544 B.R. 449
United States Bankruptcy Court,
S.D. Alabama.

In re: Stephen M. Middleton, Allyson N. Singley, Jennifer Pistole, Crystal R. Vinson, Leonard G. Thiewes and Michele M. Thiewes, Diana C. Chapman, Thomas Marshall Marr, Jr., James A. Harper, Tamarcus Jerome Monigan, Melissa Jerkins Zak, Mary Paige Rabren, Brad A. Shelton, Terri L. Justice, Timmie Eugene Godwin and Simone Godwin, Joanne O. Brodie, Willie E. Niles and Lula L. Niles, Rhodongia R. Cleveland, Scott N. Murphy, Elijah Howard and Shelia Yelding Howard, Patsy Bayer, Joseph S. Skelton and Marty M. Flirt, Monica Latrese Hegler, Tiffany M. Murray, Brandon W. Saksa, Carolyn E. Reid, Angela R. Shaffer, Susan D. Ernandez, Carola A. Conrad, Alicia V. Shamberger, Robert Kimbrough, Gabrielle S. Morgan, Gwendolyn Mitchell LeFoy, Walter Raymond Lister and Barbara Jean Lister, Rickie Earl Dailey, Jr., Lana Joy Phillips, Darrell V. Miller and Charlene D. Miller, Shermiane Cartez Hall, Philip Wayne Linton and Peggy Ray Linton, Byron Cowan, Jr. and Constance Cowan, John F. Herman, Evelyn F. Ellzey

Case No. 15–01879–JCO, Case No. 15–02015–JCO, Case No. 15–02132–HAC, Case No. 15–02151–HAC, Case No. 15–02167–JCO, Case No. 15–02380–HAC, Case No. 15–02399–JCO, Case No. 15–02417–HAC, Case No. 15–02430–HAC, Case No. 15–02446–HAC, Case No. 15–02452–JCO, Case No. 15–02456–JCO, Case No. 15–02490–HAC, Case No. 15–02567–HAC, Case No. 15–02640–JCO, Case No. 15–02656–HAC, Case No. 15–02657–HAC, Case No. 15–02660–HAC, Case No. 15–02668–HAC, Case No. 15–02685–JCO, Case No. 15–02732–JCO, Case No. 15–02740–JCO, Case No. 15–02745–JCO, Case No. 15–02753–HAC, Case No. 15–02756–HAC, Case No. 15–02774–HAC, Case No. 15–02775–JCO, Case No. 15–02779–HAC, Case No. 15–02790–HAC, Case No. 15–02796–JCO, Case No. 15–02856–HAC, Case No. 15–02947–JCO, Case No. 15–02960–JCO, Case No. 15–02969–JCO, Case No. 15–03001–HAC, Case No. 15–03003–HAC, Case No. 15–03007–HAC, Case No. 15–03063–JCO, Case No. 15–03086–HAC, Case No. 15–03101–HAC, Case No. 15–03162–JCO

Signed January 15, 2016

Synopsis

Background: Dispute arose in multiple Chapter 7 cases regarding proper application of amendments to Alabama's exemption scheme, which increased amount of personal and homestead exemptions available to debtors, in cases in which debtors' debts were incurred either entirely before amendments went into effect or partially before and partially after effective date of amendments.

Holdings: The Bankruptcy Court, Henry A. Callaway and Jerry C. Oldshue, Jr., JJ., held that:

[1] in Chapter 7 case in which all of debtor's debts were incurred prior to amendment of Alabama exemption statutes to increase amount of personal property and homestead exemption amounts, debtor should be limited to old exemption amounts, but

[2] in "mixed debt" cases, bankruptcy court should apply the exemption limits that were in effect on petition date, despite language in Alabama exemption statutes specifying that date on which debt was incurred would determine which exemption amount applied.

So ordered.

West Headnotes (10)

[1] **Bankruptcy**
Validity and effect of opt-out legislation
Exemptions
Retroactive Operation
Homestead
Retroactive Operation

In Chapter 7 case in which all of debtor's debts were incurred prior to amendment of Alabama exemption statutes to increase amount of personal property and homestead exemption amounts, debtor should be limited

to old exemption amounts. Ala. Code §§ 6-10-1, 6-10-2, 6-10-6.

1 Cases that cite this headnote

[2] **Bankruptcy**
Date of determination

In Chapter 7 case in which debtor has a "mix" of debts, some of which were incurred prior to amendment of Alabama exemption statutes to increase amount of personal property and homestead exemption amounts, and some of which were incurred subsequent to change in exemption amounts, bankruptcy court should apply the exemption limits that were in effect on petition date, despite language in Alabama exemption statutes specifying that date on which debt was incurred would determine which exemption amount applied; Bankruptcy Code requirement that claims of the same class be paid "pro rata" prevented court from apportioning payments to unsecured creditors based upon date of debt. 11 U.S.C.A. § 726(b); Ala. Code §§ 6-10-1, 6-10-2, 6-10-6.

2 Cases that cite this headnote

[3] **Bankruptcy**
Purpose

Bankruptcy
Priorities

Bankruptcy
Distribution

Bankruptcy Code is designed to achieve equality of treatment among similarly situated creditors; creditors within a given class are to be treated equally, and bankruptcy courts may not create their own rules of superpriority within a single class.

1 Cases that cite this headnote

[4] **Bankruptcy**
Validity and effect of opt-out legislation

Opt-out state's ability to define its exemptions is not absolute and must yield to conflicting policies in the Bankruptcy Code.

Cases that cite this headnote

[5] **Bankruptcy**
Application of state or federal law in general

Bankruptcy
Bankruptcy power generally

Congress has plenary power to enact uniform federal bankruptcy laws, and inconsistent state laws are preempted by conflicting Bankruptcy Code provisions. U.S. Const. art. 1, § 8, cl. 4.

Cases that cite this headnote

[6] **Bankruptcy**
Validity and effect of opt-out legislation

When debtor claims exemptions in bankruptcy pursuant to state law, effect of claiming the exemptions should be determined under state law; however, to extent that governing bankruptcy law restricts, modifies or derogates state exemptions, federal law prevails pursuant to the Supremacy Clause. U.S. Const. art. 6, cl. 2.

Cases that cite this headnote

[7] **Bankruptcy**
Date of determination

Debtor's exemptions are determined as of date of filing of bankruptcy petition.

2 Cases that cite this headnote

[8] **Bankruptcy**
Exemptions

Exemptions
Construction of exemption laws in general

While bankruptcy court may not enlarge a statutory exemption and read words into it that the legislature did not intend, it must nonetheless liberally interpret exemption statutes in favor of debtor, with any doubts

to be resolved in favor of allowing the exemption.

1 Cases that cite this headnote

[9] **Bankruptcy**
Exemptions
Exemptions
Construction of exemption laws in general

Exemptions should be liberally construed in furtherance of debtor's right to fresh start.

Cases that cite this headnote

[10] **Constitutional Law**
Application to state and local laws and regulations

Contract Clause, which forbids a state government from passing a law that impairs the obligations of contracts, applies only to the states. U.S. Const. art. 1, § 10, cl. 1.

Cases that cite this headnote

Attorneys and Law Firms

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OPINION

HENRY A. CALLAWAY and JERRY C. OLDSHUE, JR., U.S. BANKRUPTCY JUDGES

These cases present an issue which last vexed Alabama bankruptcy petitioners and judges in the early 1980's: how to apply a change in Alabama's exemption limits —which by statute are based on the date of debt—to bankruptcy cases with dozens of debts? We find that, under the binding authority of *First National Bank v. Norris*, 701 F.2d 902 (11th Cir.1983), the "old" exemption limits apply in Chapter 7 cases where all the debts were incurred prior to the exemption change. But for "mixed" cases involving debts incurred both before and after the exemption change, Bankruptcy Code § 726(b)'s mandate that claims of the same class be paid "pro rata" prohibits apportionment of payments to unsecured creditors based upon the date of debt. After examining various options, the Court ***452** finds that applying the exemption limits as of the date of the petition in "mixed debt" Chapter 7 cases complies with § 726(b) and is the approach most consistent with bankruptcy law and other state laws.

Jurisdiction

The two undersigned bankruptcy judges heard oral argument on the trustees' objections to exemptions in the 41 above-listed Chapter 7 cases on December 11, 2015. The Court has jurisdiction to hear the matter pursuant to 28 U.S.C. §§ 1334 and 157 and the order of reference of the District Court. This is a core proceeding pursuant to 28 U.S.C. § 157(b)(2)(B), and the Court has authority to enter a final order. However, this opinion is *not* a final order. Because the entry of an order on exemptions will involve a review of the claims in each Chapter 7 case, the Court will set the cases for separate hearings to determine the exemptions available in each particular case pursuant to the guidelines set out in this opinion. The rulings in this opinion will be incorporated in a final order on objections to exemptions which will be entered separately in each case.

Discussion

On June 11, 2015, Alabama amended the state's homestead and personal property exemptions for the first time in over thirty-five years. The personal property exemption was raised from $3,000 to $7,500, and the homestead exemption was raised from $5,000 to $15,000. Alabama Code §§ 6–10–2, 6–10–6. A new provision found at § 6–10–12 provides that every three years, beginning in April 2018, the exemption limits shall be adjusted to reflect the cumulative change in the federal Consumer Price Index.

Although the Bankruptcy Code provides for both state and federal exemptions, it allows states to "opt out" of the federal exemptions altogether, which Alabama has done. 11 U.S.C. § 522(b)(2); Alabama Code § 6–10–11. Alabama bankruptcy debtors are thus limited to the state exemptions. By comparison, the current federal bankruptcy exemptions are $3,675 for a motor vehicle,

$12,250 for household items, and $22,975 for homestead. 11 U.S.C. § 522(d).

The problem with applying Alabama exemptions in bankruptcy court is caused by Alabama Code § 6–10–1, which provides that the exemptions as of the date of debt apply:

> The right of homestead or other exemption shall be governed by the law in force when the debt or demand was created, but the mode or remedy for asserting, ascertaining, contesting, and determining claims thereto shall be as prescribed in this chapter.

Application of this "date of debt" provision is straightforward enough in the usual state court context of a creditor suing a debtor on one note or debt. But the statute, which predates both the 1898 Bankruptcy Act and the 1978 Bankruptcy Code, does not fit perfectly in the context of a single bankruptcy case with numerous debts arising on different dates.

The applicable exemptions in a Chapter 7 determine what the debtor will be allowed to keep when making the "fresh start" envisioned by the bankruptcy process. The Chapter 7 trustee liquidates all property of the estate that is not exempt and distributes the proceeds to creditors pursuant to the distribution scheme of Bankruptcy Code § 726. If the debtor wants to keep personal property or homestead valued at more than the applicable exemption, he can "buy back" the property from the trustee by either paying cash or agreeing to pay over time. For example, assume a Chapter 7 debtor under the pre-June 2015 law owns a vehicle worth $5,000 with no lien on it. Even if he has no other ***453** personal property whatsoever, he must pay the trustee the $2,000 over and above his $3,000 exemption in order to keep the car. The debtor thus in effect pays twice for the vehicle––once to the original seller and then (at least for a significant portion) again to the trustee.

[1] *Pure "old debt" cases.* The Eleventh Circuit considered the application of Alabama Code § 6–10–1 in the context of a Chapter 7 case where all the debts predated the exemption change in *First National Bank v. Norris*, 701 F.2d 902 (11th Cir.1983). Prior to May 19, 1980, Alabama's homestead exemption was $2,000, to be shared by joint debtors; on that date, it was increased to $5,000, which could be claimed by each debtor in a joint case. *Id.* at 903–4. The married debtors in Norris claimed a $10,000 joint homestead exemption based upon the amended law even though all their debts predated the change in law. The Eleventh Circuit found that Bankruptcy Code § 522(b)(3),[1] which provides for state's exemptions that are "applicable on the date of the filing of the petition," incorporates *all* of the state exemption law, including the "date of debt" provision of Alabama Code § 6–10–1. *Id.* at 905. The court thus ruled that the old exemptions applied in a pure "old debt" Chapter 7 case.

The debtors here argue that *Norris* is no longer good law for two reasons. First, debtors argue that the inflation index provision found in the new Alabama Code § 6–10–12 implicitly repeals Alabama Code § 6–10–1's "date of debt" provision in favor of a "date of claiming" rule:

> On July 1, 2017, and at the end of each 3–year period thereafter, the State Treasurer shall adjust each dollar amount in this article or, for each adjustment after July 1, 2017, each adjusted amount, by an amount determined by the State Treasurer to reflect the cumulative change in the Consumer Price Index (CPI) as published by the United States Department of Labor, or, if that index is no longer published, a generally available comparable index, for the 3–year period ending on the December 31, preceding the adjustment date and rounded to the nearest twenty-five dollars ($25.00). The State Treasurer shall publish the adjusted amounts. ***The adjusted amounts apply to exemptions claimed on or after April 1, following the adjustment date.***

[Emphasis added.] The last sentence of § 6–10–12 appears inconsistent with the "date of debt" provision of § 6–10–1. However, at least in the context of this case, the Court

finds that the new § 6–10–12 does not amend or repeal § 6–10–1 by implication. Alabama Constitution Article IV, Section 45 requires a statute to list specifically any prior laws it is amending, which did not occur with respect to § 6–10–1. And the indexing provision of § 6–10–12 does not take effect until April 2018; there may be an argument as to implicit amendment or repeal in 2018, but it is not yet ripe.

Second, debtors contend that *U.S. v. Security Industrial Bank,* 459 U.S. 70, 103 S.Ct. 407, 74 L.Ed.2d 235 (1982), cited by the Eleventh Circuit in *Norris,* has been subsequently overruled in *Owen v. Owen,* 500 U.S. 305, 111 S.Ct. 1833, 114 L.Ed.2d 350 (1991), and thus the rationale of *Norris* has been undermined. Even if that were true, until the Eleventh Circuit overrules *Norris,* it is still binding precedent in this circuit and on this court. *See Rodriguez De Quijas v. Shearson/American Express, Inc.*, 490 U.S. 477, 484, 109 S.Ct. 1917, 104 L.Ed.2d 526 (1989) (the court of appeals should follow its precedent in a ***454** directly controlling case even if it "appears to rest on reasons rejected in some other line of decisions"). Moreover, both *Security Industrial* and *Owen* are not directly on point since they deal with lien avoidance under Bankruptcy Code § 522(f), not the claiming of an exemption under § 522(b)(3). The Court thus concludes that, in Chapter 7 cases where all the debts were created prior to the change in law, the old exemption limits apply pursuant to *Norris.*

[2] *"Mixed old and new debt" cases.* The more difficult issue here is what to do regarding exemptions in Chapter 7 cases with debts arising both *before* and *after* the June 11, 2015 change in exemption limits. These 41 cases constitute the first batch of post-amendment exemption challenges, and most involve pure "old debt." However, some of the cases are "mixed," and most cases for the foreseeable future will be "mixed." As of the writing of this opinion, seven months after the June 2015 amendment, almost all or certainly most of the Chapter 7 cases currently being filed involve a mixture of pre- and post-amendment debt, since most Chapter 7 debtors will have incurred at least some debt within the last several months prior to their bankruptcy filing.

And the problem of debts with different applicable exemptions will get more complicated in the future. Since the new Alabama Code § 6–10–12 indexes the exemption amounts every three years starting in April 2018, many cases filed in the second half of 2018 will have debts subject to *three* sets of exemption limits: pre-June 11, 2015; June 11, 2015 through March 30, 2018; and post-April 1, 2018. Chapter 7 cases filed after April 2021 (when the next adjustment takes place) will routinely have debts incurred during *four* sets of exemptions periods. With mortgage loans now extending up to forty years and new automobile loans up to eight years, a Chapter 7 debtor may have an unsecured deficiency claim arising out of a mortgage loan or vehicle loan many years—even decades—after the debt was incurred.

The local bankruptcy and federal district courts struggled with this issue over thirty years ago, after the Alabama exemptions were last raised in 1980. Bankruptcy Judge Will Caffey initially held that where "most, if not all, of the debts" were incurred prior to the amendment, the exemptions should be limited to the old amounts. *In re Browning,* 13 B.R. 6, 8 (Bankr.S.D.Ala.1981). *See also In re Bradley,* 19 B.R. 265 (Bankr.S.D.Ala.1982). However, in *Goldsby v. Stewart*, 46 B.R. 692 (S.D.Ala.1983) and *In re Perine*, 46 B.R. 695 (S.D.Ala.1983), District Judge Virgil Pittman found that applying the old exemptions where there was a mixture of old and new debt was unfair because it deprived the debtors of the larger exemption to which they were entitled and provided the new creditors a "windfall to which they are not entitled." *Goldsby*, 46 B.R. at 694. Judge Pittman noted at the time of his 1983 opinions, approximately three years post-amendment, that the number of pre-amendment exemption claims should be diminishing. *Id.* That observation is little comfort now because, as described above, the exemption amounts will continue to change every three years as a result of § 6–10–12's new indexing provision. Judge Pittman remanded both cases to the bankruptcy court to address the "practical problem of apportioning the exemption" without specifying what method should be used. *Id.*

Then–Chief District Judge Brevard Hand confronted the issue in *In re Rester*, 46 B.R. 194 (S.D.Ala.1984). The bankruptcy judge had allowed the debtor the post–1980 $3,000 personal property exemption but then applied the old exemption ($1,000) ***455** to the extent there were pre–1980 claims. Judge Hand rejected that approach:

> The Bankruptcy Court, therefore, instead of *apportioning* the

> exemptions between "old" and "new" creditors, is simply paying off "old" creditors to the extent of $2,000.00. Any property claimed as exempt above the old $1,000.00 exemption is paid into court and held until the pre-May 19, 1980 creditors filed a claim for it.... This scheme is not *apportionment*. Instead, the Bankruptcy Court is paying off pre-May 1980 creditors while not affording the debtor any advantage to which the new law entitles him.

46 B.R. at 199 [emphases in original].

Judge Hand noted that *Norris* "does not mandate" a holding that exemptions be based upon the date of debt in a mixed debt bankruptcy case and offered several reasons for applying the exemption amounts applicable on the date of the petition. *Id.* at 194–95. First, the other bankruptcy courts in Alabama were applying the new exemptions in "mixed" cases, and the interest of uniformity inclined him to reject split exemptions. *Id.* at 199. Second, Bankruptcy Code § 522(b) authorizes exemptions from "property of the estate," which is created by the filing of the bankruptcy petition. 11 U.S.C. § 541(a). "Thus, the appropriate date for determining exemptions is the date of filing, not the date of indebtedness. Use of the latter time creates confusion in a process intended to simplify financial problems." *Id.* at 200. Finally, applying the outdated lower exemptions to a current bankruptcy would make "a mockery of the 'fresh start' intended by Congress." *Id.*

However, because other local district court opinions had called for apportionment without specifying the exact method, Judge Hand declined to adopt the "date of petition" method and instead set out what he saw as the best apportionment method. He called for the difference between the old and new exemption amounts to be allocated to the "old" creditors in proportion of their debt to the total unsecured indebtedness. *Id.* at 201. In effect, the debtor could utilize only the old exemption plus that portion of the increased exemption available against post-amendment creditors.

Although the *Rester* method has the advantage of being fairer to debtors and not allowing a windfall to "old" creditors, it has both practical and legal problems. On a practical level, the exemption apportionment process is probably more complicated than Judge Hand envisioned. It is unclear from the *Rester* opinion whether the unsecured debt would be determined by claims *scheduled* or claims *filed*. Bankruptcy Schedule F contains a place for debtors to list the date each debt was incurred, but there is no requirement for any kind of detail or for multiple dates. Basing the apportionment on claims *filed* raises another set of problems. A Chapter 7 trustee needs to know the applicable exemptions at the beginning of a case to determine whether there is any property in the estate to be liquidated for the benefit of unsecured creditors and whether to tell creditors to file a claim. Proofs of claim for non-governmental entities must be filed within 90 days after the first meeting of creditors and by governmental entities within 180 days. Fed. R. Bankr.P. 3002(c). The timing creates something of a chicken-and-egg problem if the apportionment is based on claims filed: the Chapter 7 trustee often does not know whether there is non-exempt property to be distributed (and thus whether to tell creditors to file claims) until he knows the applicable exemption amounts, but he will not know the exemption amounts until the proofs of claim are in.

***456** Of course, the proofs of claim may not themselves solve the problem. Among the most prolific filers of unsecured claims in this court are debt purchasers who have purchased old credit card debt. Few have documentation other than an account name, account number, and amount of debt. *See* Federal Trade Commission, *The Structure and Practices of the Debt Buying Industry*, p. 29–37 (2013). For purposes of the Alabama Code § 6–10–1, it is unclear when unsecured credit card debt was incurred—when the charges were made (usually extending over years), at the time of the last payment, or at the time of charge-off. Either the trustee or the creditors must bear the expense and burden of obtaining information about the dates of debts.

More significantly, the legal problem with the *Rester* approach is that it violates Bankruptcy Code § 726(b), which mandates that payments on unsecured claims "shall be made pro rata among claims of the kind specified in each such particular paragraph ..." "11 U.S.C. § 726(b) plainly mandates pro rata distribution of assets among creditors in the same statutory class.... The use of a

word 'shall' with the pro rata requirement in § 726(b) indicates that such distribution is not discretionary." *Specker Motor Sales Co. v. Eisen*, 393 F.3d 659, 662 (6th Cir.2004). Thus, for example, if a Chapter 11 debtor's counsel has received interim compensation in a case which later proves to be administratively insolvent, the lawyer must disgorge those fees so that he or she receives only the same prorated distribution made to other approved administrative claimants. *Id.* The same rule applies to unsecured claims:

> Although unsecured creditors may belong in different statutory classes for distribution purposes based on their priority status (§ 507(a)) or the timeliness of the filing of their claim (§ 726(a)), there is no basis for dividing unsecured creditors into different classes of distribution based on differing exemption rights.

In re Kyle, 510 B.R. 804, 816 fn. 15 (Bankr.S.D.Ohio 2014).

[3] The priority schemes and equality of treatment in §§ 507(a) and 726(a) and (b) are the foundation of the Bankruptcy Code's goal to fairly distribute a debtor's non-exempt assets among creditors. The Code is designed to achieve an "equality of treatment among similarly situated creditors." *In re Jet Florida System, Inc.*, 841 F.2d 1082, 1083 (11th Cir.1988); "Creditors within a given class are to be treated equally, and bankruptcy courts may not create their own rules of superpriority within a single class." *Matter of Saybrook Mfg. Co., Inc.*, 963 F.2d 1490, 1496 (11th Cir.1992). This basic tenet of bankruptcy law should not be undermined by state exemption law. [2]

[4] ***457** Although states have the right to define their own exemptions, the U.S. Supreme Court held in *Owen v. Owen*, 500 U.S. 305, 111 S.Ct. 1833, 114 L.Ed.2d 350 (1991) that it "ha[s] no basis for pronouncing an opt-out policy absolute, but must apply it along with whatever other competing or limiting policies the statute contains." "[A] state's ability to define its exemptions is not absolute and must yield to conflicting policies in the Bankruptcy Code." *Patriot Portfolio, LLC v. Harry Weinstein (In re Weinstein)*, 164 F.3d 677, 683 (1st Cir.1999).

[5] **[6]** Congress has plenary power to enact uniform federal bankruptcy laws, and inconsistent state laws are preempted by conflicting bankruptcy code provisions. U.S. Const. art. 1, § 8, cl. 4; *Weinstein, supra* at 682. Applying different exemptions to creditors based upon the date their claims arose would violate §§ 507(a) and 726(b) of the Bankruptcy Code, neither of which provide for such treatment:

> ***458** [Prorating the exemptions based upon the date of debt] in the manner suggested by the Trustee would foster unequal treatment of similarly situated creditors. Administrative costs and complexities aside, tolerating multiple tiers of debt within the same class with disparate treatment as defined by state exemption statutes strikes at the heart of federal bankruptcy law.

In re Kyle, 510 B.R. 804, 819 (Bankr.S.D.Ohio 2014). *See also In re Pursley*, 2014 WL 293557 (Bankr.N.D.Ohio 2014). "When a debtor claims bankruptcy exemptions under state law, the effect of claiming the exemptions should be determined under state law. [Citation omitted.] However, to the extent that governing bankruptcy law restricts, modifies or derogates state exemptions, federal law prevails pursuant to the Supremacy Clause." *Matter of Wickstrom*, 113 B.R. 339, 343 (Bankr.W.D.Mich.1990) (*citing Perez v. Campbell*, 402 U.S. 637, 651–52, 91 S.Ct. 1704, 1712, 29 L.Ed.2d 233 (1971)); U.S. Const. art. 6 cl. 2.

If *Rester*-type proration of exemptions violates Bankruptcy Code § 726(b), how should the exemption amounts be determined in a "mixed" case with both pre- and post-amendment debt? As Judge Pittman pointed out in *Goldsby* and *Perine, supra,* the original *Browning* method of simply applying the old exemption amount when there is a mixture of debts is unfair because it denies the debtor the benefit of the increased exemption amount until absolutely all of his "old" debt is gone—which could be several more decades in the case of a mortgage loan deficiency. Some courts have applied the old exemption amounts to the extent of pre-amendment debt and then

attempted to comply with the *pro rata* requirement of § 726(b) by distributing the funds to all unsecured creditors pro rata according to ordinary bankruptcy priorities. *See, e.g., In re Fishman,* 241 B.R. 568, 574–75 (Bankr.N.D.Ill.1999). However, this approach gives "new" creditors more than they would have otherwise received and is "an artificial alteration of state law that no longer complies with the language or purpose of a state exemption...." *In re Kyle,* 510 B.R. at 819, fn. 18.

The undersigned judges find that, in Chapter 7 cases with a "mix" of debts which pre-and postdate the change in exemptions, the approach which complies with the Bankruptcy Code and is most consistent with other law is to apply the exemption limits in effect at the time of the bankruptcy petition, for several reasons.

[7] First, as set out above, applying the exemption limits applicable as of the date of the petition is consistent with other provisions of the Bankruptcy Code determining the rights of creditors and debtors as of the petition date. "It is hornbook bankruptcy law that a debtor's exemptions are determined as of the date of the filing of the petition." *Wickstrom,* 113 B.R. at 343–44 (quoting *In re Friedman,* 38 B.R. 275, 276 (Bankr.E.D.Pa.1984); 11 U.S.C. § 522(b)(3)(A). As Judge Hand noted in *Rester,* Bankruptcy Code § 522(b) authorizes an individual debtor to claim exemptions "from property of the estate," which is created on the petition date by the filing of the petition under Bankruptcy Code § 541(a). And although this rationale was not sufficient in itself to override Alabama Code § 6–10–1 in the pure "old debt" case of *Norris,* 701 F.2d at 904, the trustee's avoidance powers to pursue preferential transfers and fraudulent transfers are determined as if he were a hypothetical judgment lien creditor as of the date of the bankruptcy petition. 11 U.S.C. § 544(a). Significantly, since *Norris* the U.S. Supreme Court has held in ***459** *Owen v. Owen, supra,* that a debtor's ability to avoid a judgment lien under Bankruptcy Code § 522(f) is determined by the state law exemption at the time of the petition—not when the lien was perfected.

[8] **[9]** Second, applying the exemption limits applicable at the time of the petition date is consistent with Congress's intent to allow debtors a "fresh start" in bankruptcy. *See In re Brown,* 541 B.R. 906, 909 (Bankr.M.D.Fla.2015)("[t]he primary purpose of bankruptcy law is to provide an honest debtor with a fresh start by relieving the burden of indebtedness"). Such fresh start requires a liberal interpretation of exemption limits to allow a debtor to retain a minimum level of property to ensure that the debtor and his or her family will not be completely destitute and thus a burden to society. *In re Starr,* 485 B.R. 835, 837 (Bankr.N.D.Ohio 2012). Though a court may not enlarge a statutory exemption and read words into it that the legislature did not intend, it must nonetheless liberally interpret exemption statutes in favor of the debtor with any doubts to be resolved in favor of allowing the exemption. *In re Hasse,* 246 B.R. 247, 251–52 (Bankr.E.D.Va.2000) (citations omitted). "[E]xemptions should be liberally construed in furtherance of the debtor's right to a 'fresh start.' " *In re Gutierrez Hernández,* 2012 WL 2202931, at *2 (Bankr.D.P.R. June 14, 2012); *In re Newton,* 2002 WL 34694092, at *3 (1st Cir. BAP 2002); *Christo v. Yellin (In re Christo),* 228 B.R. 48, 50 (1st Cir. BAP 1999).

If all pre-June 2015 debt must be gone before the updated exemptions are applied in a Chapter 7 bankruptcy case, as a practical result many debtors will not benefit from the updated exemptions for another decade or more, leaving the 1980 limits in effect for about forty-five years. Having an automobile available to go to work is a practical necessity for most Alabamians, given the scarcity of public transportation in this state. It is not realistic to expect a debtor to be able to fit all of his personal property, including a vehicle, under the 1980–version $3,000 personal property exemption and retain a vehicle with which to go to work. It is also not consistent with the Bankruptcy Code's "fresh start" goal to require a Chapter 7 debtor who needs to keep his vehicle in order to go to work to re-purchase the portion of his vehicle's value which (along with the value of all of his other earthly possessions) exceeds $3,000. The post-June 2015 personal exemption of $7,500 is still not overly generous, but it gives the debtor a chance at a "fresh start."

Third, this result is consistent with Judge Hand's reasoning (although not his holding) in *Rester, supra.* As discussed above, Judge Hand noted that *Norris* did not mandate that exemptions in bankruptcy court are dependent on the date on which the debt was incurred and that there were "at least three arguments for rejecting *Norris*' application in this situation [of mixed old and new debt]." 46 B.R. at 199. Judge Hand felt constrained to go along with some sort of apportionment method based on other rulings in the Southern District of Alabama but made clear his preference for a "date of petition" rule.

There is no evidence in *Rester* that the parties brought Bankruptcy Code § 726(b)'s pro rata mandate to his attention.

Fourth, a date of petition rule for mixed debt cases is consistent with the state legislature's admittedly imperfectly-conveyed intent. Although we find, as described above, that the last sentence of the new Alabama Code § 6–10–12 does not repeal § 6–10–1 (at least at this time), it does not make sense for the legislature to use current inflation as measured by the Consumer Price Index per the new § 6–10–12 if ***460** the revised exemption is to be applied in a bankruptcy which may not take place for a couple of decades.

[10] Applying a "date of petition" rule to "mixed debt" Chapter 7 cases is not unconstitutional as an impairment of contract rights. The contract clause of the Constitution of the United States (Article I, section 10, clause 1) forbids a state government from passing a law that impairs the obligations of contracts; however, the contract clause applies only to states. *See In re Curry,* 5 B.R. 282, 292 (Bankr.N.D.Ohio 1980), superseded and vacated on other grounds, *In re Curry,* 698 F.2d 298 (6th Cir.1983); *see also In re Pape,* 7 B.R. 443, 447 (Bankr.N.D.Fla.1980). Under its power to establish bankruptcy law, Congress can discharge a debtor's personal obligation because it is not prohibited from impairing the obligations of contracts as states are. *See Louisville Joint Stock Land Bank v. Radford,* 295 U.S. 555, 589, 55 S.Ct. 854, 79 L.Ed. 1593 (1935). So even if there were a problem with a state changing exemptions from "date of debt" to date of suit or date of exemption claim, there is no such problem with Congress doing so through the Bankruptcy Code.

Judge Hand's reluctant apportionment system ordered in *Rester* is not binding on this Court. *See In re Harper,* 497 B.R. 155, 158–59 (Bankr.N.D.Ga.2013) ("[a] bankruptcy court, as a unit of the district courts, is not bound by a previous decision of a district court even in the same district relating to the same issue when that court is in a multi-judge district since that district court decision would not be binding in that district as a whole") (quoting *In re Maurer,* 271 B.R. 207, 211 n. 13 (Bankr.M.D.Fla.2002)). As noted above, Judge Hand was apparently not presented with the pro rata requirement of Bankruptcy Code § 726(b). Nor did he have the benefit of the Supreme Court's less "hands off" approach to state exemptions in *Owen v. Owen.* Given the thirty-one years since *Rester* and the fact that the exemption changes in Alabama will no longer be a one-time event as in the 1980's, the undersigned judges believe it is time to reexamine *Rester* and adopt a new approach.

The result reached here is not perfect. It is impossible to reconcile completely Alabama Code §§ 6–10–1 and 6–10–12 with Bankruptcy Code §§ 507(a), 522(b) and 726(b) in the context of a "mixed debt" Chapter 7. It is somewhat incongruous that just a small amount of post-amendment debt will, under this holding, flip the applicable exemption limits from old to new. [3] However, the undersigned judges believe that applying the exemption limits as of the date of the petition in "mixed debt" Chapter 7 cases complies with the pro rata mandate of Bankruptcy Code § 726(b) and is the approach most consistent with other state and bankruptcy provisions.

Conclusion

The Clerk of the Court is requested to set each of the above-listed cases for a hearing on the Court's regular dockets for determination of the exemption amounts applicable in each particular case and entry of a final order in each of the cases which is consistent with this opinion.

All Citations

544 B.R. 449

Footnotes

1 11 U.S.C. § 522(b)(1) at the time of the *Norris* opinion.

2 *See e.g., Howard Delivery Serv., Inc. v. Zurich Am. Ins. Co.,* 547 U.S. 651, 655–56, 126 S.Ct. 2105, 165 L.Ed.2d 110 (2006) ("we are mindful that the Bankruptcy Code aims, in the main, to secure equal distribution among creditors. We take into account, as well, the complementary principle that preferential treatment of a class of creditors is in order only when clearly authorized by Congress"); *see also Kothe v. R.C. Taylor Trust,* 280 U.S. 224, 227, 50 S.Ct. 142, 74 L.Ed. 382 (1930); *Kuehner v. Irving Trust Co.,* 299 U.S. 445, 451, 57 S.Ct. 298, 81 L.Ed. 340 (1937)); *Nathanson v. NLRB,* 344 U.S. 25, 29, 73 S.Ct. 80, 97 L.Ed. 23 (1952); *United States v. Embassy Restaurant, Inc.,* 359 U.S. 29, 31, 79 S.Ct.

554, 3 L.Ed.2d 601 (1959); *In re Lockard,* 884 F.2d 1171, 1178 (9th Cir.1989); *In re Nat'l Gas Distributors, LLC,* 556 F.3d 247, 259 (4th Cir.2009) ("an overarching policy of the Bankruptcy Code is to provide equal distribution among creditors"); *In re Bethlehem Steel Corp.,* 479 F.3d 167, 172 (2d Cir.2007) ("Because the presumption in bankruptcy cases is that the debtor's limited resources will be equally distributed among his creditors, statutory priorities are narrowly construed"); *Boston Reg'l Med. Ctr., Inc. v. Massachusetts Div. of Health Care Fin. & Policy,* 365 F.3d 51, 57 (1st Cir.2004) (provisions that grant priority in bankruptcy are to be narrowly construed) (*citing Cramer v. Mammoth Mart, Inc. (In re Mammoth Mart, Inc.),* 536 F.2d 950, 953 (1st Cir.1976) (stating, "[w]e begin with the premise that the theme of the Bankruptcy Act is equality of distribution. If one is to be preferred over others, the purpose should be clear from the statute") (quotation marks omitted); *In re Dow Corning Corp.,* 237 B.R. 380, 393 (Bankr.E.D.Mich.1999) ([a] central policy of the Bankruptcy Code is the equitable distribution of a debtor's assets among its creditors. *Begier v. IRS,* 496 U.S. 53, 58, 110 S.Ct. 2258, 110 L.Ed.2d 46 (1990); *In re McCafferty,* 96 F.3d 192, 196 (6th Cir.1996); *In re Plourde,* 418 B.R. 495, 507 (1st Cir. BAP 2009) ("In most Chapter 7 cases, like this one, a claim holder's 'rung' on the priority 'ladder' created under section 726 is crucial because the estate assets are limited. There are usually insufficient assets to pay all claimants in full, and section 726(b) mandates pro rata distribution among all claimants at each level, or rung of the priority ladder, with an absolute priority cutoff. All allowed claimants at a particular level or rung of the ladder must be paid in full before any estate funds can be distributed to holders of claims at the next lower rung. Thus, the race among claimants is to reach the highest rung on the claims ladder" (*citing In re Stoecker,* 151 B.R. 989, 995 (Bankr.N.D.Ill.1992), *rev'd on other grounds,* 179 B.R. 532 (N.D.Ill.1994)); *Matter of Wickstrom,* 113 B.R. 339, 349 (Bankr.W.D.Mich.1990) ("[T]here should be orderly administration of debtor's property without a race by creditors for judgments and liens which give priority to the more aggressive creditors." "An inequitable distribution of property, including a preferential payment to one creditor at the expense of other creditors, or a fraudulent conveyance, subverts the spirit as well as the mandate of the Bankruptcy Code and undermines federal policy. A fundamental purpose of the bankruptcy laws is to distribute property pro rata to creditors; the statute would become seriously deficient if construed to allow a creditor or a transferee of property to defeat its purpose and obtain an advantage over other creditors"); *see also Reed v. McIntyre,* 98 U.S. 507, 25 L.Ed. 171 (1878). *Accord, Acme Harvester Co. v. Beekman Lumber Co.,* 222 U.S. 300, 32 S.Ct. 96, 56 L.Ed. 208 (1911); *Kothe v. R.C. Taylor Trust,* 280 U.S. 224, 50 S.Ct. 142, 74 L.Ed. 382 (1930); *Wukelic v. U.S.,* 544 F.2d 285 (6th Cir.1976); *In re Dzierzawski,* 528 B.R. 397, 417 (Bankr.E.D.Mich.2015) (Debtor proposed voluntary dismissal based on agreement in which two non-priority unsecured creditors would be paid the same priority level as two creditors that would be paid in full under the proposed dismissal. The court rejected the dismissal on the grounds that "in effect, the Debtor's proposed dismissal would result in a reordering of priorities, which is one of the factors that cases recognize as disfavoring a voluntary dismissal under § 707(a)"; *see generally Pension Benefit Guaranty Corp. v. Belfance (In re CSC Indus., Inc.),* 232 F.3d 505, 508 (6th Cir.2000) ("[A] fundamental objective of the Bankruptcy Code is to treat similarly situated creditors equally"); *In re Warren,* 181 B.R. 136, 139 (Bankr.N.D.Ala.1995) (denying a joint motion by the debtor and the petitioning creditors to dismiss an involuntary bankruptcy, because the proposed settlement did not pay similarly situated creditors equally).

3 However, assuming the country does not experience dramatic inflation, Alabama's exemption changes in the future under the new indexing provision will be less dramatic than those which took effect in May 1980 and June 2015.

End of Document

2017 WL 125040
Only the Westlaw citation is currently available.
United States District Court, S.D. Alabama, Southern Division.

Trustee Lynn Harwell ANDREWS, Appellant,
v.
Debtor Susan D. ERNANDEZ, Appellee.
Trustee Lynn Harwell Andrews Appellant,
v.
Debtor Charles B. Williamson, Appellee.
Trustee Lynn Harwell Andrews Appellant,
v.
Debtor Theodore Smith, Jr., Appellee.
Trustee Lynn Harwell Andrews Appellant,
v.
Debtor Angela R. Shaffer, Appellee.

CIVIL ACTION NO. 16-0284-CG-C, CIVIL ACTION NO. 16-0285-CG-C, CIVIL ACTION NO. 16-0286-CG-C, CIVIL ACTION NO. 16-0287-CG-C
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Signed 01/11/2017

Attorneys and Law Firms

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William J. Casey, Mobile, AL, for Appellee.

ORDER

Callie V. S. Granade, SENIOR UNITED STATES DISTRICT JUDGE

***1** These matters are before the Court on appeals from the bankruptcy court, pursuant to 28 U.S.C. § 158(a). The parties have filed appellate briefs, which the court has reviewed. The Court has determined that the facts and legal arguments are adequately presented in the briefs and the record and that the decisional process would not be significantly aided by oral argument. As will be explained below, this Court finds that the bankruptcy court did not err in deciding to overrule the Chapter 7 Trustee's objections to the Debtors' claims of exemptions. Accordingly, the orders appealed in each of these cases will be affirmed.

I. Facts

The facts of these cases are not disputed. All four cases involve debtors who filed for Chapter 7 bankruptcy relief after Alabama amended the state's homestead and personal property exemptions. On June 11, 2015, Alabama raised the personal property exemption from $3,000 to $7,500 and raised the homestead exemption from $5,000 to $15,000. ALA. CODE §§ 6-10-2, 6-10-6. All of the debtors in these cases have debts that arose both before and after the June 11, 2015 amendment. In such "mixed debt" cases the parties dispute the extent to which the new exemption limits should apply. The Bankruptcy Court for the Southern District of Alabama ruled in *In re Middleton*, 544 B.R. 449 (Bankr. S.D. Ala. 2016) that in mixed debt cases the date of the petition determines which exemption limits apply. As such, the new exemption limits were applied to mixed debt cases that were filed after June 11, 2015. In the cases on appeal here, the Trustee objected to the application of the amended exemptions and the bankruptcy court overruled those objections based on *In re Middleton.* The Trustee now appeals the decisions overruling the objections.

II. Standard of Review

A bankruptcy court's findings of fact are reviewed for clear error, and its legal conclusions and any mixed questions of law and fact are reviewed *de novo.* *Educ. Credit Mgmt. v. Mosley (In re Mosley)*, 494 F.3d 1320, 1324 (11th Cir. 2007) (citation omitted); *Christopher v. Cox (In re Cox)*, 493 F.3d 1336, 1340 n. 9 (11th Cir. 2007) (citation omitted); FED. R. BANKR. P. 8013. "The district court makes no independent factual findings," but instead reviews "the bankruptcy court's factual determinations under the 'clearly erroneous' standard." *In re Colortex Industries, Inc.*, 19 F.3d 1371, 1374 (11th Cir. 1994) (citation omitted). In the instant cases, the parties do not dispute the bankruptcy court's factual findings, only it legal conclusions. Therefore, this Court's review is *de novo.*

III. Discussion

The Trustee contends that the exemption to be used should be determined by the date each debt was created. The Trustee argues that under ALA. CODE § 6-10-1, the right of exemption is "governed by the law in force when the debt or demand was created." Section 6–10–1 has been applied to prevent a debtor from claiming the new exemption if the debts

were incurred prior to the amendment. In *First National Bank of Mobile v. Norris*, 701 F.2d 902 (11th Cir. 1983), the Court of Appeals for the Eleventh Circuit addressed the application of a similar homestead exemption increase that went into effect on May 19, 1980. In *Norris*, the Eleventh Circuit concluded that the debtor was limited to the old exemption where the debts were created prior to the change in Alabama law. *Norris* found that the new exemptions were prospective. *Norris*, 701 F.2d at 905. However, in *Norris* all of the debts in the debtor's estate were created prior to the amendment. *Norris* was solely an "old debt" case and its application to "mixed debt" cases was not considered by that Court. [1]

***2** This Court was previously confronted with the issue of how to apply exemption limits to mixed debt estates after Alabama raised the exemption limits on May 19, 1980. [2] *Goldsby v. Stewart*, 46 B.R. 692 (S.D. Ala. 1983); *In re Perine*, 46 B.R. 695 (S.D. Ala. 1983); *In re Rester*, 46 B.R. 194 (S.D. Ala. 1984). In *Goldsby*, Judge Pittman found that limiting debtors to the pre-amendment exemptions when some of their debts were incurred after the amendment violates § 6-10-1. *Goldsby*, 46 B.R. at 694. The Court stated that "[u]nder Alabama law, the applicable exemption is determined by the statute in force when the debt was created." *Id.* (citing ALA. CODE § 6-10-1). Judge Pittman noted there were problems with this conclusion but stated that the accounting and other problems that arise due to different amounts of exemptions being allowed to different creditors "will probably be of short duration" since the pre-May 1980 exemption claims were then approximately three years old. *Id.* Judge Pittman then remanded the case to the bankruptcy court to determine the manner in which to apply the exemptions. *Id.*

In *Perine*, Judge Pittman again found that § 6-10-1 requires the application of the exemption statute that was in force when a debt was created and thus, that the debtor could not be limited to the pre-May 19, 1980 exemption when some listed debts were created after May 19, 1980. *In re Perine*, 46 B.R. at 697. "Rather, the pre-May 19, 1980 exemptions apply to the debts incurred prior to May 19, 1980, and the post-May 19,1980 exemptions apply to the debts incurred after that date." *Id.* Judge Pittman then remanded the case to the bankruptcy court to apply the exemptions consistent with his order. *Id.*

In *Rester*, Judge Hand noted the decisions by Judge Pittman in *Goldsby* and *Perine* and found that in the case before him the bankruptcy court's attempt to apply the different exemption limits was not proper because it had not engaged in any apportionment. *In re Rester*, 46 B.R. at 198. The bankruptcy court had allowed the debtor the post-amendment $3,000 personal property exemption for the post-amendment debts, but then allowed any creditors with pre-May 19, 1980 claims to reach up to the excess of $2,000 over the old exemption. [3] *Id.* Judge Hand found that this method did "not [afford] the debtor any advantage to which the new Alabama law entitles him." *Id.* Judge Hand stated that this resulted in the pre-amendment creditors being granted priority "based on the fortuitous date selected by the Alabama legislature to improve the lot of bankrupts by increasing the Alabama exemptions." *Id.* at 199. Judge Hand noted that the intent of Congress "was to give all individual debtors a fresh start, not allow some creditors to profit at the expense of the debtor's exemptions." *Id.* (internal citations omitted). Judge Hand further stated the following:

> Strictly applied, *Norris* does not mandate the Court's holding in this case that exemptions are dependent on the date on which the debt was incurred. There are at least three arguments for rejecting *Norris*' application in this situation. First, the bankruptcy courts in the other federal districts in Alabama are allowing the debtor a full $3,000.00 exemption in situations like this one. Thus the interest of uniformity in the bankruptcy laws, inclines the Court to reject split exemptions. More important is Congress' scheme for allowing bankrupts to salvage a limited amount of personal property from the financial debacle. Section 522(b) authorizes an "individual debtor" to "exempt from property of the estate", 11 U.S.C. § 522(b) (1979) (emphasis added). The estate is created by the filing of a bankruptcy petition. 11 U.S.C. § 541(a) (1979). Thus, the appropriate date for determining exemptions is the date of filing, not the date of indebtedness. Use of the latter time creates confusion in a process intended to simplify financial problems.

***3** Finally, it is evident from the legislative history that Congress intended some equitable amount of property to be exempt. The "opt-out" provision of section 522(b) does allow states to set exemptions based on local conditions and circumstances. The state exemption need not be identical to the federal exemptions in section 522(d). *See, e.g.,*

Rhodes v. Stewart, 705 F.2d 159 (5th Cir. 1983). It is argued that the state exemption must not be set so low as to make a mockery of the "fresh start" intended by Congress. *See, e.g.*, *Cheeseman v. Nachman*, 656 F.2d 60 (4th Cir. 1981). There is some reasoning that Congress did not merely defer completely to the states on exemptions. Comporting with this rationale, the low exemptions available under Alabama law before May 19, 1980 would not meet the needs of the present bankruptcy system. It is arguable therefore that construing the new Alabama law as not completely repealing Ala.Code § 6–10–1 (1975) would result in a conflict between the Alabama exemption law and the superior federal Bankruptcy Code. To prevent such a conflict it would be necessary to hold that the new Alabama exemptions apply without regard to the date on which the debt was incurred. Such an approach to the Alabama exemption problem cannot now be applied, as prior opinions of the District have concluded otherwise.

In re Rester, 46 B.R. at 199–200 (footnotes omitted). Thus, Judge Hand believed a Debtor with pre and post-May 19, 1980 debts should be granted the post-amendment exemption, but he found it inappropriate to do so because of Judge Pittman's prior decisions. Instead, Judge Hand held that a pre-amendment creditor (or "old" creditor) would share in the $2,000 difference between the exemption limits to the extent of each old creditor's share in the total unsecured indebtedness. *Id.* at 201. For instance, if the pre-amendment unsecured claims represented 10% of the total unsecured indebtedness, their total share in the differential would be $200, effectively leaving the Debtor an exemption in the amount of $2,800 ($200 less than the post-1980 exemption). Using the 2015 amendment, the personal property exemption was increased from $3,000 to $7,500 and if 10% of the total unsecured indebtedness was represented by old debt they would be entitled to reach an additional $450—leaving the debtor an effective personal property exemption in the amount of $7,050. [4]

Judge Hand's method of applying the exemptions after the 1980 amendment would provide creditors with the exemption in place at the time the creditors agreed to the debts and compromises the debtor's fresh start and entitlement to the new exemption only to the extent that the debtor has old debts, but its application would present difficulties. The *Middleton* court noted that Judge Hand's method has both practical and legal problems. *In re Middleton*, 544 B.R. at 455.

Under Judge Hand's split exemption method, the debtor and trustee could not know the amount of the exemptions until all claims had been filed, unless the calculation was based on the debtor's own list of debts on his schedules. Bankruptcy Schedule F lists the debts but does not require the date each debt was incurred. Determining the dates for some debts may require considerable research and could result in debts to some creditors being split as portions of the debt could have been incurred at different times. *Middleton* points out that if it is unknown which exemption will be applied, the Chapter 7 trustee cannot determine whether there is any non-exempt property to be liquidated and whether to even tell creditors to file claims. *Id.* at 455. Additionally, old credit card debts are often purchased with no documentation indicating when the debts were incurred. *See Id.* at 456. Such difficulties would not be short lived because a new provision provides for periodic adjustment of the exemption amounts. Pursuant to ALA. CODE § 6-10-12, Alabama will review exemptions and adjust them to reflect the cumulative change in the federal Consumer Price Index on July 1, 2017 and every three years thereafter. "The adjusted amounts apply to exemptions claimed on or after April 1 following the adjustment date." ALA. CODE § 6-10-12. Thus, application of § 6-10-12 will complicate exemptions further in the future because after April 2018, debtors may come into bankruptcy with debts that arose when three or more different exemption limits were in effect.

***4** The *Middleton* court pointed out that the last sentence of § 6-10-12, specifying that the adjusted amounts will apply "to exemptions *claimed* on or after April 1, following the adjustment date" indicates that the exemption to be applied is the exemption in effect at the time the exemption is claimed. ALA. CODE § 6-10-12 (emphasis added) and *see Middleton*, 544 B.R. at 453. However, as the bankruptcy court concluded, although the statement in § 6-10-12 appears inconsistent with the "date of debt" provision of § 6-10-1, a statute must specifically list any prior laws it is amending, which it did not, and the statute does not take effect until April 2018.

Even if the last sentence of § 6-10-12 does not impliedly mandate that the time of filing be determinative, according to the *Middleton* court, Judge Hand's split exemption method violates the Bankruptcy Code. In *Middleton*, the bankruptcy court found that for mixed debt cases applying the exemption limits as of the date of the petition "complies with Bankruptcy Code § 726(b) and is the approach most consistent with bankruptcy law and other state laws." *In re*

Middleton, 544 B.R. at 452. Section 726(b) states the following:

> Payment on claims of a kind specified in paragraph (1), (2), (3), (4), (5), (6), (7), (8), (9), or (10) of section 507(a) of this title, or in paragraph (2), (3), (4), or (5) of subsection (a) of this section, shall be made pro rata among claims of the kind specified in each such particular paragraph, except that in a case that has been converted to this chapter under section 1112, 1208, or 1307 of this title, a claim allowed under section 503(b) of this title incurred under this chapter after such conversion has priority over a claim allowed under section 503(b) of this title incurred under any other chapter of this title or under this chapter before such conversion and over any expenses of a custodian superseded under section 543 of this title.

11 U.S.C. § 726(b). Thus, under § 726(b), payments on claims of a specified class must be made pro rata among claims of that specified class. "Section 726(b) embodies the Bankruptcy Code's fundamental goal for the equitable and consistent treatment of similarly situated creditors." *In re Chewning & Frey Sec., Inc.*, 328 B.R. 899, 917 (Bankr. N.D. Ga. 2005) (citations omitted). "This is designed to promote equal treatment among classes of creditors versus the result produced outside of bankruptcy when creditors who are swifter and more aggressive in their collection efforts benefit at the expense of other creditors. 9D Am. Jur. 2d *Bankruptcy* § 3262 (2016) (citations omitted).

The Trustee in the instant cases advocates for a different calculation of the exemption amounts. Citing *In re Murillo*, 4 B.R. 612 (Bankr. C.D. Cal. 1981) and courts that followed *Murillo*,[5] the Trustee argues that a debtor should be entitled to the exemption amount allowed by the exemption statute in effect as of the commencement of the case, minus the aggregate of all claims predating the new exemption, with the aggregate limited to the amount of the increase in the exemption. For example, if only the personal property exemption is claimed the increase from $3,000 to $7,500 would result in a differential of $4,500. Under the Trustee's proposed method, if the pre-amendment unsecured creditors had claims above the pre-amendment amount of $3,000, then *all* of the unsecured creditors were entitled to up to the $4,500 differential. The cases cited by the Trustee do not explain in detail how this amount will actually be distributed among the creditors. The courts that used this method determined the amount of the exemptions to be allowed and provided no directive as to how the funds should be distributed between the old and new creditors. The implication is that the debtor is simply allowed the determined exemptions and they are then applied equally against all unsecured debts as if they had all been created at the same time. Under this calculation a debtor with no homestead who owes $7,500 or more to pre-amendment debtors could only claim the pre-amendment personal property exemption of $3,000, regardless of the percentage of the total debt the pre-amendment creditors represented. This result is similar to what Judge Hand held in *Rester*: it affords the debtor no advantage to which the new Alabama law entitles him. Under the Trustee's proposed calculations even if the "old debts" represented only 10% of the total unsecured debt, as in the example discussed previously, the debtor would still only receive the pre-amendment exemption if the pre-amendment debts amounted to $4,500 or more. Under this scenario the "new debt" creditors would receive more if a portion of the unsecured debt is "old" because the exemptions would be reduced and they would be able to share in the allowed differential amount with the pre-amendment creditors. The Court notes that this method still presents the previously discussed problems in determining, at the time the petition is filed, which debts are pre-amendment and thus, determining the amount of the exemptions in a timely manner. In all of the cases presented here on appeal, the pre-amendment debts have been determined to exceed the differential between the pre and post-amendment exemption limits and thus, all of the instant debtors would receive only the pre-amendment exemptions under the Trustee's proposed calculations. *See* (Doc. 11, p. 27 (setting out Trustee's calculations)). This Court finds little advantage to the *Murillo* method which is not easier to determine or more equitable than Judge Hand's method in *Rester*. The method does comply with Bankruptcy Code § 726(b), but it does not afford the debtors any benefit from the new exemptions and thereby contravenes their right to a fresh start.

***5** It is a "well-settled proposition that exemptions in bankruptcy are to be liberally construed in order to afford the honest debtor a fresh start." *In re Abbott*, 408 B.R. 903, 911 (Bankr. S.D. Fla. 2009) (citing *In re Hafner*, 383 B.R. 350, 353 (Bankr. N.D. Fla. 2008) and *In re Barker*, 768 F.2d 191, 196 (7th Cir. 1985)) *see also* *In re Michael*, 339 B.R. 798, 801 (Bankr. N.D. Ga. 2005) ("Given that these exemptions are a fundamental component of a debtor's fresh start, they are construed liberally and the objecting party bears the burden of proof to show that an exemption has not been properly claimed." (citation omitted)); *In re Maritas*, 2008 WL 7801998, at *3 (S.D. Fla. Nov. 24, 2008) ("the court should begin with the basic proposition that exemptions are to be construed liberally in favor of providing the benefits of the exemptions to debtors, because such liberal interpretation would 'best accord with the public benefit." (citation and internal quotations omitted)).

Middleton's conclusion is also consistent with the Supreme Court's holding in *Owen v. Owen*, 500 U.S. 305 (1991). In *Owen*, the debtor was entitled to a homestead exemption on his condominium when he filed his bankruptcy petition in 1986, but did not have that right in 1984 when a judicial lien attached to the property. *Id.* at 315-16. The Supreme Court held that a debtor's ability to avoid the judgment lien under Bankruptcy Code § 522(f) was determined by the state law exemption in place at the time of the petition. Bankruptcy Code § 522(b) establishes a debtor's right to claim exemptions from "property of the estate" and the estate is created when the debtor files for bankruptcy. *See* *id.* at 316; 11 U.S.C. § 522(b).

The relevant case law and statutes present a complicated web of conflicting directives. The Court is aware of no method of applying the different exemptions that would be completely consistent with Alabama law, the Bankruptcy Code and relevant case law. After reviewing the case law and statutes, the Court agrees with the bankruptcy court's thorough analysis in *Middleton* and finds the conclusion in Middleton is sound.

Because all claims of the same class must be paid pro rata under § 726(b), the *Middleton* court found that payments to unsecured creditors could not be apportioned based on the date of the debt. Under § 726(b), payments to two creditors of the same statutory class must be made pro rata regardless of when each debt was created. "[T]here is no basis for dividing unsecured creditors into different classes of distribution based on differing exemption rights." *In re Middleton*, 544 B.R. at 456 (quoting *In re Kyle*, 510 B.R. 804, 816 (Bankr. S.D. Ohio 2014)).

As the *Middleton* court noted, "the state's ability to define its exemptions is not absolute and must yield to conflicting policies in the Bankruptcy Code." *In re Middleton*, 544 B.R. at 457 (quoting *In re Weinstein*, 164 F.3d 677, 683 (1st Cir. 1999)). "The power of Congress to establish uniform laws on the subject of bankruptcies throughout the United States is unrestricted and paramount." *Int'l Shoe Co. v. Pinkus*, 278 U.S. 261, 265, (1929) (citing U.S. Const. art. 1, § 8, cl. 4.). "States may not pass or enforce laws to interfere with or complement the Bankruptcy Act or to provide additional or auxiliary regulations." *Id.* (citations omitted). Thus, to the extent Alabama Code § 6-10-1 requires debts in the same class to be treated differently because of the date the debts were created, the statute is preempted by the Bankruptcy Code. The Bankruptcy Code sets up priority schemes and requires that debts in the same class be treated equally. Accordingly, unless all of the debts in a Chapter 7 bankruptcy estate were created prior to the amendment, the date of the petition must determine the exemptions to be applied. This conclusion is consistent with 11 U.S.C. § 726(b), with the statement in ALA. CODE § 6-10-1 that "[t]he adjusted amounts apply to exemptions claimed on or after April 1, following the adjustment date," with Judge Hand's view (although not his conclusion) that the appropriate date for determining exemptions is the date of filing, with the Supreme Court's decision in *Owen* regarding the applicability of exemptions to pre-existing judgment liens, with the Bankruptcy Code's goal of providing a fresh start and with the interests of equitable and orderly distribution.

IV. Conclusion

***6** For the reasons stated above, the following orders of the bankruptcy judges, which overruled the Chapter 7 Trustee's objections to the Debtors' claims of exemptions, are hereby **AFFIRMED**:

Order dated April 7, 2016 in Bankruptcy case No. 15-2775-JCO (Appellate case No. 16-284),

Order dated March 28, 2016 in Bankruptcy case No. 15-4067-JCO, (Appellate case No. 16-285),

Order dated April 8, 2016 in Bankruptcy case No. 15-3245-JCO, (Appellate case No. 16-286), and

Order dated March 21, 2016 in Bankruptcy case No. 15-2774-HAC, (Appellate case No. 16-287).

DONE and **ORDERED** this 11th day of January, 2017.

All Citations

Not Reported in Fed. Supp., 2017 WL 125040

Footnotes

1 The *Middleton* case, on which the bankruptcy court based its decisions here, determined that "in Chapter 7 cases where all debts were created prior to the change in law, the old exemption limits apply pursuant to *Norris*." *In re Middleton*, 544 B.R. at 453.

2 The Bankruptcy Court for the Southern District of Alabama also addressed mixed debt cases resulting from the 1980 change in exemptions. *See* *In re Browning*, 13 B.R. 6, 8 (Bankr. S.D. Ala. 1981); *In re Bradley*, 19 B.R. 265 (Bankr. S.D. Ala. 1982). The bankruptcy court found in *Browning* that where "most, if not all, of the debts listed therein were incurred prior to May 19, 1980 ... the debtor is limited to those exemptions allowed prior to that date." *In re Browning*, 13 B.R. at 8. The *Bradley* court, citing *Browning*, found that because the debtor in that case had debts that were incurred prior to May 19, 1980 he was entitled to claim only those exemptions allowable prior to May 19, 1980. *In re Bradley*, 19 B.R. at 267.

3 The personal property exemption prior to May 19, 1980 was $1,000.

4 This example assumes, as in the *Rester* case, that there has been no homestead exemption claimed.

5 *In re Marzella*, 171 B.R. 485 (Bankr. D. Conn. 1994), *In re Duda*, 182 B.R. 662 (Bankr. Conn. 1995), and *In re Banner*, 394 B.R. 292 (Bankr. D. Conn. 2008).