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

ORDERED PUBLISHED

UNITED STATES BANKRUPTCY APPELLATE PANEL
OF THE NINTH CIRCUIT

6	In re:)	BAP No.	EC-09-1356-KwPaJu
)		
7	LAURENCE R. NICHOLSON and)	Bk. No.	09-24547
	JOYCE V. NICHOLSON,)		
8)		
	Debtors.)		
9)		
	<hr/>)		
10	KAREN TYNER; APPLIED SCIENCE,)		
	INC.,)		
11)		
	Appellants,)		
12	v.)	A M E N D E D	
)	O P I N I O N	
13	LAURENCE R. NICHOLSON;)		
	JOYCE V. NICHOLSON,)		
14)		
	Appellees.)		
15	<hr/>)		

Argued on May 18, 2010
at San Francisco, California
Submitted on June 29, 2010

Original Opinion Filed - July 16, 2010
Amended Opinion Filed - July 29, 2010

Appeal from the United States Bankruptcy Court
for the Eastern District of California

Hon. Robert S. Bardwil, Bankruptcy Judge, Presiding

Before: KWAN¹, PAPPAS and JURY, Bankruptcy Judges.

¹ Hon. Robert N. Kwan, Bankruptcy Judge for the Central District of California, sitting by designation.

1 KWAN, Bankruptcy Judge:
2

3 Chapter 7 debtors, Laurence R. Nicholson and Joyce V.
4 Nicholson amended their bankruptcy schedules to claim an
5 exemption in shares of stock in Applied Science, Inc. ("ASI").
6 The trustee objected to the amendment on the ground that the
7 debtors had claimed the exemption in bad faith. Karen Tyner,
8 who had joined in the trustee's objection, and ASI appeal the
9 bankruptcy court's order overruling the objection and denying
10 the appellants' request for an evidentiary hearing.² We hold
11 that the bankruptcy court did not abuse its discretion by not
12 conducting an evidentiary hearing. We VACATE the bankruptcy
13 court's order, however, and REMAND for further proceedings,
14 because the bankruptcy court required the appellants to prove
15 bad faith by the incorrect standard of "clear and convincing
16 evidence."

17 **I. FACTS**

18 **A. The Debtors' Claim of Exemption and the Trustee's Sale of**
19 **the ASI Stock**

20 Laurence R. Nicholson and Cliff Tyner were 50/50 owners of
21 ASI, which manufactures whole blood collection devices for blood
22 donation centers. In January 2009, Cliff Tyner passed away, and
23 his widow, Karen Tyner, became executor of his estate, inherited
24 his interest in ASI, and became chairperson of ASI's board of
25

26 _____
27 ² Karen Tyner asserts that she and ASI are creditors in
28 this bankruptcy case. The parties do not dispute this assertion
on appeal.

1 directors. At that time, ASI's revenues had been falling since
2 2005 and it had more liabilities than assets.

3 On March 16, 2009, the debtors filed a voluntary petition
4 under Chapter 7 of the Bankruptcy Code.³ On Schedule B
5 (Personal Property) of the petition, the debtors listed the
6 value of their 25 shares in ASI (50% ownership) as \$0.00,
7 described the asset as "worthless" and commented that the
8 company had more liabilities (\$860,726) than assets (\$468,711).
9 The debtors did not claim the shares as exempt property on
10 Schedule C (Property Claimed as Exempt) of the petition. At the
11 § 341(a) meeting of creditors, Nicholson testified that the
12 shares had "no value" because "the corporation owes a
13 considerable amount of money." One day after concluding the
14 meeting of creditors, the chapter 7 trustee, Thomas A. Aceituno,
15 filed a report of no distribution in the case. Tyner filed an
16 objection to the no distribution report, asserting that
17 Nicholson was commissioning an appraisal of ASI and that the
18 shares may have value. The trustee then withdrew the report.

19 On July 28, 2009, the trustee filed a motion seeking the
20 bankruptcy court's approval of a sale of the shares free and
21 clear of liens to Tyner, subject to overbids, for \$5,000. On
22 the same day, the debtors amended their bankruptcy schedules to
23 list the value of their ASI shares as \$19,949 and to claim the
24 entire amount as exempt under California Code of Civil Procedure

25
26 ³ Unless otherwise indicated, all chapter and section
27 references are to the Bankruptcy Code, 11 U.S.C. §§ 101-1532.
28 All "Rule" references are to the Federal Rules of Bankruptcy
Procedure, Rules 1001-9037.

1 ("CCP") § 703.140(b)(5). Three days later, on July 31, 2009,
2 the debtors again amended their schedules to list the value of
3 shares as \$0.00, but increased the amount of the exemption in
4 the shares to \$22,024 (by adding the amount of \$2,075 as exempt
5 under CCP § 703.140(b)(6)). On August 4, 2009, the debtors
6 filed an objection to the proposed sale of the shares, asserting
7 that the initial bid of \$5,000 must be increased by the amount
8 of their claimed exemption of \$22,024.

9 On August 19, 2009, the bankruptcy court approved the
10 trustee's proposed sale of the shares for \$25,949, free and
11 clear of liens, to Rostrevor Partners, LLC, the successful
12 overbidder at the sale hearing. The sale order provided that
13 the trustee was to hold a portion of the sale proceeds totaling
14 \$19,949, the amount of the exemption claimed by the debtors, in
15 a separate account until the trustee's objection to the
16 exemption was resolved. On August 20, 2009, ASI appointed
17 Rostrevor Partners' managing member as its president and CEO and
18 terminated Nicholson's employment.

19 **B. The Trustee's Objection to the Debtors' Claim of Exemption**

20 On August 12, 2009, the trustee filed a timely objection to
21 the debtors' claim of exemption in the shares. He contended
22 that "[t]he amendment was obviously filed as a result of the
23 offer to acquire the stock which I had arranged despite the
24 Debtors' repeated representations that the Stock was
25 'worthless.'" Tyner joined in the trustee's objection,
26 asserting that the debtors had claimed the exemption in bad
27 faith.

1 On August 17, 2009, the debtors amended their schedules for
2 the third time, listing the value of the shares as \$25,000 on
3 Schedule B, but eliminating the additional \$2,075 they had
4 claimed as exempt on Schedule C.

5 On September 16, 2009, the debtors filed an opposition to
6 the trustee's objection to their claim of exemption, contending
7 that they had honestly claimed that ASI had no value when they
8 filed the petition. The debtors argued that the company's sales
9 had dramatically increased in late June and early July 2009 due
10 primarily to Nicholson's sales efforts, and particularly from
11 his developing relationship with Pall Medical, a large medical
12 company. The debtors did not serve their opposition to the
13 trustee's objection on Tyner or her counsel.

14 In her reply to the debtors' opposition, filed on September
15 25, 2009, Tyner asserted that Nicholson knew of Pall Medical's
16 interest in ASI no later than April 2009. At that time, she
17 contended, Nicholson made an offer to purchase her shares while
18 commissioning a "bogus" no-value appraisal to support his claim
19 that they were worthless. She also asserted that Nicholson
20 delayed finalizing a deal with Pall Medical to avoid having to
21 disclose the negotiations in the bankruptcy case.

22 In support of her reply, Tyner submitted an unsigned
23 document, dated April 27, 2009, that appeared to be an offer
24 from ASI to purchase Tyner's shares based on mandatory buyout
25 provisions in Cliff Tyner's employment agreement with ASI for:
26 (a) \$250; (b) 4% of ASI's total sales of the "HemoFlow
27 200/300/400" devices through March 31, 2012 to the extent that
28 new product sales totaled at least \$25,000 per month; (c) accord

1 and satisfaction of an alleged overpayment of income draws from
2 ASI to Cliff Tyner vis-à-vis Nicholson; and (d) ASI's promise to
3 use its best efforts to reduce any offsets of the buyout amount
4 from Cliff Tyner's personal guarantees of ASI's debts. The
5 document stated that ASI was currently "under water" in value,
6 but that "a distribution agreement has been proposed with Pall
7 Medical" and that "[i]f Pall is interested, some form of buyout
8 may be negotiated between ASI and Pall."

9 Tyner also submitted a sheet of typewritten notes
10 ("Notes"), which Nicholson purportedly wrote around July 3, 2009
11 after a discussion with his attorney and which was allegedly
12 discovered among ASI's files. The Notes stated:

13 Play [Tyner's] objection low. . . . Do not
14 push Tyner[] to withdraw [it], as this may
15 constitute [bankruptcy] fraud. If we know
16 that the present value of the shares is worth
17 something, . . . then the court may say we
18 conspired to conceal the value that the
19 trustee should have known. Quiet is the
20 word. . . . Obtain [a] short 1 page valuation
21 (in the works) and submit [it] to [the]
[t]rustee and Tyner[]. . . . Shows that value
is in my knowledge, not the company. Too
much information may cause the trustee to dig
deeper and find out about the Pall
discussions. . . . We cannot negotiate any
deal with Pall until after the August 5
hearing, and we cannot close the deal until
after September 16.

22 A single handwritten word, "CONFIDENTIAL," appeared on the
23 Notes. Tyner attempted to prove the handwriting was Nicholson's
24 by attaching a series of signed checks for purposes of
25 comparison. She did not, however, submit a declaration to
26 authenticate the Notes or the checks.

27 On September 30, 2009, the bankruptcy court held a hearing
28 on the trustee's objection to the debtor's claim of exemption.

1 At the hearing, the debtors objected to the Notes as
2 inadmissible because the document lacked foundation. Tyner,
3 through her counsel, contended that she did not submit a
4 declaration to authenticate the Notes because the debtors did
5 not serve her with the opposition and because she expected to be
6 able to cross-examine Nicholson at the hearing as to whether he
7 wrote the Notes. The bankruptcy court denied Tyner's request to
8 cross-examine Nicholson, ruling that it could not hold an
9 evidentiary hearing because she had not filed the required
10 notice that the parties disputed a material fact. The
11 bankruptcy court also ruled, however, that the parties could
12 file supplemental evidence and that it would then take the
13 matter under submission.

14 The trustee timely filed supplemental evidence. Some of
15 this evidence appears to link the Notes to Nicholson in several
16 ways. Other evidence suggested that ASI had begun to develop a
17 relationship with Pall Medical as early as April. The trustee
18 submitted a printout of an e-mail allegedly from Nicholson to
19 Pall Medical, dated March 6, 2009, in which Nicholson
20 purportedly "propose[d] that Pall become the ASI sales
21 representative in Europe and for the American Red Cross" because
22 he had "just found out that there will be a large tender issued
23 in Europe in early April." The evidence also contained an
24 unsigned document, dated April 2, 2009, that apparently explored
25 issues in establishing a distribution relationship between both
26 companies.

27 As part of their supplemental evidence, the debtors
28 submitted an appraisal of ASI, which valued the company as "\$0

1 (Zero)" as of March 31, 2009. The appraiser based this
2 valuation on a combination of a negative total average adjusted
3 net income over the last three years and total net assets of
4 negative \$502,923. The appellants did not contest this
5 appraisal.

6 **C. The Bankruptcy Court's Ruling**

7 On October 22, 2009, the bankruptcy court filed an order
8 overruling the trustee's objection to the debtors' exemption.
9 In its memorandum decision filed the same day, the bankruptcy
10 court, citing Martinson v. Michael (In re Michael), 163 F.3d
11 526, 529 (9th Cir. 1998), stated that it would overrule the
12 objection based on its finding that the appellants had failed to
13 present "clear and convincing" evidence that the debtors had
14 acted in bad faith in claiming the exemption in the shares.

15 The bankruptcy court concluded that the debtors were honest
16 in initially claiming that the shares had no value. The
17 bankruptcy court observed that Nicholson's communications with
18 Pall Medical in March and April 2009 were "preliminary
19 negotiations" that did "not make for a valuable contractual
20 right." The bankruptcy court also stated that the April 27,
21 2009 buyout proposal for Cliff Tyner's shares "reflected the
22 speculative nature of the Pall Medical relationship" because it
23 only provided for a nominal initial payment, which was to be
24 augmented by a percentage of ASI sales payable only if a sales
25 threshold of \$25,000 per month was met.

26 The bankruptcy court gave "little evidentiary weight" to
27 the Notes, finding that Tyner had not laid a sufficient
28 foundation for the admission of the document. The bankruptcy

1 court also concluded that, even if the document was genuine, it
2 did not prove bad faith. "At most," the bankruptcy court
3 stated, "the document reflects Nicholson's belief that ASI had
4 value and his desire that the trustee not learn of the Pall
5 Medical discussions." The bankruptcy court further stated that
6 if Nicholson had written the document, he would have done so on
7 or around July 3, 2009, which would have "reveal[ed] nothing
8 about debtors' assessment of ASI's value on March 16, 2009, but
9 rather [was] consistent with [his] testimony that ASI's
10 prospects improved in late June [2009]." Also observing that
11 "[t]he bad faith exception to Rule 1009(a) regulates bad-faith
12 acts, not thoughts," the bankruptcy court noted that the debtors
13 had first amended their schedules in July 2009 to reflect this
14 change in value only after ASI's prospects improved in June
15 2009.

16 Finally, the bankruptcy court rejected the trustee's
17 assertion that the debtors had claimed an exemption in the
18 shares to prevent their sale. The bankruptcy court reasoned
19 that mere delay in claiming exemptions does not prove bad faith,
20 and that "once the debtors realized the shares had value, they
21 had every right to use their exemption claims in an attempt to
22 capture that value."

23 ASI and Tyner timely appealed the bankruptcy court's order.
24 After hearing oral arguments on appeal, we ordered the parties
25 to submit additional briefing on whether the bankruptcy court
26 applied the correct burden of proof to the trustee's objection.
27
28

1 Hahn (In re Khachikyan), 335 B.R. 121, 128 (9th Cir. BAP 2005).
2 In applying an abuse of discretion test, we first “determine de
3 novo whether the [bankruptcy] court identified the correct legal
4 rule to apply to the relief requested.” United States v.
5 Hinkson, 585 F.3d 1247, 1262 (9th Cir. 2009). If the bankruptcy
6 court identified the correct legal rule, the court abused its
7 discretion if its “application of the correct legal standard [to
8 the facts] was (1) ‘illogical,’ (2) ‘implausible,’ or (3)
9 without ‘support in inferences that may be drawn from the facts
10 in the record.’” Id., (quoting Anderson v. City of Bessemer
11 City, N.C., 470 U.S. 564, 577 (1985)).

12 **V. DISCUSSION**

13 “When a debtor files a Chapter 7 bankruptcy petition, all
14 of the debtor’s assets become property of the bankruptcy estate,
15 see 11 U.S.C. § 541, subject to the debtor’s right to reclaim
16 certain property as ‘exempt,’ § 522(l).” Schwab v. Reilly, 2010
17 WL 2400094, at *4 (U.S. June 17, 2010). “The Bankruptcy Code
18 specifies the types of property debtors may exempt, § 522(b), as
19 well as the maximum value of the exemptions a debtor may claim
20 in certain assets, § 522(d).” Id. “Section 522(b) allow[s a
21 debtor] to choose the exemptions afforded by state law or the
22 federal exemptions listed in § 522(d).” Taylor v. Freeland &
23 Kronz, 503 U.S. 638, 642 (1992). “Section 522(l) states the
24 procedure for claiming exemptions and objecting to claimed
25 exemptions as follows: ‘The debtor shall file a list of
26 property that the debtor claims as exempt under subsection (b)
27 of this section. . . Unless a party in interest objects, the
28 property claimed as exempt on such list is exempt.’” Id.

1 Here, the chapter 7 trustee objected to the debtors'
2 amendment of the schedules claiming an exemption on the ground
3 of bad faith. Federal Rule of Bankruptcy Procedure 1009(a)
4 provides: "A voluntary petition, list, schedule, or statement
5 may be amended by the debtor as a matter of course at any time
6 before the case is closed." Fed. R. Bankr. P. 1009(a). "No
7 court approval is required for an amendment, which is liberally
8 allowed." In re Michael, 163 F.3d at 529, citing In re Doan,
9 672 F.2d 831, 833 (11th Cir. 1982). "Whether [debtors may]
10 amend their schedules post-petition," however, "is separate from
11 the question whether the exemption [itself is] allowable." Id.,
12 citing In re Sandoval, 103 F.3d 20, 22 (5th Cir. 1997).

13 We reject the debtors' argument that bankruptcy courts have
14 no authority to disallow exemptions claimed in bad faith.
15 Section 522(1) of the Bankruptcy Code and Rule 4003(b) of the
16 Federal Rules of Bankruptcy Procedure permit a party in interest
17 to object to a debtor's claim of exemption. Further, the
18 Supreme Court has recognized the "broad authority granted to
19 bankruptcy judges," pursuant to § 105(a) of the Bankruptcy Code,
20 "to take appropriate action in response to fraudulent conduct by
21 the atypical litigant who has demonstrated that he is not
22 entitled to the relief available to the typical debtor."
23 Marrama v. Citizens Bank of Massachusetts, 549 U.S. 365, 374-75
24 (2007); see also Latman v. Burdette, 366 F.3d 774, 784-86 (9th
25 Cir. 2004)(recognizing inherent powers of bankruptcy courts to
26 equitably surcharge a debtor's exemption to protect integrity of
27 the bankruptcy process and to ensure debtor does not exempt
28 amount greater than allowed under Bankruptcy Code despite lack

1 of express Code provision for equitable surcharge of
2 exemptions). In Andermahr v. Barrus (In re Andermahr), the
3 panel adopted the rule of the Eleventh Circuit in In re Doan
4 that a bankruptcy court may disallow a claim of exemption on a
5 showing of "bad faith by the debtor or prejudice to creditors."
6 30 B.R. 532, 533 (9th Cir. BAP 1983), citing In re Doan, 672
7 F.2d at 833. The Ninth Circuit also adopted the rule stated in
8 Doan. See In re Michael, 163 F.3d at 529, citing In re Doan,
9 672 F.2d at 833.

10 **A. The Bankruptcy Court did not Apply the Correct Burden of**
11 **Proof to the Trustee's Objection.**

12 Rule 4003(c) of the Federal Rules of Bankruptcy Procedure
13 provides that, if a party in interest timely objects, "the
14 objecting party has the burden of proving that the exemptions
15 are not properly claimed." An exemption is "presumptively
16 valid" and the objecting party, therefore, has the burden of
17 producing enough evidence to rebut that presumption. Carter v.
18 Anderson (In re Carter), 182 F.3d 1027, 1029 n.3 (9th Cir.
19 1999). Even if this burden is met, the burden of persuasion
20 remains on the objecting party. Id.

21 The Bankruptcy Code and Bankruptcy Rules do not indicate
22 what is the appropriate burden of persuasion for disallowing a
23 claim of exemption. The Ninth Circuit has not defined this
24 burden. The panel has, outside of the bad faith context,
25 applied the ordinary "preponderance of the evidence" standard.
26 See Kelley v. Locke (In re Kelley), 300 B.R. 11, 16-17 (9th Cir.
27 BAP 2003). "Proof by the preponderance of the evidence means
28 that it is sufficient to persuade the finder of fact that the

1 proposition is more likely true than not." United States v.
2 Arnold & Baker Farms (In re Arnold & Baker Farms), 177 B.R. 648,
3 654 (9th Cir. BAP 1994).

4 The debtors argue that "clear and convincing" evidence of
5 bad faith is necessary to disallow a claim of exemption on that
6 basis. "Clear and convincing evidence is a higher standard
7 requiring a high probability of success." Id. The debtors make
8 several arguments in support of this position.

9 First, the debtors argue that the panel adopted the "clear
10 and convincing" standard for resolving objections to exemptions
11 for bad faith in Magallanes v. Williams (In re Magallanes), 96
12 B.R. 253 (9th Cir. BAP 1988), and that the Ninth Circuit, by
13 citing Magallanes in Martinson v. Michael (In re Michael), 163
14 F.3d 526 (9th Cir. 1998), did the same. Therefore, they argue,
15 the bankruptcy court correctly relied on Michael in applying
16 this standard. Each of these contentions is incorrect.

17 In Magallanes, the panel stated that "bad faith must be
18 established by clear and convincing evidence." 96 B.R. at 256.
19 The panel reasoned that "[t]his standard allows the party
20 alleging bad faith an opportunity to prove his or her claim, but
21 also implements the policy of liberally allowing the debtors to
22 amend their exemption claims in order to enhance their fresh
23 start." Id., citing Brown v. Sachs (In re Brown), 56 B.R. 954,
24 958 (Bankr. E.D. Mich. 1986). This discussion, however, was
25 dicta because it was "not necessary to the decision and thus
26 [has] no binding or precedential impact in the present case."
27 Export Group v. Reef Industries, Inc., 54 F.3d 1466, 1471-72
28

1 (9th Cir. 1995), citing inter alia Black's Law Dictionary 454
2 (6th ed. 1990)(defining "dictum" as "an observation or remark
3 . . . not necessarily involved in the case or essential to its
4 determination") and Wainwright v. Witt, 469 U.S. 412, 422
5 (1985). The discussion was not essential to the panel's
6 decision in Magallanes because it did not review whether the
7 bankruptcy court applied the correct burden of proof. Instead,
8 the panel held that the bankruptcy court had not made a factual
9 determination as to the appropriateness of the amended schedules
10 when the bankruptcy court disallowed the debtor's amended claim
11 of a homestead exemption because of its prior order disallowing
12 his original exemptions for his failure to appear at a scheduled
13 trial. In re Magallanes, 96 B.R. at 256. Therefore, the panel
14 remanded for the bankruptcy court to make factual findings on
15 whether the debtor had claimed the exemption in bad faith. Id.

16 The Ninth Circuit's discussion of the issue in Michael was
17 also dicta. In Michael, the Ninth Circuit affirmed the panel's
18 reversal of the bankruptcy court's holding that the debtors
19 could not amend their bankruptcy schedules to claim a homestead
20 exemption more than a year after the petition date. 163 F.3d at
21 528-29. Citing the panel's opinion in Magallanes, the Ninth
22 Circuit observed that the trustee had not objected to the
23 amendment for bad faith. Id. at 529. Because of this, neither
24 the Ninth Circuit nor the panel had an opportunity in Michael
25 to reach the issue of whether the bankruptcy court had applied
26 the correct burden of proof.

27 After Michael, the panel in Arnold observed that "[i]t is
28 not entirely clear whether bad faith or prejudice [in claiming

1 exemptions] must be shown by a 'preponderance of the evidence'
2 or 'clear and convincing' evidence." 252 B.R. at 784.⁴ The
3 panel in Arnold suggested that the Supreme Court may have
4 answered this question in Grogan v. Garner, 498 U.S. 279 (1991).
5 Id. In Grogan, the Supreme Court held that a party in interest
6 must prove, by a "preponderance of the evidence," that a debt
7 should be excepted from discharge under 11 U.S.C. § 523.
8 498 U.S. at 291. Finding that the statute and its legislative
9 history did not indicate the appropriate burden of proof, the
10 Court stated that "[t]his silence is inconsistent with the view
11 that Congress intended to require a special, heightened standard
12 of proof." Id. at 286. "Because the preponderance-of-the-
13 evidence standard results in a roughly equal allocation of the
14 risk of error between litigants," the Court continued, "we
15 presume that this standard is applicable in civil actions
16 between private litigants unless 'particularly important
17 individual interests or rights are at stake.'" Id. (citation
18 omitted). The Court held that a debtor's interest in a
19 discharge was not important enough to rebut this presumption,
20 because "a debtor has no constitutional or 'fundamental' right
21 to a discharge in bankruptcy." Id. The Court also rejected the
22 argument that "the clear-and-convincing standard" is "required
23 to effectuate the 'fresh start' policy of the Bankruptcy Code."
24 Id.

27 ⁴ The panel in Arnold did not decide the issue because it
28 would have reversed the bankruptcy court's decision under either
standard. See id. at 784 n.10.

1 The Ninth Circuit has not addressed whether Grogan has
2 determined the burden of proving that an exemption is claimed in
3 bad faith. We are persuaded that Grogan has for the following
4 reasons. First, because Congress is silent, under Grogan we
5 must presume that exemptions may be disallowed for bad faith by
6 a "preponderance of the evidence." If the right to a discharge
7 was not important enough to rebut this presumption in Grogan,
8 neither is the right to an exemption, because it is not a
9 constitutional or "fundamental" right. Rather, allowance of
10 exemptions in bankruptcy is a matter of congressional
11 authorization under the Bankruptcy Code. See Schwab v. Reilly
12 at *4. Second, under Grogan, a higher standard is not necessary
13 to protect the "fresh start" purpose of the exemption statutes.
14 See id., at *11 ("exemptions in bankruptcy cases are part and
15 parcel of the fundamental bankruptcy concept of a 'fresh
16 start'")(internal quotation marks omitted). We find no support
17 for the debtors' contention that the Grogan Court limited its
18 reasoning to the facts of that case. Accordingly, following
19 Grogan, we reject the argument that "the clear-and-convincing
20 standard" is "required to effectuate the 'fresh start' policy of
21 the Bankruptcy Code." 498 U.S. at 286.

22 The Tenth Circuit's decision in Gillman v. Ford (In re
23 Ford), 492 F.3d 1148 (10th Cir. 2007) supports our conclusion
24 that Grogan controls the burden of proof. In Ford, the
25 bankruptcy court held that there was "clear and convincing"
26 evidence that a debtor had amended her schedules to claim an
27 exemption in pending litigation in bad faith. Id. at 1153-54.
28 The Tenth Circuit affirmed the bankruptcy court's ruling, but

1 adopted the "preponderance of the evidence" standard instead.
2 Id. at 1154, 1157. Discussing Grogan, the Ford court analogized
3 that the "discharge of debt under § 523 is analytically similar
4 to obtaining an exemption in bankruptcy - in each case, the
5 debtor is seeking a preference vis-à-vis creditors that will be
6 sustained absent bad faith on the part of the debtor." Id. at
7 1154. The Tenth Circuit also observed that the "preponderance
8 of the evidence" standard "reflects a fair balance between [the
9 creditor's interest in recovering full payment of debts and the
10 debtor's interest in a fresh start]" equally in exemption
11 proceedings as in dischargeability actions. Id. at 1154-55.

12 Our conclusion is also reinforced by the panel's
13 observation in Arnold that having different standards for
14 exemption proceedings and dischargeability actions would create
15 "seemingly anomolous results" after Grogan. 252 B.R. at 784
16 n.10. For example, as the panel stated, a bankruptcy court may
17 allow a debtor's exemption under the higher standard, but deny
18 the same debtor a discharge under the lower one. Id. Following
19 Arnold, we now conclude that a uniform standard will achieve a
20 consistent balance between debtors' and creditors' interests and
21 will avoid such anomolous results.

22 "Courts [after Grogan] are split over the question of
23 whether bad faith or prejudice must be established by a
24 preponderance of the evidence or by clear and convincing
25 evidence." In re Rolland, 317 B.R. 402, 415 n.19 (Bankr. C.D.
26 Cal. 2004) (collecting cases). Courts in this circuit, however,
27 have universally applied the "preponderance of the evidence"
28 standard. See, e.g., id.; In re Reardon, 403 B.R. 822, 830

1 (Bankr. D. Mont. 2009). Moreover, although the Seventh Circuit
2 applied the higher standard in In re Yonikus, 996 F.2d 866, 872
3 (7th Cir. 1993), that court offered no explanation for doing so.
4 Id. (though citing In re Brown, 56 B.R. at 958).

5 Second, the debtors argue that the "clear and convincing"
6 standard is necessary to avoid infringing on exemption rights
7 created under California law. We disagree. As the Supreme
8 Court has recognized, bankruptcy exemptions are authorized and
9 regulated by Congress in § 522 of the Bankruptcy Code. See
10 Schwab v. Reilly, at *5. Although state law may control the
11 "nature and extent" of state law exemptions, subject to the
12 limitations set forth in the Bankruptcy Code, "the manner in
13 which such exemptions are to be claimed, set apart, and awarded,
14 is regulated and determined by the federal courts, as a matter
15 of procedure in the course of bankruptcy administration, as to
16 which they are not bound or limited by state decisions or
17 statutes." In re Moore, 274 F. 645, 648 (E.D. Mich. 1921); see
18 also Raleigh v. Illinois Dep't of Revenue, 530 U.S. 15, 21
19 (2000) ("Congress of course may do what it likes with
20 entitlements in bankruptcy"). Because Congress has regulated
21 the allowance of exemptions in bankruptcy, the Code and Rules
22 may alter burdens of proof relating to exemptions, even if those
23 burdens are part of the "substantive" right under state law.
24 See Raleigh v. Illinois Dep't of Revenue, 530 U.S. at 21-22 and
25 n.2. In implementing the provisions of § 522(l), Rule 4003(c)
26 places the burden of proof on the objecting party, see Fed. R.
27 Bankr. P. 4003, Advisory Committee Note ("This rule is derived
28

1 from § 522(1) of the Code").⁵ Bankruptcy courts may, in turn,
2 define that burden because of their "equitable powers to adjust
3 rights between creditors." Raleigh v. Illinois Dep't of
4 Revenue, 530 U.S. at 24; see also Thomas E. Plank, The Erie
5 Doctrine and Bankruptcy, 79 Notre Dame L. Rev. 633, 679-80
6 (2004).

7 Third, the debtors argue that the appellants waived their
8 right to contest this issue by failing to raise it on appeal.
9 We are mindful that, "[a]bsent exceptional circumstances, this
10 court generally will not consider arguments raised for the first
11 time on appeal." See United Student Funds, Inc. v. Wylie (In re
12 Wylie), 349 B.R. 204, 213 (9th Cir. BAP 2006). However, "unlike
13 a legal argument that is forfeited below, we are not obligated
14 to apply an erroneous evidentiary standard." In re Ford, 492
15 F.3d at 1154 n.6. Moreover, we cannot, as the panel did in
16 Arnold, avoid deciding this issue because, as we explain below,
17 the bankruptcy court could have reached a different result if it
18 had applied a lower standard of proof.

19 For these reasons, as the panel suggested in Arnold, we
20 hold that a party objecting to a debtor's claim of exemption
21

22 ⁵ In this case, we construe the trustee's objection to a
23 claim of exemption based on an act of bad faith to be cognizable
24 as a matter of federal common law pursuant to Section 105(a) of
25 the Bankruptcy Code and the inherent powers of the bankruptcy
26 court as courts of equity to protect the integrity of the
27 bankruptcy process. Marrama, 549 U.S. at 374-75; Latman, 366
28 F.3d at 784-86. We take no position on an issue not presented in
this case that the burden of proof may be different for an
objection to a claim of exemption on a non-federal ground, which
was an issue identified by Judge Klein in his concurring opinion
in the panel's decision in Gonzales v. Davis (In re Davis),
323 B.R. 732, 740-45 (9th Cir. BAP 2005) (Klein, J., concurring).

1 must prove bad faith by a "preponderance of the evidence" and
2 not by "clear and convincing" evidence.

3 **B. The Bankruptcy Court could have Found, by a Preponderance**
4 **of the Evidence, that the Debtors Claimed the Exemption in Bad**
5 **Faith.**

6 "Bad faith [in claiming exemptions] is determined by an
7 examination of the 'totality of the circumstances.'" In re
8 Rolland, 317 B.R. at 414. "Concealment of assets is the usual
9 ground for a finding of 'bad faith.'" Id. at 415, citing In re
10 Arnold, 252 B.R. at 785. However, "a debtor's intentional and
11 deliberate delay in amending an exemption for the purpose of
12 gaining an economic or tactical advantage at the expense of
13 creditors and the estate [also] constitutes 'bad faith.'" Id.
14 at 416.

15 Under the totality of the circumstances, the bankruptcy
16 court could have found, by a "preponderance of the evidence,"
17 that the debtors concealed the value of the shares from the
18 trustee. The bankruptcy court could have found that the debtors
19 did not honestly believe, as they had testified, that the shares
20 were worthless. The March 6, 2009 e-mail proposal and the April
21 2, 2009 agreement suggest that Nicholson was already negotiating
22 a deal with Pall Medical on the petition date. Pall Medical was
23 apparently a multi-billion dollar company that would procure
24 sales for ASI throughout Europe and to the Red Cross. This
25 relationship was, therefore, expected to produce a dramatic
26 increase in revenues. Nicholson attested, in his opposition to
27 the trustee's objection, that the deal with Pall Medical would
28 "easily push total sales for this fiscal year in excess of

1 \$1Million [sic], more than double last year's sales." Also,
2 Nicholson's April 27, 2009 buyout offer to have ASI purchase
3 Tyner's shares was made only six weeks after the petition date.
4 "[A]n offer to purchase an asset would normally constitute
5 strong evidence of the asset's value, even if there is only one
6 such offer." Grueneich v. Doeling (In re Grueneich), 400 B.R.
7 680, 687 (8th Cir. BAP 2009). Although the bankruptcy court
8 found that the consideration for the buyout was "speculative,"
9 the court could have found that, by a preponderance of the
10 evidence, the debtors did not believe that the shares were
11 worthless as of the petition date because such a lucrative deal
12 was on the horizon.

13 The bankruptcy court gave little weight to the debtors'
14 beliefs or motives, opining that "[t]he bad faith exception to
15 Rule 1009(a) regulates bad-faith acts, not thoughts." However,
16 a debtor's subjective intent is an important, although not
17 determinative, factor in determining bad faith. Marsch v.
18 Marsch (In re Marsch), 36 F.3d 825, 828 (9th Cir. 1994).

19 We recognize that bad faith beliefs and motives are, as a
20 matter of law, insufficient. In Grueneich, the debtor amended
21 his schedules to claim an exemption in stock that he had valued
22 at \$0. 400 B.R. at 682. The Eighth Circuit BAP held that the
23 bankruptcy court clearly erred in sustaining the trustee's
24 objection to the amendment. Id. at 687. The Eighth Circuit BAP
25 reasoned that there was no evidence, other than a recent
26 purchase offer, that the debtor did not honestly believe that
27 the stock had no value or that anyone was misled by the
28 schedules. Id. The Eighth Circuit BAP also noted that the

1 bankruptcy court did not allow the debtor to present evidence
2 that the company's liabilities exceeded its assets and that the
3 prospective buyer's motive was questionable. Id. Here, as in
4 Grueneich, the appellants submitted an uncontested appraisal
5 showing that ASI was underwater and had a purchase offer from an
6 insider that may not, therefore, be reliable evidence of value.

7 Here, however, unlike in Grueneich, the bankruptcy court
8 could have found that the debtors misled the trustee by
9 testifying that the stock was worthless. The trustee likely
10 would have abandoned the shares if Tyner had not objected
11 because the debtors did not amend their schedules until the same
12 day that the trustee noticed them for sale. Also, it is
13 apparently undisputed that Nicholson did not want Tyner to
14 acquire full control of ASI. Although mere delay in claiming
15 exemptions is insufficient evidence of bad faith, In re Arnold,
16 252 B.R. at 786, this delay, therefore, may have been a
17 deliberate attempt by Nicholson to gain an economic or tactical
18 advantage at the expense of his creditors. Nevertheless, we
19 leave it to the bankruptcy court to weigh the evidence again in
20 the first instance under the correct standard of proof.

21 **C. The Bankruptcy Court did not Abuse its Discretion by not**
22 **Setting an Evidentiary Hearing.**

23 The Fifth Amendment's requirement of due process applies in
24 bankruptcy proceedings. Gonzalez-Ruiz v. Doral Financial Corp.
25 (In re Gonzalez-Ruiz), 341 B.R. 371, 381 (1st Cir. BAP 2006).
26 Section 102(1)(A) of the Bankruptcy Code defines the phrase,
27 "after notice and a hearing" as "such notice as is appropriate
28

1 in the particular circumstances, and such opportunity for a
2 hearing as is appropriate in the particular circumstances."
3 11 U.S.C. § 102(1)(A). Therefore, "[t]he concept of 'notice and
4 a hearing' is a flexible one," In re Gonzalez-Ruiz, 341 B.R. at
5 381, citing Credit-Alliance Corp. v. Dunning-Ray Insurance
6 Agency, Inc. (In re Blumer), 66 B.R. 109, 113 (9th Cir. BAP
7 1986), aff'd, 826 F.2d 1069 (9th Cir. 1987). "The bankruptcy
8 judge has considerable, albeit not unlimited, discretion in
9 determining if the notice and a hearing requirement has been
10 satisfied." Id.

11 Likewise, Rule 43(c) of the Federal Rules of Civil
12 Procedure, which is applicable to contested matters under Rule
13 9017 of the Federal Rules of Bankruptcy Procedure, provides:
14 "When a motion relies on facts outside the record, the court may
15 hear the matter on affidavits or may hear it wholly or partly on
16 oral testimony or on depositions." Under this rule, bankruptcy
17 courts have "wide discretion" in deciding whether to take oral
18 testimony at an evidentiary hearing. United Commercial
19 Insurance Service, Inc. v. Paymaster Corp., 962 F.2d 853, 858
20 (9th Cir. 1992); accord Garner v. Shier (In re Garner), 246 B.R.
21 617, 624 (9th Cir. BAP 2000).

22 An evidentiary hearing is generally appropriate when there
23 are disputed and material factual issues that the bankruptcy
24 court cannot readily determine from the record. Thus, if a
25 contested matter in a bankruptcy case "cannot be decided without
26 resolving a disputed material issue of fact, an evidentiary
27 hearing must be held at which testimony of witnesses is taken in
28 the same manner as testimony is taken in an adversary proceeding

1 or at trial in a district court civil case." Fed. R. Bankr. P.
2 9014, Advisory Committee Note to 2002 Amendment. This advisory
3 committee note "makes clear that this requirement is intended to
4 require a trial when there is a genuine factual dispute." In re
5 Khachikyan, 335 B.R. at 126 and n.4.

6 However, "[n]othing in [Rule 9014(d)] prohibits a court
7 from resolving any matter that is submitted on affidavits by
8 agreement of the parties." Fed. R. Bankr. P. 9014, Advisory
9 Committee Note to 2002 Amendment. Therefore, "[w]here the
10 parties do not request an evidentiary hearing or the core facts
11 are not disputed, the bankruptcy court is authorized to
12 determine contested matters . . . on the pleadings and arguments
13 of the parties, drawing necessary inferences from the record."
14 In re Gonzalez-Ruiz, 341 B.R. at 381.

15 Rule 9014(e) requires bankruptcy courts to "provide
16 procedures that enable parties to ascertain at a reasonable time
17 before any scheduled hearing whether the hearing will be an
18 evidentiary hearing at which witnesses may testify." The
19 Eastern District of California has, accordingly, promulgated a
20 local rule that provides:

21 If the moving party does not consent to the
22 Court's resolution of disputed material
23 factual issues pursuant to FRCivP 43(e), the
24 moving party shall file and serve, within
25 the time required for a reply, a separate
26 statement identifying each disputed material
27 factual issue. . . . Failure to file the
28 separate statement shall be construed as
consent to resolution of the motion and all
disputed material factual issues pursuant to
FRCivP 43(e).

Bankr. E.D. Cal. R. 9014-1(f)(1)(iii).

1 We quickly dispense with the appellants' claim that this
2 local rule, on its face, denied them due process of law. "The
3 three-part test for the validity of a local bankruptcy rule is:
4 (1) whether it is consistent with Acts of Congress and the
5 Federal Rules of Bankruptcy Procedure; (2) whether it is more
6 than merely duplicative of such statutes and rules; and (3)
7 whether it prohibits or limits the use of the Official Forms."
8 In re Garner, 246 B.R. at 624, citing Fed. R. Bankr. P.
9 9029(a)(1). Local Rule 9014-1(f)(1)(ii) easily satisfies each
10 of these requirements. First, the rule obeys Rule 9014(e)'s
11 directive by providing procedures that allow parties to request
12 an evidentiary hearing. Second, the local rule supplements the
13 Federal Rule because that Rule expressly does not provide such
14 procedures. Third, the local rule does not prohibit or limit
15 the use of the Official Forms.

16 We also reject the appellants' argument that the bankruptcy
17 court applied the local rule in a manner that deprived them of
18 due process. "A local rule imposing a requirement of form shall
19 not be enforced in a manner that causes a party to lose rights
20 because of a nonwillful failure to comply with the requirement."
21 Fed. R. Bankr. P. 9029(a)(2). However, the bankruptcy court
22 appropriately interpreted the appellants' non-compliance with
23 the notice requirement as consent to let the matter rest on the
24 record alone. Although Tyner was not served with the debtors'
25 opposition to the trustee's objection to the claimed exemption,
26 she, along with the trustee who was served with the opposition,
27 could have filed the notice of disputed material factual
28 issue(s) with the reply, or at any time thereafter.

1 Further, even if the appellants had complied with the rule,
2 the bankruptcy court did not abuse its discretion. Bad faith is
3 a "highly factual determination" but does not generally require
4 an evidentiary hearing. C-TC 9th Ave. Partnership v. Norton Co.
5 (In re C-TC 9th Ave. Partnership), 113 F.3d 1304, 1312 (9th Cir.
6 1997). The appellants argue that whether Nicholson wrote the
7 Notes was a material and disputed fact. However, the appellants
8 had every opportunity to prove this fact without Nicholson's
9 testimony. They retained the full range of rights to discovery
10 in this contested matter, see In re Khachikyan, 335 B.R. at 126,
11 and were even permitted to supplement the record with
12 declarations and other evidence. Thus, the bankruptcy court was
13 able to determine this disputed fact from the record alone.
14 Again, however, since we remand this matter for further
15 proceedings, the bankruptcy court may, in the exercise of its
16 discretion, determine whether an evidentiary hearing is
17 appropriate.

20 VI. CONCLUSION

21 Because we conclude that the bankruptcy court applied the
22 incorrect burden of proof to the trustee's objection to the
23 debtors' claim of exemption, we VACATE the bankruptcy court's
24 order overruling the trustee's objection and REMAND this matter
25 for further proceedings consistent with this opinion.
26
27
28