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U.S. BKCY. APP. PANEL  
OF THE NINTH CIRCUIT**

**UNITED STATES BANKRUPTCY APPELLATE PANEL  
OF THE NINTH CIRCUIT**

In re: ) BAP No. AZ-05-1163-SKMo  
)  
FREDRICK EDWARD SMITH and ) Bk. No. 02-19420-GBN  
CHERYL LYNN SMITH, )  
)  
Debtors. )  
)  
\_\_\_\_\_)  
MAUREEN GAUGHAN, Chapter 7 )  
Trustee, )  
)  
Appellant, )  
)  
v. ) **O P I N I O N**  
)  
FREDRICK EDWARD SMITH; )  
CHERYL LYNN SMITH, )  
)  
Appellees. )  
\_\_\_\_\_)

Argued and Submitted on  
September 22, 2005 at Phoenix, Arizona

Filed - April 7, 2006

Appeal from the United States Bankruptcy Court  
for the District of Arizona

Honorable George B. Nielsen, Jr., Bankruptcy Judge, Presiding  
\_\_\_\_\_

Before: SMITH, KLEIN and MONTALI, Bankruptcy Judges.

1 SMITH, Bankruptcy Judge:

2  
3 The chapter 7 trustee, Maureen Gaughan, appeals a final  
4 order of the bankruptcy court, entered April 11, 2005, which  
5 effectively denied her motion to compel the turnover of certain  
6 homestead funds claimed exempt by debtors, Frederick Edward and  
7 Cheryl Lynn Smith (collectively, "Debtors"). The trustee timely  
8 filed a notice of appeal on April 20, 2005. We REVERSE.

9 **I. FACTS**

10 The facts are undisputed. On October 22, 2002, Debtors sold  
11 their residence and deposited the net proceeds into a bank  
12 account. On December 3, 2002, they filed a chapter 7<sup>1</sup> petition.  
13 At the time of the filing, approximately \$19,482 remained in the  
14 account. In their schedules, Debtors claimed an exemption in the  
15 proceeds pursuant to Arizona Revised Statute ("A.R.S.") § 33-  
16 1101(C). The trustee objected to the exemption on the ground  
17 that Debtors had provided insufficient documentation to support  
18 the claim. The objection included the following notice:

19 Notice is given that the exemption will be  
20 denied as recommended by the Trustee on or  
21 before 20 days from service unless the debtor  
22 sends sufficient documentation to the Trustee  
23 and receives from the Trustee a withdrawal of  
24 the objection OR the debtor files and serves  
a response to the Objection with the Clerk of  
the Court . . . . If the Debtor timely files  
and serves a response to the objection, the  
Trustee will request a hearing from the  
Court.

25  
26 <sup>1</sup> Unless otherwise indicated, all chapter, section and rule  
27 references are to the Bankruptcy Code, 11 U.S.C. §§ 101-1330, and  
28 to the Federal Rules of Bankruptcy Procedure, Rules 1001-9036, as  
enacted and promulgated prior to the effective date of The  
Bankruptcy Abuse Prevention and Consumer Protection Act of 2005,  
Pub. L. 109-8, Apr. 20, 2005, 119 Stat. 23.

1 Debtors timely filed and served a response, but the trustee  
2 did not withdraw the objection or request a hearing. Instead, on  
3 February 7, 2005, after the objection to exemption deadline had  
4 passed, the trustee filed a motion to compel turnover of the sale  
5 proceeds as nonexempt property of the estate (the "turnover  
6 motion"). The trustee argued that, in order to preserve the  
7 exempt status of the sale proceeds under applicable Arizona  
8 homestead exemption law, A.R.S. § 33-1101(C), Debtors were  
9 required to reinvest the proceeds into another homestead within  
10 eighteen months of the sale. According to the trustee, because  
11 the homestead property was sold on October 22, 2002, the proceeds  
12 were rendered nonexempt by operation of law as of April 22,  
13 2004.<sup>2</sup>

14 Debtors responded that the trustee failed to provide  
15 adequate notice of the objection to the exemption. Specifically,  
16 the objection did not mention the eighteen-month reinvestment  
17 deadline. They urged that if the turnover motion was to be  
18 construed as an objection to the homestead exemption, it was  
19 filed ten months after the exemption deadline, and therefore,  
20 untimely.

21 The hearing was held on April 5, 2005, at which time, the  
22 bankruptcy court issued the following oral ruling:

23 Here, I recognize the Trustee may not have  
24 been in a position to argue that this

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25 <sup>2</sup> The trustee has not sought all of the proceeds of the sale  
26 of the residence, but only the amount on hand as of the  
27 expiration date of the exemption. Thus, we assume - without  
28 deciding - that debtors' use of a portion of the proceeds during  
the period they were exempt was permissible. We assume further  
that had Debtors expended all of the proceeds before April 22,  
2004, the trustee would have had nothing to seek to recover.

1 exemption was invalid because the 18-month  
2 window had not lapsed. To the extent that  
3 the Trustee wanted to follow this matter  
4 along and preserve any objections, she could  
5 have been able to preserve that objection,  
6 possibly, by timely filing a motion to extend  
7 the deadline for filing an objection to the  
8 homestead. Or she could have filed a  
9 conditional objection noting as the Court  
indicated in Earnest<sup>3</sup> that as of the petition  
date, it couldn't be determined whether the  
Debtors' homestead would be preserved because  
the 18-month reinvestment window has lapsed.  
But unlike Earnest, here, there was little to  
suggest that the Trustee had given the  
Debtors' notice of her continuing interest in  
the homestead.

10 I take the Trustee's comment here, and I  
11 agree with it. These Debtors are essentially  
12 in a position that they would not be in, as  
13 favorable position, had they not filed a  
14 bankruptcy. But, that is the result of  
15 existing law. I'm constrained by the  
16 Bankruptcy Appellate Panel's learned  
17 decisions, I'm -- and the Supreme Court's  
18 decision and Rule 4003(b). So I don't  
19 believe the Trustee's met her burden. And as  
20 accordingly, I'm going to deny her turnover  
21 motion.

22 Transcript of Proceedings, April 5, 2005, p. 14.

23 The trustee appeals.

## 24 **II. JURISDICTION**

25 The bankruptcy court had jurisdiction under 28 U.S.C. § 1334  
26 and §§ 157(b)(1) and (b)(2)(B). We have jurisdiction under 28  
27 U.S.C. § 158(c).

## 28 **III. ISSUE**

Whether the bankruptcy court erred in denying the trustee's  
motion to compel turnover of proceeds from the sale of Debtors'  
homestead on the ground that she failed to properly object to the  
exempt status of the proceeds.

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<sup>3</sup> In re Earnest, 42 B.R. 395 (Bankr. D. Or. 1984).

#### IV. STANDARD OF REVIEW

Questions regarding the right of a debtor to claim exemptions are questions of law reviewed de novo. In re Arnold, 252 B.R. 778, 784 (9th Cir. BAP 2000); In re Goswami, 304 B.R. 386, 389 (9th Cir. BAP 2003); In re Kim, 257 B.R. 680, 684 (9th Cir. BAP 2000). "Whether property is included in a bankruptcy estate is a question of law also subject to de novo review." In re Kim, 257 B.R. at 684; In re Central Ark. Broad. Co., 68 F.3d 213, 214 (8th Cir. 1995).

#### V. DISCUSSION

The trustee's position on this appeal is straightforward. She asserts that the sale proceeds from Debtors' residence lost their exempt status when they failed to reinvest the proceeds into another homestead within eighteen months of the sale in accordance with Arizona law, and therefore, became property of the estate. In support of her position, the trustee relies on the Ninth Circuit's decision in In re Golden, 789 F.2d 698 (9th Cir. 1986), interpreting California homestead law, as well as an Oregon bankruptcy decision, In re Earnest, 42 B.R. 395 (Bankr. D. Or. 1984). Both cases hold if state law requires the reinvestment of sale proceeds of a homestead within a statutory period, and debtor fails to do so within that time, the proceeds are deemed nonexempt and become property of the estate.

Debtors argue that the holdings in Golden and Earnest are inapposite because, unlike the homestead provisions of California and Oregon, Arizona does not require that the sale proceeds be reinvested into another homestead. According to Debtors, under Arizona law, there is no clear language conditioning the

1 allowance of the exemption on a requirement to be met over a  
2 period of time. We disagree.

3 The commencement of a bankruptcy case creates an estate  
4 comprised of all legal and equitable interests in property  
5 (including potentially exempt property) of the debtor. 11 U.S.C.  
6 § 541. A debtor in bankruptcy is entitled to exempt certain  
7 assets from the estate. 11 U.S.C. § 522. Arizona has elected to  
8 "opt out" of the federal exemption scheme; therefore, Arizona law  
9 governs homestead exemptions. A.R.S. § 33-1133.<sup>4</sup>

10 Debtors claimed an exemption in the proceeds of their pre-  
11 petition sale of their homestead under A.R.S. § 33-1101(C), which  
12 provides

13 The homestead exemption, not exceeding the  
14 value provided for in subsection A,  
15 automatically attaches to the person's  
16 interest in identifiable cash proceeds from  
17 the voluntary or involuntary sale of the  
18 property. The homestead exemption in  
19 identifiable cash proceeds continues for  
eighteen months after the date of the sale of  
the property or until the person establishes  
a new homestead with the proceeds, whichever  
period is shorter. Only one homestead  
exemption at a time may be held by a person  
under this section.

20 Although there are very few cases interpreting the  
21 reinvestment provision of A.R.S. § 33-1101(C), those that have

22 <sup>4</sup> A.R.S. § 33-1133 provides

23 A. Nothing in this article shall be construed to  
24 displace other provisions of law which afford  
25 additional or greater protection to a debtor's  
property.

26 B. Notwithstanding subsection A, in accordance with 11  
27 U.S.C. 522(b), residents of this state are not entitled  
28 to the federal exemptions provided in 11 U.S.C. 522(d).  
Nothing in this section affects the exemptions provided  
to residents of this state by the constitution or  
statutes of this state.

1 touched on the issue support the trustee's position that  
2 reinvestment of the proceeds is required in order to maintain  
3 exempt status. In In re Strasser, 303 B.R. 841, 848 (Bankr. D.  
4 Ariz. 2004), the bankruptcy court, in dicta, noted that sale  
5 proceeds "do not qualify as exempt homestead proceeds [where]  
6 debtor fail[s] to reinvest them in a new homestead within 18  
7 months as the statute [A.R.S. § 33-1101(C)] expressly requires."

8 And another court observed,

9           the homestead exemption automatically  
10           attaches to the individual's equity interest  
11           in identifiable cash proceeds from the sale .  
12           . . [and] only continues for an 18-month  
            period after the sale or until the individual  
            files a new homestead declaration, whichever  
            period is shorter.

13 In re Elia, 198 B.R. 588, 599 (Bankr. D. Ariz. 1996) (emphasis  
14 added).

15           These cases support a plain meaning interpretation of the  
16 statute, i.e., that sale proceeds only remain exempt for the  
17 earlier of eighteen months or until they are reinvested into  
18 another homestead. See In re Plant, 300 B.R. 22, 23 (Bankr. D.  
19 Ariz. 2003) ("Since homesteads are purely creatures of statute,  
20 the statute must be reviewed to determine the meaning of  
21 homestead; and if the statutory language is plain, the courts  
22 must follow it.").

23           Contrary to the analysis posed by Debtors, the statute  
24 simply cannot be read to create a permanent exemption in the sale  
25 proceeds, absent reinvestment in another homestead. Because  
26 Debtors failed to use the proceeds for the purchase of a new  
27 homestead, or otherwise, the exemption lapsed automatically by  
28 operation of law.

1 Debtors nevertheless maintain that even if the proceeds  
2 became nonexempt at some point after the commencement of the  
3 case, such post-petition transformation is of no consequence  
4 because the only relevant date for determining their right to the  
5 exemption is the date of the bankruptcy filing. On this point,  
6 Debtors refer us to In re Kim, 257 B.R. 680 (9th Cir. BAP 2000),  
7 In re Herman, 120 B.R. 127 (9th Cir. BAP 1990), and In re  
8 Graziadei, 32 F.3d 1408 (9th Cir. 1994).

9 In Kim, we indeed articulated the general rule that  
10 exemption rights are determined as of the petition date. 257  
11 B.R. at 685. We also noted that “[u]nsupported by legal  
12 authority and contravened by the plain language of the Code, [a]  
13 debtor’s attempt to carve out an exception to the well-  
14 established law that exemption rights are determined on the  
15 petition date must be rejected.” Id. at 685 (quoting In re Wolf,  
16 248 B.R. 365, 368 (9th Cir. BAP 2000)).

17 Debtors’ lament is certainly understandable as exemptions  
18 are generally determined as of the petition date. However, where  
19 an applicable state law requires compliance with a pre-condition  
20 to maintain exempt status, the Ninth Circuit has clearly held  
21 otherwise. Under facts similar to those in this case, the Ninth  
22 Circuit in Golden, interpreting California’s exemption law, held

23 California law requires reinvestment in order  
24 to prevent the debtor from squandering the  
25 proceeds for nonexempt purposes. Acceptance  
26 of the debtor’s position would frustrate the  
27 objective of the California homestead  
28 exemption and the bankruptcy act itself,  
which limits exemptions to that provided by  
state or federal law. Applying California  
law, we therefore hold that when the debtor  
fails to reinvest homestead proceeds within a  
period of six months in which the debtor has  
control of those proceeds, the proceeds



1           should revert to the trustee.

2   In re Golden, 789 F.2d at 700 (emphasis added).

3           Similarly, in Earnest, an Oregon bankruptcy court found that  
4 property was to be exempt under the state law that is applicable  
5 on the date of the filing of the petition. In re Earnest, 42  
6 B.R. at 398. Accordingly, if applicable state law requires  
7 certain conditions to be met as of the petition date, such as  
8 reinvestment, these conditions must be met in order to maintain  
9 exempt status. As the Earnest court describes,

10           The Oregon exemption law for homestead  
11 proceeds contains two conditions. The  
12 language of these conditions was as much a  
13 part of the applicable law on the date [the  
14 debtors] filed their bankruptcy petitions as  
15 is the language actually granting the  
16 exemption. These conditions can be labeled  
17 either conditions precedent or conditions  
18 subsequent. Under either approach the court  
19 cannot avoid, after a year's passage, a  
20 judicial inquiry to determine if the debtor  
21 either receives or keeps, as the case may be,  
the exemption. [The debtors] would like the  
court to treat the conditions as subsequent,  
to grant them the exemption, and then to deny  
itself, because of the bankruptcy filing, the  
power to later inquire if the conditions were  
met. This court finds nothing in the  
Bankruptcy Code that requires or allows it to  
fragment the state law in this manner to  
grant a benefit to the debtors they would not  
have received if they had not filed  
bankruptcy.

22   Id. at 398-99 (emphasis added).

23           In an attempt to overcome the Golden holding, Debtors assert  
24 that the Arizona homestead provision is more closely analogous to  
25 Texas law, which does not require reinvestment. They refer this  
26 panel to In re Harlan, 32 B.R. 91 (Bankr. W.D. Tex. 1983). In  
27 Harlan, the debtors sold their homestead within days of filing  
28 their bankruptcy petition and did not reinvest the proceeds

1 within six months of the sale as required by the applicable Texas  
2 homestead exemption. The court rejected the objecting creditor's  
3 argument that any portion of the sale proceeds not reinvested at  
4 the expiration of the six-month period should be deemed nonexempt  
5 and, instead, held that because the debtors' exemption rights  
6 were fixed as of the date of the petition, the proceeds remained  
7 exempt beyond the six-month period -- even if the debtors did not  
8 reinvest the funds into another homestead. In re Harlan, 32 B.R.  
9 at 93.

10 Significantly, Harlan has been overturned by the Fifth  
11 Circuit's decision in In re Zibman, 268 F.3d 298 (5th Cir. 2001),  
12 a case also involving pre-petition homestead sale proceeds held  
13 by bankruptcy debtors. In a very detailed and well-reasoned  
14 opinion, the Fifth Circuit declined to follow the ruling in  
15 Harlan and adopted the reasoning of Golden and Earnest:

16 [The lower courts] did not apply the *entire*  
17 Texas law that is applicable in the instant  
18 case. Instead, their denial of the Trustee's  
19 objection to the exemption in the instant  
20 case, "freezing" the exemption for the  
21 proceeds simply because it was in effect at  
the date the petition was filed, effectively  
22 read the 6-month limitation out of the  
23 statute, and transformed an explicitly  
24 limited exemption into a permanent one.

25 . . .

26 In a case virtually identical to this one,  
27 the Ninth Circuit rejected the debtor's  
28 similar attempt to enlarge the homestead  
exemption, saying that, "[a]cceptance of the  
debtor's position would frustrate the  
objective of the California homestead  
exemption and the bankruptcy act itself,  
*which limits exemptions to that provided by  
state or federal law.*" [citing Golden at  
700] . . . When a debtor elects to avail  
himself of the exemptions the state provides,  
he agrees to take the fat with the lean; he  
has signed on to the rights (like the post-  
petition right to file in Myers) but also to

1 the limitations (like the temporal element of  
2 the reinvestment feature of California's  
3 homestead exemption in Golden) integral in  
4 those exemptions as well. In Texas, the 6-  
5 month limitation is inextricably intertwined  
6 with the exemption the state has chosen to  
7 provide for proceeds from the sale of the  
8 homestead. As an Oregon bankruptcy court so  
9 aptly observed, "This court finds nothing in  
10 the Bankruptcy Code that requires or allows  
11 it to fragment the state law in this manner  
12 to grant a benefit to the debtors they would  
13 not have received if they had not filed  
14 bankruptcy." [citing In re Earnest at 399].

15 In re Zibman, 268 F.3d at 304 (emphasis in original).

16 At the time the bankruptcy was filed, the estate held a  
17 contingent, reversionary interest in the sale proceeds. Once  
18 Debtors failed to reinvest the proceeds into another homestead  
19 within the statutory period, the entire interest reverted to the  
20 bankruptcy estate. In other words, the proceeds, stripped of  
21 their exempt status, transformed into nonexempt property, i.e.,  
22 property of the bankruptcy estate, by operation of law. At that  
23 point, there was no need for the trustee to pursue an objection  
24 to the claimed exemption because no such exemption existed.  
25 Accordingly, the course of action taken by the trustee, the  
26 prosecution of the turnover motion, was proper.

27 Debtors also contend that even if the proceeds were no  
28 longer exempt, the trustee nevertheless failed to file a timely  
objection that put Debtors on notice that the estate had a  
continued interest in the sale proceeds. The Ninth Circuit has  
already addressed this issue in Golden, holding that "[b]ecause  
the exemption remained in effect during the [allotted  
reinvestment] period, and the trustee had no right to claim the  
proceeds during that period, [there was] no reason for requiring

1 that he notify the debtor of a claim not yet in existence." 789  
2 F.2d at 701 (emphasis added).

3 The bankruptcy court incorrectly found that the trustee  
4 failed to timely object to the exemption or to take any action to  
5 preserve the right to object. At the time the petition was  
6 filed, the claimed homestead exemption was valid and the trustee  
7 had no legal basis to object to the exemption. Only after the  
8 exemption expired by operation of law did the trustee have a  
9 legal ground for taking action against the newly nonexempt  
10 property.

11 Further, Debtors' argument that they should have been  
12 noticed of the trustee's continued interest in the homestead  
13 proceeds also fails. The Arizona homestead provision  
14 unequivocally required Debtors to reinvest the proceeds. As  
15 such, Debtors "could not have reasonably relied upon the  
16 trustee's silence as an indication of a permanent exemption."  
17 Id. at 701.

## 18 VI. CONCLUSION

19 We conclude that 1) Debtors' exemption in the sale proceeds  
20 was contingent upon reinvestment of the proceeds in a homestead  
21 within the statutorily prescribed period; 2) by virtue of  
22 Debtors' failure to reinvest the funds in another homestead, the  
23 proceeds became nonexempt, and therefore, property of the  
24 bankruptcy estate subject to the control of the trustee; and 3)  
25 the trustee properly moved to compel turnover of the money to the  
26 estate. We reverse.

1 KLEIN, Bankruptcy Judge, concurring:

2  
3 I join the majority decision with some reluctance because  
4 there is considerable common sense in the bankruptcy judge's  
5 ruling and join only because I am unable to distinguish the  
6 California exemption that was addressed in England v. Golden (In  
7 re Golden), 789 F.2d 698 (9th Cir. 1986), from the similar  
8 Arizona exemption involved in this appeal. Although there is  
9 merit to the view that Golden is binding law of the circuit only  
10 with respect to California exemptions because (even in the case  
11 of identically-worded exemptions) the respective state supreme  
12 courts might construe them differently, a decent respect for  
13 precedent and predictability counsels in favor of applying  
14 Golden.

15 The issue is difficult, and Golden may not have been  
16 correctly decided in 1986. The basic reason for pause is that if  
17 funds that are conditionally exempt following the sale of a  
18 homestead are spent during the period of conditional exemption  
19 for some non-homestead purpose, there is no reason to think that  
20 a judgment creditor could force the expenditure to be undone.  
21 Moreover, if the conditionally-exempt funds are in the debtor's  
22 bank account during the bankruptcy, the rule of Golden creates an  
23 incentive for the trustee and creditors to force the case to  
24 remain open until after the relevant time expires. In such  
25 circumstances, the debtor could be in the difficult and  
26 disadvantageous position of needing to purchase a homestead  
27 property during the bankruptcy, notwithstanding the general  
28 reluctance of mortgage lenders to deal with consumers until after

1 a bankruptcy is finished.

2 I must confess, however, that the perverse incentive that I  
3 perceive in Golden has not frequently manifested itself in  
4 bankruptcy cases in the ensuing decades. Either trustees are not  
5 unduly prolonging cases for that reason or they are permitting  
6 conditionally-exempt funds to be abandoned as being of  
7 inconsequential value and benefit to the estate. In other words,  
8 the opportunity for abuse following upon Golden has remained more  
9 theoretical than real.