IN THE UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT OF ARKANSAS
FAYETTEVILLE DIVISION

IN RE: JOHNNY BELEW, Debtor **No. 5:17-bk-71508**
Ch. 7

ORDER

Before the Court is the chapter 7 trustee's *Objection to Exemptions* timely filed on January 7, 2018. The Court set the objection for hearing on February 21, 2018, at which time the debtor responded to the trustee's objection. The trustee argues that the debtor's second amended schedules–specifically Schedule C, The Property You Claim as Exempt–that the debtor filed on December 8, 2017, should be disallowed "as being in bad faith and prejudicial to creditors." In the debtor's amended schedules, which were filed after the time to object to the debtor's discharge had expired, the debtor listed for the first time (1) a possible interest in a bank account held in his wife's name, (2) two unpublished manuscripts written by the debtor, (3) a possible interest in what was referred to as "Home Safe Cash" in the amount of $30,000.00, and (4) a pre-petition transfer to his wife in the amount of $11,788.69. According to the trustee, she has incurred significant administrative expenses investigating the debtor's finances and business dealings, all of which, again according to her, led to the eventual disclosure of the additional property the debtor failed to list on either his original petition or his first set of amended schedules.

The debtor argues that he did not originally disclose the Home Safe Cash because he believed the money belonged to his wife; he neglected to disclose the Direct Express Account because it only had $2.00 in the account at the time the petition was filed. He stated that he disclosed all of the additional property to his attorney as soon as he realized that he had failed to list the property earlier.

The Eighth Circuit has previously stated that the general rule regarding exemptions is to allow the liberal amendment of exemption claims. *In re Kaelin*, 308 F.3d 885, 889 (8th Cir. 2002). It has also previously recognized that a bankruptcy court has the discretion to

deny the exemptions "if the amendment is proposed in bad faith or would prejudice creditors." *Id.* at 888 (citing *In re Michael*, 163 F.3d 526, 529 (9th Cir. 1998)). Both parties relied on the *Kaelin* case in their respective opening statements for the standard of proof for an objection to exemptions.[1] The trustee used the case to recognize the two exceptions to the liberal allowance of exemptions and the debtor used the case to recognize that bad faith is "determined by an examination of the totality of the circumstances." *In re Kaelin*, 308 F.3d. at 889.

However, this Court no longer recognizes *In re Kaelin* as controlling precedent with regard to the exceptions in an on-going case.[2] The bankruptcy rules allow for the amendment of schedules "by the debtor as a matter of course at any time before the case is closed." Fed. R. Bankr. P. 1009(a). An objecting party has the burden of proving that the exemptions are not properly claimed. Fed. R. Bankr. P. 4003(c). The *Kaelin* court held that a bankruptcy court, in its discretion, could deny an exemption for equitable reasons based on the debtor's alleged bad faith conduct or a perceived prejudice to creditors. *In re Kaelin*, 308 F.3d. at 889. However, in 2014, the Supreme Court abrogated this holding by finding that "federal law provides no authority for bankruptcy courts to deny an exemption on a ground not specified in the Code." *Law v. Siegel*, 134 S. Ct 1188, 1196-97 (2014) (italics deleted). Specifically, the *Siegel* Court held that the bankruptcy court does not have the equitable power "to deny exemptions based on a debtor's bad-faith conduct." *Id.* at 1196.

In *Siegel*, the chapter 7 trustee did not object to the debtor's claim of exemption but later filed a motion to "surcharge" the debtor's $75,000.00 homestead exemption that was otherwise allowable under California law. The debtor had reported that his home was

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[1] The trustee relied on an unpublished bankruptcy case from the Western District of Arkansas, which in turn cited to *In re Kaelin*, 308 F.3d 885 (8th Cir. 2002).

[2] This is not to say that the Court would not consider the two *Kaelin* exceptions in a case that was reopened to amend Schedule C.

subject to two mortgages. After protracted litigation that lasted approximately five years and during which the trustee incurred attorney fees in excess of $500,000.00, the bankruptcy court found that one of the two mortgages was fraudulent. Based on this finding, the trustee filed his motion to surcharge the otherwise allowable exemption to help defray the trustee's expenses. The bankruptcy court granted the trustee's motion and the decision was affirmed by the Ninth Circuit Bankruptcy Appellate Panel and the Ninth Circuit. *In re Siegel*, 134 S. Ct at 1193-94.

On appeal, the Supreme Court reversed the lower courts, holding that the "surcharge" was unauthorized because it contravened two specific provisions of the bankruptcy code. Although a court has the authority under § 105(a) to "issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of" the bankruptcy code under 11 U.S.C. § 105(a), "in exercising those statutory and inherent powers, a bankruptcy court may not contravene specific statutory provisions." *In re Siegel*, 134 S. Ct at 1194. In *Siegel*, the Court stated that under California law, § 522(b)(3)(A) entitled the debtor to exempt $75,000.00 of equity in his home from the bankruptcy estate. It further stated that under § 522(k), the exempt $75,000.00 was "not liable for payment of any administrative expense." *Id*. at 1195. It was clear to the Court that the trustee's attorney fees were "indubitably an administrative expense." The Court found that the bankruptcy court had violated § 522's express terms when it ordered the debtor's protected homestead exemption be made available to pay the trustee's administrative fee. *Id*.

The *Siegel* Court also discussed the debtor's entitlement to the exemption in the light of the debtor's fraudulent mortgage. It stated unequivocally that courts do not have the "discretion to grant or withhold exemptions based on whatever considerations they deem appropriate. Rather, the statute exhaustively specifies the criteria that will render property exempt. . . . [T]he court may not refuse to honor the exemption absent a valid statutory basis for doing so." *In re Siegel*, 134 S. Ct at 1196. The Court then recognized the code's "meticulous–not to say mind-numbingly detailed–enumeration of exemptions

and exceptions to those exemptions . . . ." *Id.*[3]

The chapter 7 trustee in *Siegel* also pointed to a number of courts that have claimed authority to disallow an exemption based on the debtor's concealment of an asset and a bankruptcy court's equitable power to deny the exemption based on the debtor's bad faith conduct.[4] However, the Court was adamant in its position that the denial of an exemption that is allowed under the bankruptcy code can only be based on a ground specified in the code. *In re Siegel*, 134 S. Ct at 1196 ("*federal law* provides no authority for bankruptcy courts to deny an exemption on a ground not specified in the Code")

After *Siegel*, and without the advantage of *Kaelin*'s equitable holding, the Court finds that the trustee failed to meet her burden of proving the debtor did not properly claim his exemptions. For the above stated reasons, the Court overrules the trustee's objection to

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[3] According to the *Siegel* Court:

> Moreover, § 522 sets forth a number of carefully calibrated exceptions and limitations, some of which relate to the debtor's misconduct. For example, § 522(c) makes exempt property liable for certain kinds of prepetition debts, including debts arising from tax fraud, fraud in connection with student loans, and other specified types of wrongdoing. Section 522(o) prevents a debtor from claiming a homestead exemption to the extent he acquired the homestead with nonexempt property in the previous 10 years "with the intent to hinder, delay, or defraud a creditor." And § 522(q) caps a debtor's homestead exemption at approximately $150,000 (but does not eliminate it entirely) where the debtor has been convicted of a felony that shows "that the filing of the case was an abuse of the provisions of" the Code, or where the debtor owes a debt arising from specified wrongful acts—such as securities fraud, civil violations of the Racketeer Influenced and Corrupt Organizations Act, or "any criminal act, intentional tort, or willful or reckless misconduct that caused serious physical injury or death to another individual in the preceding 5 years." § 522(q) and note following § 522.

In re Siegel, 134 S. Ct. at 1196.

[4] One of those courts was the Eleventh Circuit in the case of *In re Doan*, 672 F.2d 831 (11th Cir. 1982). The Eighth Circuit cited to *In re Doan* favorably in its *Kaelin* opinion.

the debtor's amended claim of exemptions that was filed on December 8, 2017.

IT IS SO ORDERED.

cc: Bianca Rucker, chapter 7 trustee
Todd F. Hertzberg, attorney for the debtor
Patricia J. Stanley, attorney for the U.S.T.