of all the schedules, the Chapter 11 Plan, and the Disclosure Statements, any ambiguity in what she meant by "100% of FMV" must be construed against her. *Hyman*, 967 F.2d at 1319 & n.6 (construing "any ambiguity" against the debtor because "the debtor controls the schedules").

[7] In ignoring the fact that Masingale's case started as a Chapter 11 case, the BAP failed to consider that 11 U.S.C. § 1115(a)(1) extends the definition of estate property to assets acquired between the petition date and conversion.

Greenacres home from the estate, including the intervening appreciation of more than $250,000. *Id.*

This ruling conflicts squarely with the Ninth Circuit's binding holding in *Gebhart*. There, this Court held that "homestead exemptions," like the one at issue here, "do not permit the exemption of entire properties, but rather specific dollar amounts." 621 F.3d at 1210. Even if a trustee fails to object to a homestead exemption, "the asset itself remains in the estate, at least if [the asset's] value at the time of filing is in fact higher than the exemption amount." *Id.* By statute, all post-petition interest accrues to the benefit of the estate, not the debtor. 11 U.S.C. § 541(a)(6). Thus, while the asset remains in the estate and may appreciate to the benefit of creditors, the "value of the debtor's exemption" is "frozen as of the date of filing the petition." *Id.* at 1211.

The *Gebhart* holding applies on all fours here. At the time of filing, Masingale claimed, and was statutorily entitled to, 100% of the fair market value of her "aggregate interest" (aka the equity) in the Greenacres home. 11 U.S.C. § 522(d)(1). That amount was fixed on September 28, 2015, the day her petition was filed. 4-StateER-684-739. On that date, 100% of the equity totaled $34,706—the difference between the home's value and its mortgage.

4-StateER-713.[8] All intervening appreciation remains in the estate for the benefit of creditors. *Gebhart*, 621 F.3d at 1211 (citing cases). Thus, under *Gebhart*, even if "100% of FMV" magically exempted the entire value of the Greenacres home at the time of filing, that value was still "frozen" at the filing date. *Gebhart*, 621 F.3d at 1211. As a result, even if the Court agrees with the BAP that "100% of FMV" allows Masingale to override the statutory exemption limit, the very most Masingale could receive would be the home's full value on September 28, 2015, which Masingale assessed at $165,430. 4-StateER-713. The BAP had no authority to displace the Bankruptcy Code or *Gebhart*. This Court should reverse the BAP and reaffirm that post-petition appreciation belongs to the bankruptcy estate.

4. The Court should not extend the *Schwab* dicta to this case, because doing so would produce absurd results

Even if the Court were to conclude that *Schwab* puts appointed trustees on notice to object to "100% of FMV" in the context of a Chapter 7 proceeding, there are at least three reasons why this Court should decline to extend the *Schwab* dicta to this case, which originated as a Chapter 11 matter.

[8] As noted above, the bankruptcy court found that the Chapter 7 Trustee consented to the full statutory exemption amount of $45,950, 2-StateER-94 at n.7, a ruling no party has appealed.

First, at all times relevant to this appeal, Masingale was the debtor in possession of the home. *Masingale*, 644 B.R. at 534. As discussed above, unlike Chapter 7 debtors, Chapter 11 debtors are permitted continued possession of their property, subject to stringent fiduciary duties. 11 U.S.C. § 1107(a) (commanding that debtors in possession "shall perform all the functions and duties . . . of a trustee").

The reason a debtor in possession must assume the fiduciary duties of a trustee is that, ordinarily, "if a debtor remains in possession . . . a trustee is not appointed." *Commodity Futures Trading Comm'n v. Weintraub*, 471 U.S. 343, 355 (1985). "Indeed, the willingness of courts to leave debtors in possession 'is premised upon an assurance that the [debtor and their agents agents] can be depended upon to carry out the fiduciary responsibilities of a trustee.'" *Id.* (quoting *Wolf v. Weinstein*, 372 U.S. 633, 649-652 (1963)). Without this fiduciary guarantee, debtors in possession would be incentivized to maximize their own personal gains from assets remaining in their control, rather than safeguarding those assets for possible future payment to creditors. *See United States v. Sims* (*In re Feiler*), 218 F.3d 948, 952 (9th Cir. 2000) (explaining "the trustee's duty is to maximize the assets of the bankruptcy estate to allow maximum recovery for the debtor's creditors").

The BAP decision never discusses how Masingale's fiduciary duty could *possibly* be consistent with a reading of her schedules whereby she intentionally steals an asset from the estate. In fact, the BAP decision fails to mention—even once—Masingale's heightened, fiduciary role as the debtor in possession of the home. Instead, and rather than read Masingale's schedules as consistent with her fiduciary duty, the BAP arrived at a paradoxical outcome: Masingale successfully may claim an illegitimate exemption that filches a valuable asset from the estate, while *simultaneously* running so afoul of the Bankruptcy Code's requirements as to warrant likely sanctions. *Masingale*, 644 B.R. at 544. The BAP panel acknowledged this bizarre result in candid terms, awarding Masingale the $422,000 home while also labeling her conduct "frivolous," "blatantly improper," "baseless," and a "tactic" with "no colorable statutory basis." *Id.* at 534-35, 541, 544. The BAP went further still, identifying no fewer than four separate bases on which Masingale and her attorney may be sanctioned. *Id.* at 544. And indeed, eight days after the BAP issued its decision, the bankruptcy court ordered the debtor's counsel to show cause why sanctions, in

the form of disgorgement of attorneys' fees charged over the course of the bankruptcy, should not be imposed. 2-StateER-61-62.[9]

The Court should not construe the Bankruptcy Code to simultaneously reward and condemn the same conduct. The Ninth Circuit takes care to avoid these types of irrational results in bankruptcy cases. *See, e.g.*, *Miller v. United States*, 363 F.3d 999, 1009 (9th Cir. 2004) (rejecting debtor's interpretation of his obligations in Chapter 11 bankruptcy because it "would lead to absurd results"); *Sambo's Rests., Inc. v. Wheeler* (*In re Sambo's Rests., Inc.*), 754 F.2d 811, 816 (9th Cir. 1985) (rejecting Chapter 11 debtor in possession's efforts to limit claims against the estate "because such a rule would lead to absurd results"). The Court should hold that the tactic set loose by the *Schwab* dicta is, at best, limited to Chapter 7 cases, and is unavailable in Chapter 11 cases where the debtors *themselves* serve as trustees. *See Mosier v. Ever-Fresh Food Co.* (*In re IRFM, Inc.*), 52 F.3d 228, 230 (9th Cir. 1995) (rejecting debtor's argument that would trigger "absurd results" if applied in new context).

[9] The bankruptcy court continued the sanctions proceedings, which potentially implicate $253,510.59 in paid and outstanding attorneys' fees, until this appeal is resolved. 2-StateER-53-60 (listing fee amounts); 2-StateER-34-42, 31-33 (continuing sanctions proceedings pending appeal).

The second reason this Court should not extend the *Schwab* dicta to the Chapter 11 context is that it creates inefficiency and uncertainty in the scheduling and review of a debtor's claimed exemptions. Since *Schwab* was decided in 2010, debtors frequently have attempted to leverage the "100% of FMV" dicta, plaguing the exemption practice with uncertainty and resulting litigation.[10] Bankruptcy courts at the trial and appellate levels have had to grapple with claims by debtors that the Supreme Court has approved of phrases

[10] *See, e.g.*, *Soori-Arachi v. Ferrara* (*In re Soori-Arachi*), 623 B.R. 181, 185 (B.A.P. 1st Cir. 2021); *In re Goldfeder*, No. 17-12873, 2020 WL 6820809, at *6 (Bankr. D. Del. 2020); *Levitz v. Alicia's Mexican Grille, Inc.*, No. H-19-3929, 2020 WL 710013, at *4 (S.D. Tex. 2020); *Wilson*, 909 F.3d at 308; *In re Farmer*, No. 16-42135, 2017 WL 3207679, at *2-3 (Bankr. E.D. Tex. 2017); *Peake v. Ayobami* (*In re Ayobami*), 879 F.3d 152, 153 (5th Cir. 2018); *In re Odam*, No. 17-50035-RLJ-7, 2018 WL 1054115, at *1 (Bankr. N.D. Tex. 2018); *In re Scotchel*, No. 12-09, 2014 WL 4327947, at *3 (Bankr. N.D. W. Va. 2014); *In re Orton*, 687 F.3d 612, 618 (3d Cir. 2012); *Dehart v. Stone* (*In re Travis*), Nos. 5-17-bk-00482-JJT, 5-17-bk-01661-JJT, 2017 WL 4277128, at *4 (Bankr. M.D. Pa. 2017); *Kornhauser v. Block* (*In re Block*), Nos. NV-15-1307-DFB, 14-51415-BTB, 2016 WL 3251406, at *2 (B.A.P. 9th Cir. 2016); *In re Ayobami*, No. 15-35488, 2016 WL 828743, at *8 (Bankr. S.D. Tex. 2016); *In re Gregory*, 487 B.R. 444, 454 (Bankr. E.D.N.C. 2013); *Williams v. Biesiada*, 498 B.R. 746, 752 (S.D. Tex. 2013); *Massey v. Pappalardo* (*In re Massey*), 465 B.R. 720, 721 (BAP 1st Cir. 2012); *In re Luckham*, 464 B.R. 67, 69 (Bankr. D. Mass. 2012); *In re Figueroa*, No. 5:11-bk-74710, 2012 WL 13135220, at *2 (Bankr. W.D. Ark. 2012); *In re Messer*, Nos. AZ-11-1505-JuPaD, 11-03007, 2012 WL 762828, at *3 (B.A.P. 9th Cir. 2012); *In re Massey*, 455 B.R. 17, 17 (Bankr. D. Mass. 2011); *In re Stoney*, 445 B.R. 543, 554 (Bankr. E.D. Va. 2011); *In re Salazar*, 449 B.R. 890, 901-02 (Bankr. N.D. Tex. 2011); *In re Wiczek*, 452 B.R. 762, 766 (Bankr. D. Minn. 2011); *Hefel v. Schnittjer* (*In re Hefel*), No. 11-CV-1010-LRR, 2011 WL 3292929, at *5 (N.D. Iowa 2011); *Orton v. Crawford*, No. 2:11-cv-921, 2011 WL 13176163, at *3 (W.D. Pa. 2011); *In re Moore*, 442 B.R. 865, 868 (Bankr. N.D. Tex. 2010); *In re Winchell*, No. 10-05827-PCW13, 2010 WL 5338054, at *2 (Bankr. E.D. Wash. 2010).

like "100% of FMV" as a mechanism to evade the statutory limits on exemptions. Of course, *Schwab* did no such thing, given that the exemption claimed in that case was well *within* the applicable statutory limit. 560 U.S. at 775-76. Nonetheless, debtors like Masingale have pounced on *Schwab*'s language and sought to press it as an advantage.

The U.S. Judicial Conference has attempted to address the misuse of the *Schwab* dicta. In 2015, the Judicial Conference approved amendments to Official Form 106C, titled "Schedule C: The Property You Claim as Exempt." *See* U.S. Admin. Off. of the Cts., Jud. Conf. of the U.S., Comm. on Rules of Prac. and Proc. (May 28, 2015).[11] Now, Schedule C contains a check-box for "100% of fair market value," followed by the *express caveat* that the exemption may be claimed "up to any applicable statutory limit." U.S. Admin. Off. of the Cts., Bankr. Forms: Official Form 106C (April 2022).[12]

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[11] Available at: https://www.uscourts.gov/sites/default/files/2015-05-28-standing_cmte_minutes_final_0.pdf. *See also* U.S. Admin. Off. of the Cts., Advisory Comm. on Rules of Bankr. Proc., Report of the Advisory Committee on Bankruptcy Rules, 8-9 (May 6, 2014), https://www.uscourts.gov/sites/default/files/fr_import/BK05-2014.pdf (describing the Committee's recommendations for changes to the forms in light of *Schwab*).

[12] Available at: https://www.uscourts.gov/sites/default/files/form_b_106c.pdf.

This Court should reject the BAP's construction of "100% of FMV" and clarify that, as a matter of law, such shorthand is *always* subject to the applicable statutory limits. In doing so, the Court will confirm that the approach taken by the Judicial Conference to amend Schedule C is consistent with—and indeed required by—the limits set by Congress in 11 U.S.C. § 522(d). It will also limit any future efforts by debtors to invent phrases that might be used to evade the statutory limits Congress has placed on their exemptions. Simply put, a rule that promotes order, efficiency, and predictability in the exemption-scheduling process is the best way to advance "the just, speedy, and inexpensive determination of every case." Fed. R. Bankr. P. 1001.

Third and finally, consistent enforcement of the statutory limits on exemptions is also required to give effect to Congress's purpose in setting those limits. *See Miller v. United States*, 363 F.3d at 1009 (rejecting interpretation that would "undermine[]" the "legislative purpose underlying the Bankruptcy Code"); *Gumport v. Sterling Press* (*In re Transcon Lines*), 58 F.3d 1432, 1440 (9th Cir. 1995) (Bankruptcy Code must be construed "consistent with our canons of statutory construction and most likely to effectuate congressional intent"). As the Supreme Court itself emphasized in *Schwab*, Congress set the limits on a debtor's allowable exemptions after "balancing difficult choices" between

debtors' and creditors' interests. 560 U.S. at 791. Courts may not "alter this balance" by allowing debtors to use gimmicks that change "an exemption's validity under the Code." *Id.* at 792. The Court should confirm that it is the statute—and not shorthand like "100% of FMV"—that caps the value of the homestead exemption debtors may claim.

IX. CONCLUSION

For the foregoing reasons, this Court should reverse the BAP.

RESPECTFULLY SUBMITTED this 7th day of April 2023.

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[ ] is a **cross-appeal** brief and complies with the word limit of Cir. R. 28.1-1.

[ ] is an **amicus** brief and complies with the word limit of FRAP 29(a)(5), Cir. R. 29-2(c)(2), or Cir. R. 29-2(c)(3).

[ ] is for a **death penalty** case and complies with the word limit of Cir. R. 32-4.

[ ] complies with the longer length limit permitted by Cir. R. 32-2(b) because *(select only one)*:
- [ ] it is a joint brief submitted by separately represented parties.
- [ ] a party or parties are filing a single brief in response to multiple briefs.
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[ ] complies with the length limit designated by court order dated _____.

[ ] is accompanied by a motion to file a longer brief pursuant to Cir. R. 32-2(a).

Signature *s/ Dina L. Yunker* **Date** April 7, 2023
*(use "*s/[typed name]*" to sign electronically-filed documents)*