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

REPLY BRIEF OF APPELLANT STATE OF WASHINGTON

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TABLE OF CONTENTS

TABLE OF AUTHORITIES

Cases

Constitutional Provisions

Statutes

Rules

Other Authorities

ADDENDUM TO BRIEFS

Pursuant to Circuit Rule 28-2.7, all applicable statutes are contained in the Appellant State of Washington's Addendum to Opening Brief.

I. INTRODUCTION

Masingale's response brief is most significant for what it omits, rather than what it includes. Masingale fails to meaningfully respond to, let alone refute, the State's authority demonstrating that the Chapter 11 Plan is a binding contract with res judicata effect on Masingale. Bankruptcy protections are meant to grant "a fresh start" to the "honest but unfortunate debtor," not to reward a debtor who hoodwinks creditors years after they relied on the debtor's sworn assurances. *See Marrama v. Citizens Bank of Mass.*, 549 U.S. 365, 367 (2007) (citation omitted). Masingale repeatedly represented to creditors that her homestead exemption fell under the statutory caps set by Congress, and she repeatedly promised to pay all creditors in full in exchange for retaining assets in excess of allowable exemptions. More importantly, Masingale represented that if for any reason she failed to make the payments specified in her plan, the property that exceeds allowable exemptions would be available to her creditors.

Instead of grappling with the legal result of these undisputed facts, what Masingale's response brief relies on is three essential points. First and asserted most frequently, no timely objection was made. Second, *Schwab's* dicta is binding. Third, the entire residence was removed from the estate. While

Masingale proffers a number of responses to the Trustee's and the State's legal arguments, all of Masingale's counterpoints hinge on these three themes.

Masingale's first argument fails because creditors are not required to object where the exemption is sought for an interest in an asset listed in 11 U.S.C. § 522(d), and the debtor's aggregate interest is less than or equal to the statutory cap specified in the Code for that particular type of asset.

Masingale's second argument—including its reading of the *Schwab* dicta—is misguided. First, Congress knows how to write an unlimited exemption if it so chooses. But in cases where Congress sets an express cap, debtors cannot circumvent it through use of "100% of FMV." Masingale asks this Court to upend the status quo and inject significant controversy about what the phrase "100% of FMV" means on an exemption schedule. The Court should decline and hold that the value of a debtor's exemption, whether expressed in dollars or percentages, is and always has been capped by the limits set forth in the Code.

Masingale's third argument, that the entire value of the asset was removed from the estate, contravenes well established Ninth Circuit precedent and renders the statutory exemption scheme of 11 U.S.C. § 522 meaningless. Since the State submitted its opening brief, this Circuit decided *Castleman v. Burman* (In re Castleman), No. 22-35604, 2023 WL 4833486 (9th Cir. July 28, 2023), which is

just the latest in this Court's series of consistent holdings that a post-petition increase in the equity of an asset belongs to the bankruptcy estate. *Castleman* and prior cases foreclose Masingale's effort to keep more than $250,000 in post-petition interest.

The Court should reverse the BAP and affirm the bankruptcy court.

II. ARGUMENT

Both federal and state law capped Masingale's homestead exemption at the federal exemption limit. None of Masingale's arguments establishes she is entitled to a windfall over the federal exemption amount.

A. Masingale Does Not Meaningfully Respond to the Argument that the Chapter 11 Plan Constituted a Contract and is Binding Res Judicata

In response to the State's lead argument—that the Chapter 11 Plan created a binding contract with res judicata effect—Masingale's response is simply to ignore it. At no point does Masingale deny that the Chapter 11 Plan formed a contract and that Masingale breached this contract. *See* Opening Br. 26-34; *Hillis Motors, Inc. v. Hawaii Auto. Dealers Ass'n*, 997 F.2d 581, 588 (9th Cir. 1993); *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)). Masingale instead refers back to the argument repeated

throughout her brief, that *Taylor* and *Schwab* establish the State of Washington should not prevail in this appeal. In doing so, Masingale leaves out that, unlike here, *Taylor and Schwab* did not involve a Chapter 11 case where the debtor owed a fiduciary duty to creditors and where a confirmed Chapter 11 Plan carries the force of law.

Masingale addresses only one of the many cases cited by the State confirming that the terms of the Chapter 11 plan operate as res judicata. *See, e.g., 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); *Laing v. Johnson* (*In re Laing*), 31 F.3d 1050, 1051 (10th Cir. 1994). Masingale discusses *Knupfer v. Wolfberg* (*In re Wolfberg*), 255 B.R. 879 (B.A.P. 9th Cir. 2000), *aff'd*, 37 F. App'x 891 (9th Cir. 2022), and attempts to distinguish the case on the facts alone, ignoring the court's holding that a confirmed Chapter 11 Plan is res judicata. *See* Answering Br. 28-29. In *Wolfberg*, the debtor attempted to claim a homestead exemption for the first time after plan confirmation. 255 B.R. at 881. The BAP denied the homestead exemption because it was not part of the confirmed Chapter 11 Plan. *Id.* at 884. Masingale seems to argue that because there was no homestead exemption claimed prior to plan confirmation in *Wolfberg*, the

holding does not apply here because Masingale *did* claim a homestead exemption prior to plan confirmation. *See* Answering Br. 28.

Masingale's argument makes a distinction without a difference. In *Wolfberg*, the BAP held the debtors were not entitled to the homestead exemption because the plan did not provide for the exemption and the confirmation order was "a binding, final order, accorded full res judicata effect[.]" *Id.* at 882 (citing *In re Heritage Hotel P'ship 1,*160 B.R. at 377). In reaching this decision, the BAP relied on 11 U.S.C. § 1141(a), equally applicable here, which states, "the provisions [of a Chapter 11] plan bind the debtor . . . and any creditor . . . ." And importantly, the BAP emphasized that creditors are entitled to rely upon the language in the Chapter 11 Plan as well as the accompanying Disclosure Statement:

> The disclosure statement debtors provided in this case explained that the plan would be funded by the sale of the residence, among other sources. It also listed the residence as a non-exempt asset. Any creditor who reviewed debtors' schedules could confirm that debtors did not claim any exemption in the residence, and therefore rely on the fact that the entire net proceeds from the sale would be available to pay creditors under the plan. Under the circumstances, if debtors intended to claim an exemption in the primary asset being used to fund the plan, they should have done so before the plan was confirmed. Once the plan was confirmed, that plan was binding on them just as it was binding on their creditors, and they could not later attempt to exempt assets represented in the disclosure statement to be non-exempt.

Id. at 883. The debtors in *Wolfberg* were bound by their representations in the Disclosure Statement and Chapter 11 Plan and those representations are res judicata. *Id.* at 884.

Masingale is bound here by her representations in those same documents. Masingale owed a fiduciary duty to creditors at the time she told them, under oath in the Disclosure Statement and Chapter 11 Plan, that her homestead exemptions fell under the statutory limit. *An-Tze Cheng v. K & S Diversified Inv., Inc.* (*In re An-Tze Cheng*), 308 B.R. 448, 455 (B.A.P. 9th Cir. 2004), *aff'd* 160 Fed. Appx. 664 (9th Cir. 2005); *see also Wilson v. Rigby*, 909 F.3d 306, 311 (9th Cir. 2018) (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)). Likewise, she was serving as a fiduciary when she promised she would pay all creditors in full in exchange for retaining assets in excess of allowable exemptions. *See* Opening Br. 10-24, 26-34. Those representations and promises bind Masingale now. The Court should reverse the BAP and affirm the bankruptcy court's ruling that Masingale is

entitled to $45,950, the "statutory limit" to which Masingale's own contract bound her. 4-StateER-670; 3-StateER-539; 11 U.S.C. § 522(d)(1).

B. The BAP Misapplied *Taylor* and *Schwab*, With the Effect of Wiping Out Congressional Limits on Exemptions

To reach the result below, the BAP relied on overly expansive reading of two Supreme Court precedents: *Taylor v. Kronz & Freeland*, 503 U.S. 638 (1992), and *Schwab v. Reilly*, 560 U.S. 770 (2010). Neither decision supports the windfall the BAP awarded to Masingale. *Taylor* does not apply here, because the value of Masingale's claimed exemption was clear from her schedules and sworn, contemporaneous filings on which creditors were permitted to rely. And *Schwab's* dicta regarding "100% of FMV" did not—and could not—override Congress's choice to cap homestead exemptions to a defined dollar amount. In holding otherwise, the BAP's decision clears the way for debtors to override congressional limits on *all* categories of capped assets, including homesteads, motor vehicles, household furnishings, jewelry, professional equipment, accrued dividends, and other personal property. *See* 11 U.S.C. §§ 522(d)(1)-(6), (8). The Court should reject this result and enforce the unmistakably plain terms of the Bankruptcy Code.

1. No objection was required under *Taylor* because the value of the claimed exemption was clear

The BAP leaned exclusively on *Taylor* to conclude that "[b]ecause no party in interest timely objected to the homestead exemption, it is not subject to challenge." *Masingale*, 644 B.R. at 538-39 (citing *Taylor* as the single case discussed on question of the necessity of an objection). Masingale's allegation that creditors' failure to object waived their right to challenge her "100% of FMV" exemption is a red herring. Eighteen years after *Taylor*, the Supreme Court refined its decision when it decided *Schwab*. 560 U.S. at 788-91. The reasoning and outcome in *Schwab* control the instant case, and make clear that no objection was required.

In *Schwab*, the debtor claimed as exempt cooking and kitchen equipment used in her catering business. 560 U.S. at 774-75. The schedules and forms submitted by the debtor listed the value of the exemption, and that value fell within the applicable limit for exempted professional equipment under the Bankruptcy Code. *Id.* at 776. The trustee in the Chapter 7 proceeding did not object, and the debtor later claimed that the exemption worked to remove the entire asset of professional equipment from the bankruptcy estate, arguing that her intent to exempt the entire asset was clear from the schedules. *Id.*

The Supreme Court rejected this argument. Taking debtor Reilly's exemptions at face value, the *Schwab* Court "[found] them unobjectionable under the Code," and so declared, "the objection deadline we enforced in *Taylor* is inapplicable here." *Id.* at 791. The reasoning centered on the same fact pattern as we have here: there was enough information in the *Schwab* debtor's schedules to determine the value of the interests being claimed as exempt. *Id.* at 779. The debtor listed on Schedule C the property she wished to reclaim as exempt and assigned dollar figures for the values of her exemptions. *Id.* at 775. On Schedule B, she listed the business equipment on which she sought an exemption and indicated an estimated market value of that asset. *Id.* The Court was clear that trustees and creditors should be able to rely on the information the debtor "wrote on the form[s]" and to take debtors' representations "at face value." *Id.* at 779, 791.

That analysis means the State wins here. Through Schedule A,[1] the Chapter 11 Plan, and the Disclosure Statement—all signed by the debtors under oath and available to the State during the 30-day period for evaluating

[1] Note that when Official Form 106C was amended in 2015, Schedule A, dealing with real property and Schedule B, dealing with personal property were combined into one new form and are now referenced as "Schedule A/B: Property."

exemptions—it was easy to see that the homestead exemption fell within the $45,950 federal limit. 4-StateER-713 (Schedule A listing "Debtor's Home" as having a current value of "$165,430" and a mortgage of "$130,724," leaving $34,706 in equity); 4-StateER-625 (repeating market value of home, amount of mortgage, and specifying that claimed homestead exemption exceeds federal cap by "$0.00"). If that were not enough, Masingale made express promises to buy the home from creditors and conceded that, if she could not perform, creditors would receive the excess value over the statutory exemption. 4-StateER-670 ("Debtors' exemptions are not allowed to the extent they exceed the statutory limit, until full payment is made [to creditors]."); *id.* ("Debtors shall pay an amount to Creditors, which is greater than the amount by which the claimed exemptions exceed those allowable by statute."); *id.* ("Debtors must pay for property to be retained in excess of allowable exemptions."); *id.* ("Provided, further, that if for any reason Debtors do not make the payments proposed and specified by this Plan . . . Debtors shall have the right to amend their claim of exemptions. However, the property which exceeds allowable exemptions would be available to Creditors.").

Masingale asks the Court to ignore these sworn statements in the Chapter 11 Plan and Disclosure Statement. *See* Response Br. at 20-21. In doing so, she

quotes *Schwab* out of context when she argues that "the *Schwab* court directed that trustees and interested parties are to look at: three, and only three, entries on [the debtor's] Schedule C." *Id.* at 27. The quotation, in the full context in which it appears in the *Schwab* opinion, is as follows:

> For all of these reasons, we conclude that Schwab was *entitled* to evaluate the propriety of the claimed exemptions based on three, and only three, entries on Reilly's Schedule C: the description of the business equipment in which Reilly claimed the exempt interests; the Code provisions governing the claimed exemptions; and the amounts Reilly listed in the column titled "value of claimed exemption." In reaching this conclusion, we do not render the market value estimate on Reilly's Schedule C superfluous. We simply confine the estimate to its proper role: *aiding the trustee* in administering the estate by helping him identify assets that may have value beyond the dollar amount the debtor claims as exempt, or whose full value may not be available for exemption because a portion of the interest is, for example, encumbered by an unavoidable lien.

Schwab, 560 U.S. at 785 (emphases added).

This passage makes it clear that the *Schwab* Court did not *direct* trustees to confine their evaluation of estate assets to only three columns on one schedule. Rather, it said trustees are *entitled* to evaluate the debtor's rendition of the value of her claimed exemption if they are able to do so by looking to the market-value estimation included by the debtor on her exemption schedule. *Id.* at 783. *Schwab* does not address the circumstances present here—where there was *even more* information available to creditors through the schedules, the Chapter 11 Plan,

and the Disclosure Statement. Because *Schwab* did not involve a Schedule A, Chapter 11 Plan, or Disclosure Statement, nothing in *Schwab* precludes the State from relying on these filings, or confines the State to look at three and only three columns on Schedule C to determine an exemption's value.[2] Instead, *Schwab* is clear that interested parties may take debtors' representations—all of them—at "face value." *Id.* at 791. Indeed, permitting parties in interest to look to a debtors' full set of representations is fundamental for the trustee to execute their duty under 11 U.S.C. § 704(a)(1) to collect and reduce to money the property of the estate. *See Barroso-Herrans v. Lugo-Mendor* (*In re Barroso-Herrans*), 524 F.3d 341, 344 (1st Cir. 2008) (considering Schedules B and C together, stating, "The threshold question of what has been claimed calls for interpreting the schedules filed by the debtors. To start, we ask how a reasonable trustee would have understood the filings under the circumstances."); *Young v. Camelot Homes, Inc.* (*In re Young*), 390 B.R. 480, 484 n.5 (Bankr. D. Me. 2008) ("A claim of exemption should be viewed as a reasonable trustee would understand it."); *In re Rolland*, 317 B.R. 402, 414 (Bankr. C.D. Cal. 2004) ("The trustee and

[2] The *Schwab* Court *itself* did not confine its examination to Schedule C. 560 U.S. at 775 (looking to Schedules B and C and reading them together). Additionally, in determining whether there was a homestead exemption, the *Wolfberg* court analyzed the entirety of the debtors' schedules. 255 B.R. at 883-84.

parties in interest should be able to determine whether an exemption claim is valid simply by reading the debtor's schedules.") (citations omitted).

The passage from *Schwab* also makes clear that the trustee is to administer the estate by identifying assets that may have value beyond the dollar amount the debtor claims as exempt. Estimated market value is one useful piece of information in doing so. Identifying encumbrances that reduce the value of a debtor's interest in the asset is another useful piece of information. To fulfill their charge, a trustee must look at a variety of schedules to ascertain whether there is equity, not only to reach beyond secured creditors, but also to reach beyond the debtor's aggregate interest.

Here, just as the debtor's designation of dollar values in *Schwab* permitted the trustee to evaluate the claimed exemption, Masingale's full set of contemporaneous, sworn representations permitted the State to value the claimed homestead exemption. That is why Masingale's designation of "100% of FMV" is not as useless as the designation of "unknown" was for evaluating the debtor's exemption claim in *Taylor*. *See* 503 U.S. at 640. Quite the contrary, designating "100% of FMV," together with information about the residence's fair market value and encumbrances on Schedule A, permitted creditors to ascertain from the face of just two of Masingale's schedules that the value of her interest in the

residence was less than the statutory limit authorized in 11 U.S.C. § 522(d)(1). The additional promises in the Chapter 11 Plan and Disclosure Statement confirm the State's reading that Masingale's exemption fell below the applicable cap.

To the extent that Masingale's schedules and other filings were unclear, the BAP improperly construed such ambiguity *against the State*. *Masingale*, 644 B.R. at 542 ("If the State . . . was not sure how much the Masingales were claiming, the State should have objected . . . ."). But the State *was* sure, at least until Masingale changed tactics years later. The BAP's holding turns upside down the rule that ambiguous bankruptcy schedules are construed against the drafter. *Hyman v. Plotkin* (*In re Hyman*), 967 F.2d 1316, 1319 n.6 (9th Cir. 1992) ("any ambiguity" must be construed against debtor as drafter of the schedules). Indeed, as debtor in possession, Masingale was charged with administering her estate to maximize benefit to her creditors. In *Taylor*, the party with the fiduciary duty to creditors was the trustee; here it was Masingale. There is no logical reason to punish creditors now who, at the appropriate time, justifiably relied on the promises Masingale made while serving as their fiduciary.

Because creditors were able to ascertain that Masingale's interest in the residence did not exceed what the statute permitted her to exempt, there was no

reason to object. With no reason to object, Masingale's case fits within the facts and analysis of *Schwab*, and no objection to the homestead exemption was required.

2. The BAP's holding turns limited exemptions into unlimited ones, and undermines important work of the Judicial Conference Committee

It is Congress, not the courts, that holds the power to establish bankruptcy laws. U.S. Const., Art. 1, Sec. 8, Clause 4.2. Congress has done so and its work is codified in Title 11 of the Bankruptcy Code. The Code's federal exemption scheme is robust; 11 U.S.C. § 522(d) lists twelve types of assets on which an exemption claim can be made and the extent of the value debtors may claim for each. Some of the exemptions are limited in value, some are not. Of the twelve types of assets for which debtors may make exemption claims, four types may be taken in unlimited amounts.[3] Debtors may take the other eight types of exempt

[3] Specifically, 11 U.S.C. § 522(d)(7) permits debtors to exempt the entirety of unmatured life insurance contracts. Section 522(d)(9) permits debtors to exempt the entirety of professionally prescribed health aids. Section 522(d)(10) permits unlimited exemption for a variety of federal and local benefits, plus, if reasonably necessary for the support of a debtor or dependent, domestic support and contractual disability payments. Section 522(d)(11) permits debtors to exempt the entirety of crime victims reparation awards, and, to the extent reasonably necessary to support the debtor or a dependent, wrongful death and contractual life insurance payments payable on account of an individual upon whom the debtor was dependent.

property only in limited dollar values. Masingale's homestead exemption is a limited exemption. 11 U.S.C. § 522(d)(1).

Here, construing the phrase "100% of FMV" to permit circumvention of the congressionally established limit would violate both the plain text and purpose of the exemption scheme. *See Lac du Flambeau Band of Lake Superior Chippewa Indians v Coughlin*, ___ U.S. ___, 143 S. Ct. 1689, 1697, 216 L.Ed.2d 342 (2023) (giving effect to what the Bankruptcy Code's "plain text conveys"). Congress is charged with valuing exemptions and it knows how to draft language permitting exemption of property in unlimited dollar amounts. It is not the purview of the courts to modify the bankruptcy exemption scheme. *Id.* at 1698 (refusing a statutory reading that "risks upending the policy choices that the Code embodies"). To take literally Masingale's late-breaking assertion that "100% of FMV" means the entire residence is removed from the estate is to put the Court in the absurd position of endorsing an evasion of the law. *Cf. Masingale*, 644 B.R. at 544 (suggesting sanctions on Masingale and her counsel after awarding the debtor the entire residence).

The alternative is to consider Masingale's use of the phrase "100% of FMV" as consistent with 11 U.S.C. § 522(d)(1), and determine that she exempted 100% of her "aggregate interest"—i.e., the equity—in her home. That

reading is also consistent with her Schedule A, Chapter 11 Plan, and Disclosure Statement representations. Because the value of Masingale's *interest* in the residence was less than the statutory limit imposed by § 522(d)(1), no one was required to object to her designation of "100% of FMV." Such a result is consistent with the holding in *Schwab* and avoids putting courts in the inadvisable position of allowing a judicially created exemption to take from the estate what Congress properly gave to the estate. Because this reading of Masingale's schedules is at least as viable as the one she offers, the Court should impute this reading to her as the drafter of the schedules. *Hyman*, 967 F.2d at 1319 n.6.

Reading Masingale's schedules to comport with the statutory cap is also supported by the work of the Judicial Conference to amend Schedule C in the wake of *Schwab*. As of December 2015, the form has a check box in each category of exemptible asset, allowing the debtor to exempt "100% of fair market value, *up to any applicable statutory limit*." U.S. Admin. Off. of the Cts., Bankr. Forms: Official Form 106C (April 2022) (emphasis added).[4] The Advisory Committee on Bankruptcy Rules understood how to give effect to the

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

Schwab dicta while also observing the exemption limits set by Congress. This Court should color within those same lines and avoid the destabilization that the BAP ruling threatens for bankruptcy courts, trustees, and creditors across the Circuit. Specifically, if the BAP ruling is allowed to stand, debtors will be disincentivized from checking the box and agreeing to the "applicable statutory limit," perhaps preferring to try their luck with an unlimited "100% of FMV" exemption and ensuring litigation about its meaning. Encouraging a cycle of murky exemptions followed by objections and motions practice is wasteful and inefficient—the very opposite of the goals of bankruptcy court. *See* Fed. R. Bankr. P. 1001.[5] The Court should follow the lead of the Judicial Conference and construe "100% of FMV" to be an appropriate entry for Masingale to have used here, because 100% of her aggregate interest in the residence—her equity—fell within the statutory cap.

[5] Amici National Consumer Bankruptcy Rights Center and Northwest Consumer Law Center both highlight the importance of determining exemption values at the time a case is filed. *See* Br. of Nat'l Consumer Bankr. Rights Ctr., ECF No. 37-1 at 2, 4; Br. of NW Consumer Law Ctr., ECF No. 44-1 at 14, 17. In this case, Masingale first asserted that her homestead exemption was worth more than the statutory maximum in October 2021, more than six years after filing the bankruptcy petition. *See* 2-StateER-172-73. It is puzzling for amici to argue that a public policy favoring the speedy determination of exemptions could possibly support the tactics employed by Masingale and her counsel here. And going forward, a ruling affirming the BAP would only invite additional efforts at creativity and gamesmanship by debtors seeking to evade the congressional exemption caps.

C. The Phrase "100% of FMV" Does Not Remove the Entire Asset From the Estate, and Post-Petition Appreciation Belongs to the Estate

The BAP was wrong in declaring "[a]s a matter of first impression" that the value of Masingale's exemption was equivalent to the full fair market value of the residence, "includ[ing] postpetition appreciation." *Masingale*, 644 B.R. at 543. Under this Court's longstanding precedent, the snapshot rule freezes exemption values at the time of the petition, with all intervening appreciation accruing to the estate.

The fundamental problem with the BAP's holding is that it creates a mechanism for debtors to remove an entire residence from the bankruptcy estate, in contravention of statute. Section § 522(d)(1) of the Bankruptcy Code defines the character of the federal homestead exemption. That statute defines the available exemption as only the debtor's aggregate *interest* in the residence, not the residence itself. *Id.* The debtor's aggregate interest is the unencumbered portion of the property she wishes to exempt. *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 purposes of exemption."). *Schwab* makes it clear that,

regardless of whether an objection was timely, where the debtor's interest in the asset at the time of petition is less than the statutory limit, only the "interest," and not the asset "*per se*" is removed. *Schwab*, 560 U.S. at 783. The result is that value in excess of the statutory limit remains in the estate and is available to the trustee for distribution to creditors.

Ninth Circuit law is wholly consistent, which is why it is perplexing that the BAP viewed this as an issue of first impression. *See Schwaber v. Reed* (*In re Reed*), 940 F.2d 1317, 1323 (9th Cir. 1991) ("appreciation enures to the bankruptcy estate, not the debtor"); *Gebhart v. Klein* (*In re Gebhart*), 621 F.3d 1206, 1211 (9th Cir. 2010) ("the estate is entitled to postpetition appreciation in the value of property a portion of which is otherwise exempt"); *Wilson*, 909 F.3d at 309 ("as of the commencement of the case," all "'[p]roceeds, product, offspring, rents, or profits' enure to the bankruptcy estate. *This includes the appreciation in value of a debtor's home*.") (emphasis added) (quoting 11 U.S.C. § 541(a)(6)).

If there could be any further doubt, it was resolved in the Court's recent decision in *Castleman v. Burman* (*In re Castleman*), No. 22-35604, 2023 WL 4833486 (9th Cir. July 28, 2023). The operative facts in *Castleman* and this case are remarkably similar: the debtors in both cases filed bankruptcy petitions under

which they confirmed reorganization plans and both cases were eventually converted to Chapter 7 proceedings.[6]

In *Castleman*, the debtors filed for reorganization under Chapter 13. 2023 WL 4833486 at *1. They scheduled their residence with a value of $500,000, a mortgage of $375,077, and claimed a homestead exemption in the amount of the $124,923 they had in equity. *Id.* Roughly one and a half years after confirmation of their Chapter 13 Plan, the debtors converted their case to a Chapter 7 proceeding. *Id.* By the time the Chapter 7 trustee moved to sell their home, it had appreciated by approximately $200,000. *Id.* In objecting to the proposed sale, the debtors argued that the home's increased equity belonged to them rather than the bankruptcy estate. *Id*. Affirming the district and bankruptcy courts, this Court held that post-petition, pre-conversion increases in the equity of the asset belonged to the bankruptcy estate. *Id*. at *2.

In reaching its holding, this Court undertook a detailed examination of cases across the circuits that have analyzed the question of whether increased

[6] With respect to the similarity of facts between the *Castleman* case and this case, there is one exception: as a debtor in possession, 11 U.S.C. § 1107(a) required Masingale to serve as a fiduciary to her creditors whereas the debtors in *Castleman* did not serve in a fiduciary capacity. This difference does not bear on the analysis of defining estate property, but it does bear on the importance of Masingale's duty to act in good faith and maximize the value of the estate available to pay creditors. *See An-Tze Cheng*, 308 B.R. at 455, aff'd 160 F. App'x. 644 (9th Cir. 2005).

equity belongs to the debtor or the estate. *Id*. at *3-4. Focusing on Ninth Circuit cases, this Court stated:

> In this circuit, we have likewise concluded that the broad scope of § 541(a), and especially § 541(a)(6), means that post-petition "appreciation [i]nures to the bankruptcy estate, not the debtor." *Schwaber v. Reed* (*In re Reed*), 940 F.2d 1317, 1323 (9th Cir. 1991). We recently re-affirmed this in *Wilson v. Rigby*, noting that when a debtor files for bankruptcy, the "proceeds, product, offspring, rents, or profits" which become part of the estate under § 541(a)(6) "include[ ] the appreciation in value of a debtor's home." 909 F.3d 306, 309 (9th Cir. 2018).

Castleman, 2023 WL 4833486 at *3. With this, the Ninth Circuit held that the plain language of § 541(a), as incorporated by the Chapter 13 statutes, compels the conclusion that post-petition appreciation in the property, along with any corresponding increase in equity, belongs to the estate upon conversion. *Id*. at *2, 4.

Here, the same provision—11 U.S.C. § 541(a)—is also the controlling statute and compels the same result. The Court must look to 11 U.S.C. § 1115 for the definition of estate property in cases that have converted from Chapter 11. It provides, in relevant part, that:

> [P]roperty of the estate includes, in addition to the property specified in section 541[,] all property of the kind specified in section 541 that the debtor acquires after the commencement of the case but before the case is closed, dismissed, or converted to a case under chapter 7, 12, or 13, whichever occurs first . . . .

11 U.S.C. § 1115(a)(1).

Section 1115(a) thus incorporates into the estate the property described in § 541, including property acquired between the bankruptcy filing and the date of conversion. The property of this converted Chapter 11 case is the same as the property of the converted Chapter 13 case at issue in *Castleman*. As a result, *Castleman* makes crystal clear that Masingale's home, including its post-petition, pre-conversion increase in equity, is part of the bankruptcy estate and available to the Trustee for the benefit of creditors.

Applying these principles of settled law, the value of the post-petition interest belonging to the estate here is not difficult to calculate. The "snapshot rule" froze Masingale's homestead exemption at $45,950, the maximum for joint debtors on the date Masingale claimed the exemption.[7] *Wolfe v. Jacobson* (*In re Jacobson*), 676 F.3d 1193, 1199 (9th Cir. 2012); *see also* 11 U.S.C. § 522(d)(1); 2-StateER-181-87. The home sold for $422,000. 2-StateER-84-87. The difference should now be available to creditors, including the State Department

[7] The actual value of Masingale's equity on the date she filed her bankruptcy petition was lower, totaling $34,706. 4-StateER-713. Based on the Chapter 7 Trustee's apparent consent, the bankruptcy court awarded Masingale the maximum amount permitted by 11 U.S.C. § 522(d)(1), which was $45,950. 2-StateER-94 n.7. As noted in the State's Opening Brief, the State did not appeal the bankruptcy court's award of the full $45,950 amount to Masingale. ECF 19-1 at 39, 49 & n.8.

of Revenue and the Victims' Fund established through the sexual harassment lawsuit. *See* Opening Br. 14-16.

Seeking to turn years of binding Ninth Circuit precedent on its head, Masingale quotes *In re Ayobami*, No. 15-35488, 2016 WL 3854052 (Bankr. S.D. Tex. June 9, 2016), an unpublished memorandum opinion from a bankruptcy court in the Fifth Circuit. There, the court held that where "a debtor claims an interest that is measured in a percentage ownership of an asset . . . any increase in value goes to the debtor." *Id.* at *1. In citing the trial court opinion, Masingale ignores what the Fifth Circuit Court of Appeals said on review. The question certified for appeal was "May a debtor claiming federal exemptions under § 522 of the Bankruptcy Code *ever* exempt a 100% interest in an asset?" *See Peake v. Ayobami* (*In re Ayobami*), 879 F.3d 152, 153 (5th Cir. 2018) (emphasis in original.) The Fifth Circuit answered yes, but *only* when "the debtor's entire interest in an asset is less than or equal to any dollar-value limitation imposed by the applicable § 522(d) subsection . . . ." *Id*. at 154. Even then, the Fifth Circuit found it "questionable" whether the debtor could then "'walk away' with the asset itself and potentially benefit from any post-petition appreciation of it." *Id.* (quoting *Schwab*, 560 U.S. at 794 n.21). While the Fifth Circuit stopped short of resolving that question, the panel cast serious doubt on the bankruptcy court

opinion cited by Masingale here. *Id.* at 155. Because the question *is* resolved in the Ninth Circuit—with post-petition interest in homesteads belonging to the estate—*Ayobami* is of no help to Masingale.

III. CONCLUSION

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

RESPECTFULLY SUBMITTED this 28th day of August 2023.

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FOR THE NINTH CIRCUIT

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