

**OBJECTIONS TO EXEMPTIONS AND
MOTIONS TO AVOID LIENS PURSUANT
TO 11 U.S.C. § 522(F)**

SHAY A. AGSTEN

VON BRIESEN & ROPER, S.C.
411 EAST WISCONSIN AVENUE, SUITE 700
MILWAUKEE, WI 53202
(414) 287-1564
SAGSTEN@VONBRIESEN.COM

LOU JONES BREAKFAST CLUB
DECEMBER 13, 2011

I. Objection to Exemptions

a. Objections to Exemptions are controlled by Fed. R. Bankr. P. 4003

i. Deadline to Object

1. Except for limited circumstances, objections for exemptions must be filed within 30 days after the conclusion of the meeting of creditors. Fed. R. Bankr. P. 4003(b)(1).

2. If a Debtor files an amendment to the Debtor's list of exemptions, the deadline is (a) within 30 days after the conclusion of the meeting of creditors or (b) 30 days after the amendment is filed, whichever is later.

a. Filing amended schedules does not re-open the deadline for exemptions that are not amended – extended deadline only applies to exemptions impacted by the amendment.

3. However, see Fed. R. Bankr. P. 1019(2)(B)

a. Conversion of case to Chapter 7 provides a new time period for filing an objection to a claim for exemptions under Rule 4003(b) unless:

i. “[T]he case was converted to chapter 7 more than one year after the entry of the first order confirming a plan under chapter 11, 12, or 13; or”

ii. “[T]he case was previously pending in chapter 7 and the time to object to a claimed exemption had expired in the original chapter 7 case.”

ii. Copies of objections to exemptions must be served on the Debtor, Debtor's counsel and the Trustee. Fed. R. Bankr. P. 4003(b)(4).

iii. Burden of Proof: Objecting Party - Fed. R. Bankr. P. 4003(c).

b. *Schwab v. Reilly* 130 S. Ct. 2652 (2010).

i. In *Schwab v. Reilly*, 130 S. Ct. 2652 (2010), the Supreme Court resolved a disagreement among the Courts of Appeals about what constitutes a claim of exemption to which an interested party must object under 11 U.S.C. §522(l), and whether an interested party must object to a claimed exemption where the debtor's schedule of exempt property accurately describes the asset and declares the value of the claimed exemption in the asset to an amount within the limits prescribed by the Bankruptcy Code.

- ii. The Court held that an interested party is not required to object to an exemption claimed in this manner in order to preserve the estate's ability to recover value in the asset beyond the dollar value the debtor expressly declared as exempt.
- iii. The bankruptcy court denied the trustee's motion to auction the equipment and the debtor's conditional motion to dismiss her case. The trustee appealed to the district court, arguing that neither the Bankruptcy Code nor Rule 4003(b) required a trustee to object to a claimed exemption where the amount the debtor declares as the "value of the debtor's claimed exemption" in certain property is an amount within the limits the Bankruptcy Code prescribes. *Id.* The district court rejected the trustee's argument and the Court of Appeals for the Third Circuit affirmed. *Id.*
- iv. The Supreme Court reversed, concluding that the court of appeal's approach failed to account for the text of the relevant Bankruptcy Code provisions and misinterpreted the Court's decision in *Taylor*. The Court found that the trustee was not required to object to the debtor's exemptions to preserve the Bankruptcy Estate's right to retain any value in the equipment above the exempt interest. The Court found that the portion of Section 522(l) that resolved the case was not, as the debtor asserted, the provision stating that "property claimed as exempt on [Schedule C] is exempt" unless an interested party objects, but rather it was the portion of Section 522(l) that states that a interested party has a duty to object to the "list of property that the debtor claims a exempt" under Section 522(b).
- v. The Court concluded that the trustee was entitled to evaluate the propriety of the claimed exemptions based only three entries on the debtor's Schedule C: the description of the business equipment in which the debtor claimed the exemptions; the Bankruptcy Code provisions governing the claimed exemptions; and the amounts the debtor listed in the column of Schedule C titled "value of claimed exemption."

II. Motions to Avoid Liens (11 U.S.C. § 522(f))

a. Procedure

- i. Motion to Avoid a Lien pursuant to 11 U.S.C. § 522(f) is commenced by filing a contested motion pursuant to Fed. R. Bankr. P. 9014.
 - 1. Per Fed. R. Bankr. P. 4003(d), an adversary proceeding is not necessary to avoid a creditor's lien pursuant to 11 U.S.C. § 522(f).
 - 2. Per Fed. R. Bankr. P. 9014(b), "[t]he motion shall be served in the manner provided for service of a summons and complaint by Rule 7004."

- a. Pursuant to Fed. R. Bankr. P. 7004(b)(3), domestic corporations, foreign corporations and partnerships are properly served “by mailing a copy of the [motion] to the attention of an officer, a managing or general agent, or to any other agent authorized by appointment or by law to receive service of process and, if the agent is one authorized by statute to receive service and the statute so requires, by also mailing a copy to the defendant.”
- i. It is not sufficient to mail the motion to the “ABC Corporation.” The Motion must be mailed to the attention of an officer, a managing or general agent of ABC Corporation.
 - ii. *In re Sunde*, 2007 WL 3275128 (Bankr. W.D.Wis. 2007) – Debtors served an objection to a proof of claim on the filing creditor that was addressed simply to the creditor as “Glen E. Johnson Construction.” The objection was not addressed to an officer or agent of the corporation and the Court ruled that such “service did not comply with the statute.” *Sunde*, 2007 WL 3275128 at *1. The debtors argued “that strict compliance with Rule 7004(b)(3) [was] not appropriate in [their] case . . . [because] a permissible ‘address for service of process is the address creditor provided on its Proof of Claim’ which was filed with the court and signed by Glen Johnson, agent of the creditor.” *Id.* However, the Court held that the debtors’ failure to address the summons to an officer or agent of the corporation rendered service of the objection to the claim ineffective, notwithstanding the fact that it was mailed to the address the creditor provided on its proof of claim.
 - iii. In another case construing Rule 7004(b)(3), the Court held that a complaint simply addressed to the corporation, and not to an officer or agent, did not comply with Rule 7004(b)(3). *In re Cole*, 2007 WL 3275126 (Bankr. W.D.Wis. 2007). The debtor argued that strict compliance with Rule 7004(b)(3) was not required because the creditor “failed to supply the name of an officer or agent to whom the notice should be sent.” *Id.* The Court stated that

“[w]hat little dispute exists surrounding Rule 7004(b)(3) arises when the service is addressed to an office or a generic recipient such as ‘Officer’ or ‘President’ rather than a specifically named officer or agent.” *Id.* at *2. The Court held that “[e]ven if [the] court were prepared to hold that the requirements of 7004(b)(3) need not be strictly observed, the facts here fall outside the range of argument [because the debtor] . . . failed to address service to a particular officer or agent, an office or even to a generic ‘Officer’ or ‘Agent’.” *Id.* The Court held that such service of process was defective.

- ii. Per Fed. R. Bankr. P. 9014(c), the following adversary rules apply to contested motions:
 1. Fed. R. Bank. P. 7009 (Pleading Special Matters);
 2. Fed. R. Bank. P. 7017 (Parties Plaintiff and Defendant; Capacity);
 3. Fed. R. Bank. P. 7021 (Misjoinder and Non-Joinder of Parties);
 4. Fed. R. Bank. P. 7025 (Substitution of Parties);
 5. Fed. R. Bank. P. 7026 (General Provisions Governing Discovery) (except Fed. R. Civ. P. 26(a)(1)-(a)(3) and 26(f));
 6. Fed. R. Bank. P. 7028 (Persons Before Whom Depositions May be Taken);
 7. Fed. R. Bank. P. 7029 (Stipulations Regarding Discovery Procedure);
 8. Fed. R. Bank. P. 7030 (Depositions Upon Oral Examination);
 - a. Also consider the procedure available pursuant to Fed. R. Bankr. P. 2004 to depose the Debtor.
 - b. While the scope of Fed. R. Bankr. P. 2004 is more narrow than Fed. R. Bankr. P. 7030, in most cases a Rule 2004 examination will be sufficient for a creditor’s defense against a motion to avoid lien.
 - c. Scope of Fed. R. Bankr. P. 2004: “The examination of an entity under this rule or of the debtor under § 343 of the

Code may relate only to the acts, conduct, or property or to the liabilities and financial condition of the debtor, or to any matter which may affect the administration of the debtor's estate, or to the debtor's right to a discharge." In a Chapter 11 (other than a railroad reorganization), Chapter 12 or Chapter 13 case, "the examination may also relate to the operation of any business and the desirability of its continuance, the source of any money or property acquired or to be acquired by the debtor for purposes of consummating a plan and the consideration given or offered therefor, and any other matter relevant to the case or to the formulation of a plan.

d. Fed. R. Bankr. P. 2004(c) permits a party in interest to require the production of documents in connection with the Rule 2004 examination.

9. Fed. R. Bank. P. 7031 (Depositions Upon Written Questions);
10. Fed. R. Bank. P. 7032 (Use of Depositions in Adversary Proceedings);
11. Fed. R. Bank. P. 7033 (Interrogatories to Parties);
12. Fed. R. Bank. P. 7034 Production of Documents and Things and Entry Upon Land for Inspection and Other Purposes);
13. Fed. R. Bank. P. 7035 (Physical and Mental Examination of Persons);
14. Fed. R. Bank. P. 7036 (Requests for Admissions);
15. Fed. R. Bank. P. 7037 (Failure to make Discovery; Sanctions);
16. Fed. R. Bank. P. 7041 (Dismissal of Adversary Proceedings);
17. Fed. R. Bank. P. 7042 (Consolidation of Adversary Proceedings; Separate Trials);
18. Fed. R. Bank. P. 7052 (Findings by the Court);
19. Fed. R. Bank. P. 7054 (Judgments; Costs);
20. Fed. R. Bank. P. 7055 (Default);
21. Fed. R. Bank. P. 7056 (Summary Judgment);
22. Fed. R. Bank. P. 7064 (Seizure of Person or Property);

23. Fed. R. Bank. P. 7069 (Execution); and

24. Fed. R. Bank. P. 7071 (Process in Behalf of and Against Persons Not Parties).

- iii. While adversary rules do apply to contested motions, including motions to avoid liens, the timelines for resolution of these sorts of motions are typically very short, so creditors should immediately request relief under appropriate provisions of Part VII of the Federal Rules of Bankruptcy Procedure if further discovery is necessary to resolve the motion to avoid lien.
- iv. Typically, Motions to Avoid Liens are disposed of on 14 days negative notice.

b. 11 U.S.C. § 522(f)

- i. Burden of Proof: “[T]he debtor bears the burden of proving by a preponderance of the evidence all the elements required to establish his entitlement to lien avoidance under section 522(f) of the Bankruptcy Code.” *Soost v. NAH, Inc. (In re Soost)*, 262 B.R. 68, 74 (B.A.P. 8th Cir. 2001);
- ii. Purpose: “Described in its simplest terms, section 522(f) permits a debtor to wipe out the interest that a creditor has in particular property if the debtor’s interest in that property would be exempt but for the existence of the creditor’s lien or interest.” 4 Collier on Bankruptcy, ¶ 522.11[1] (Alan N. Resnick & Henry J. Sommer eds., 16th ed.).
- iii. Pursuant to Fed. R. Bankr. P. 4003(d), notwithstanding the deadlines imposed by Fed. R. Bankr. P. 4003(b) to object to exemptions, “a creditor may object to a motion filed under § 522(f) by challenging the validity of the exemption asserted to be impaired by the lien.”
 - 1. The Advisory Committee Notes (2008 Amendment) explains that “[s]ubdivision (d) [was] amended to clarify that a creditor with a lien on property that the debtor is attempting to avoid on the grounds that the lien impairs an exemption may raise in defense to the lien avoidance action any objection to the debtor’s claimed exemption.”
 - 2. This right is limited to the creditor’s attack against the exemption that the debtor claims is impaired by the lien that the debtor is seeking to avoid, and may only be attacked in the context of the lien avoidance proceeding.
- iv. Only applies to specific types of liens:

1. “A judicial lien, other than a judicial lien that secures a debt a debt of a kind that is specified in section 523(a)(5)” [for a domestic support obligation]; 11 U.S.C. § 522(f)(1)(A).
 - a. This does not include “a judgment arising out of a mortgage foreclosure” 11 U.S.C. § 522(f)(2)(C).
2. “a nonpossessory, nonpurchase-money security interest in any – (i) household furnishings, household goods, wearing apparel, appliances, books, animals, crops, musical instruments, or jewelry that are held primarily for the personal, family or household use of the debtor or a dependent of the debtor; (ii) implements, professional books, or tools, of the trade of the debtor or the trade of a dependent of the debtor; or (iii) professionally prescribed health aids for the debtor or a dependent of the debtor.” 11 U.S.C. § 522(f)(1)(B)(i) - (iii).
 - a. Definitions of the items included and excluded from the term “Household Goods” are provided in 11 U.S.C. § 522(f)(4)(A) and (B).
- v. “[A] lien shall be considered to impair an exemption to the extent that the sum of (i) the lien; (ii) all other liens on the property; and (iii) the amount of the exemption that the debtor could claim if there were no liens on the property; exceeds the value that the debtor’s interest in the property would have in the absence of any liens.” 11 U.S.C. § 522(f)(2)(A).
- vi. If the property at issue is the subject of multiple liens, “a lien that has been avoided shall not be considered in making the calculation under [§522(f)(2)(A)] with respect to other liens.” 11 U.S.C. § 522(f)(2)(B).
- vii. 11 U.S.C. § 522(f)(3)
 1. Section 522(f)(3) states:

In a case in which State law that is applicable to the debtor--

(A) permits a person to voluntarily waive a right to claim exemptions under subsection (d) or prohibits a debtor from claiming exemptions under subsection (d); and

(B) either permits the debtor to claim exemptions under State law without limitation in amount, except to the extent that the debtor has permitted the fixing of a consensual lien on any property or

prohibits avoidance of a consensual lien on property otherwise eligible to be claimed as exempt property;

the debtor may not avoid the fixing of a lien on an interest of the debtor or a dependent of the debtor in property if the lien is a nonpossessory, nonpurchase-money security interest in implements, professional books, or tools of the trade of the debtor or a dependent of the debtor or farm animals or crops of the debtor or a dependent of the debtor to the extent the value of such implements, professional books, tools of the trade, animals, and crops exceeds \$5,850.

2. *In re Parrish*, 186 B.R. 246 (Bankr. W.D. Wis. 1995) (Judge Martin)

- a. The issue in this case was whether the creditor could use § 522(f)(3) to limit the debtor's ability to avoid the creditor's lien up to the amount of \$5,000 (which was the applicable statutory limit at that time).
- b. The Court held that there were two steps to applying § 522(f)(3): (1) the Debtor must have opted to utilize the Wisconsin state law exemptions and (2) "either the state statute provides an unlimited exemption of property, or it prohibits avoidance of a consensual lien that could otherwise be claimed exempt." *Id.* at 247.
- c. The secured creditor argued that Wisconsin law had expressly prohibited the avoiding of consensual liens.
- d. The Court reviewed Wis. Stat. § 815.18(12), which states as follows:

"(12) Limitations on exemptions. No property otherwise exempt may be claimed as exempt in any proceeding brought by any person to recover the whole or part of the purchase price of the property or against the claim or interest of a holder of a security interest, land contract, condominium or homeowners association assessment or maintenance lien or both, mortgage or any consensual or statutory lien."
- e. The Court concluded that "[t]his statute, despite its opacity and its confusing disjunctions, expressly prohibits the avoiding of a consensual lien." *In re Parrish*, 186 B.R. at 248.

3. *In re Ehlen*, 207 B.R. 179 (W. D. Wis. 1997)
 - a. The Western District of Wisconsin disagreed with Judge Martin's decision in *In re Parrish*, 186 B.R. 246 (Bankr. W.D. Wis. 1995) that Wis. Stat. § 815.18(12) expressly prohibits the avoidance of a consensual lien.
4. It is an open question in the Eastern District of Wisconsin whether § 522(f)(3) is applicable by virtue of Wis. Stat. § 815.18(12)

22721162_2.DOC