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

UNITED STATES BANKRUPTCY APPELLATE PANEL  
OF THE NINTH CIRCUIT

In re:	)	BAP No.	AZ-13-1502-JuKiD
	)		
IAN NEHEMIAH GRAY and CYNTHIA JACKSON GRAY,	)	Bk. No.	3:13-bk-8071-MCW
	)		
Debtors.	)		
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IAN NEHEMIAH GRAY; CYNTHIA JACKSON GRAY,	)		
	)		
Appellants,	)		
v.	)	<b>O P I N I O N</b>	
	)		
LAWRENCE J. WARFIELD, Chapter 7 Trustee,	)		
	)		
Appellee.	)		
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Argued and Submitted on November 20, 2014  
at Phoenix, Arizona

Filed - December 9, 2014

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

Honorable Randolph J. Haines, Chief Bankruptcy Judge, Presiding

Appearances: Kenneth L. Neeley, Esq. for appellants Ian  
Nehemiah Gray and Cynthia Jackson Gray;  
Terry A. Dake, Esq. for Lawrence J. Warfield,  
Chapter 7 Trustee.

Before: JURY, KIRSCHER, and DUNN, Bankruptcy Judges.

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1 JURY, Bankruptcy Judge:  
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3 Chapter 7 debtors<sup>1</sup> Ian and Cynthia Gray appeal from the  
4 bankruptcy court's order sustaining the chapter 7 trustee's  
5 objection to an amended exemption on the grounds of bad faith.  
6 Because the Supreme Court in Law v. Siegel, 134 S. Ct. 1188  
7 (2014), determined that bankruptcy courts have no discretion  
8 either to disallow amended exemptions or to deny leave to amend  
9 exemptions based on equitable grounds not specified in the  
10 Bankruptcy Code, we VACATE and REMAND.

11 **I. FACTS**

12 Ian and Cynthia Gray (Debtors) filed their chapter 7  
13 petition and schedules on May 14, 2013. The schedules did not  
14 list as an asset or claim as exempt any prepaid rent. At the  
15 § 341(a) meeting of creditors on June 24, 2013, the chapter 7  
16 trustee (Trustee) questioned Debtors about the payment of  
17 \$2,707.00 made to their landlord on March 11, 2013. Debtors  
18 testified that the payment was a prepayment of rent for April,  
19 May, and June of 2013. On July 8, 2013, Trustee demanded  
20 turnover of \$900.00 for the prepayment of the post-petition rent  
21 due for June 2013 (the June Prepaid Rent). Debtors responded by  
22 amending schedules B and C to respectively list as an asset and  
23 claim an exemption (the Amended Exemption) in the June Prepaid  
24 Rent. Because Debtors did not claim a homestead exemption, they  
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26 <sup>1</sup> Unless otherwise indicated, all chapter and section  
27 references are to the Bankruptcy Code, 11 U.S.C. §§ 101-1532,  
28 and "Rule" references are to the Federal Rules of Bankruptcy  
Procedure.

1 were permitted to claim as exempt "prepaid rent, including  
2 security deposits . . . not exceeding the lesser of one thousand  
3 dollars or one and one-half months' rent." Ariz. Rev. Stat.  
4 Ann. § 33-1126(C).<sup>2</sup>

5 On July 9, 2013, Trustee filed an objection to the Amended  
6 Exemption and argued that Debtors' initial failure to disclose  
7 the asset constituted grounds for the denial of the exemption.  
8 Debtors filed their response on July 10, 2013, arguing that  
9 under Rule 1009(a) amendments to their schedules should be  
10 allowed as a matter of course because Debtors' failure to  
11 disclose did not amount to bad faith and Trustee failed to show  
12 prejudice to creditors.

13 After oral arguments from both parties, the bankruptcy  
14 court issued its order sustaining the objection on September 16,  
15 2013. Without holding an evidentiary hearing, the bankruptcy  
16 court disallowed the Amended Exemption because Debtors acted in  
17 bad faith and intentionally concealed the June Prepaid Rent.  
18 Debtors filed a timely notice of appeal.

## 19 **II. JURISDICTION**

20 The bankruptcy court had jurisdiction over this proceeding  
21 under 28 U.S.C. §§ 1334 and 157(b)(2)(A) and (B). We have  
22 jurisdiction under 28 U.S.C. § 158.

## 23 **III. ISSUE**

24 1. Whether the bankruptcy court has discretion either to  
25 disallow the Amended Exemption or to deny leave to amend an  
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27 <sup>2</sup> This reflects a prior version of Ariz. Rev. Stat. Ann.  
28 § 33-1126(C), effective from July 20, 2011 to September 12,  
2013.

1 exemption based on a finding of bad faith; and  
2 2. Whether the bankruptcy court abused its discretion in  
3 deciding not to conduct an evidentiary hearing.

#### 4 **IV. STANDARD OF REVIEW**

5 Questions of law are subject to de novo review. United  
6 States v. Lang, 149 F.3d 1044, 1046 (9th Cir. 1998). Questions  
7 of fact are reviewed under the clearly erroneous standard.  
8 Pullman-Standard v. Swint, 456 U.S. 273, 287 (1982).

9 The bankruptcy court's decision not to conduct an  
10 evidentiary hearing is reviewed for abuse of discretion.  
11 Khachikyan v. Hahn (In re Khachikyan), 335 B.R. 121, 128 (9th  
12 Cir. BAP 2005).

13 The bankruptcy court abuses its discretion when it applies  
14 the incorrect legal rule or when its application of the law to  
15 the facts is: (1) illogical; (2) implausible; or (3) without  
16 support in inferences that may be drawn from the facts in the  
17 record. United States v. Hinkson, 585 F.3d 1247, 1263 (9th Cir.  
18 2009) (en banc).

#### 19 **V. DISCUSSION**

##### 20 **A. The Ninth Circuit Standard Before Law v. Siegel.**

21 The briefs before the Panel and the pleadings filed with  
22 the bankruptcy court identify two issues: whether the Amended  
23 Exemption is allowed under § 522 and whether Debtors may amend  
24 under Rule 1009(a) to claim the June Prepaid Rent as exempt.  
25 Martinson v. Michael (In re Michael), 163 F.3d 526, 529 (9th  
26 Cir. 1998) ("Whether the [debtors] could amend their schedules  
27 post-petition is separate from the question whether the  
28 exemption was allowable."). Trustee relied on the asserted bad

1 faith of the Debtors to disallow the Amended Exemption of the  
2 June Prepaid Rent under either theory.

3 The distinction is substantively meaningless: denying leave  
4 to amend the exemption of property has the identical effect as  
5 disallowing an amended exemption. In fact, even before the  
6 Supreme Court in Law v. Siegel made the distinction  
7 insignificant, Ninth Circuit case law had evolved such that the  
8 judge-made exceptions used to bar amendments under Rule 1009(a)  
9 were also used as grounds to disallow amended exemptions.

10 A claimed exemption is presumptively valid. Gonzalez v.  
11 Davis (In re Davis), 323 B.R. 732, 743 (9th Cir. BAP 2005).  
12 Rule 1009(a) gives debtors the right to amend any list,  
13 schedule, or statement "as a matter of course at any time before  
14 the case is closed" and without court approval. Michael, 163  
15 F.3d at 529. The right to amend includes the right to amend the  
16 list of exempt property. Goswami v. MTC Distrib. (In re  
17 Goswami), 304 B.R. 386, 393 (9th Cir. BAP 2003).

18 Notwithstanding the unqualified and permissive language of  
19 Rule 1009(a), courts used judicially created exceptions to limit  
20 the right to amend without analyzing whether courts had the  
21 statutory authority to do so. The Eleventh Circuit in Doan v.  
22 Hudgins (In re Doan), 672 F.2d 831, 833 (11th Cir. 1982), first  
23 recognized that bankruptcy courts had discretion to deny leave  
24 to amend on a showing of either debtor's bad faith or prejudice  
25 to creditors based on its reading of Rule 110<sup>3</sup> (incorporated in

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26  
27 <sup>3</sup> Rule 110 stated that "(a) voluntary petition, schedule or  
28 statement of affairs may be amended as a matter of course at any  
(continued...)

1 present Rule 1009(a)). Likewise, the Ninth Circuit adopted the  
2 equitable exceptions set forth in Doan without citing a specific  
3 statutory provision in the Bankruptcy Code. Michael, 163 F.3d  
4 at 529.

5 Bankruptcy courts subsequently used the same equitable  
6 considerations as grounds to disallow amended exemptions. In  
7 Magallanes v. Williams (In re Magallanes), 96 B.R. 253 (9th Cir.  
8 BAP 1988), the bankruptcy court sustained the chapter 7  
9 trustee's objection to amended exemptions claimed in a converted  
10 chapter 7 case. In adopting the test articulated in Doan, the  
11 Panel found that bankruptcy courts do not have discretion to  
12 disallow amended exemptions unless the amendment either was done  
13 in bad faith or caused prejudice to third parties. Id. at 256;  
14 Arnold v. Gill (In re Arnold), 252 B.R. 778, 784 (9th Cir. BAP  
15 2000).

16 Therefore, prior to Law v. Siegel, Ninth Circuit cases had  
17 used the bad faith of debtors both to deny leave to amend  
18 exemptions and to disallow an amended exemption. The bankruptcy  
19 court here relied on this precedent to disallow the Amended  
20 Exemption.

21 **B. The Supreme Court in Law v. Siegel Discredited the Use of**  
22 **Equitable Principles to Disallow Exemptions Under Federal Law.**

23 In Law v. Siegel, 134 S. Ct. 1188 (2014), the Supreme Court  
24 held that the bankruptcy court exceeded both its statutory  
25 authority and inherent powers when it ordered that the funds  
26 protected by the debtor's homestead exemption be surcharged to

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27 <sup>3</sup>(...continued)  
28 time before the case is closed."

1 pay administrative expenses. In the bankruptcy proceeding, the  
2 debtor had created and perpetuated a false trust deed against  
3 his home to protect any equity from administration by the  
4 chapter 7 trustee. Id. at 1193. Eventually the chapter 7  
5 trustee invalidated the trust deed, and the bankruptcy court  
6 granted the chapter 7 trustee's motion to surcharge the debtor's  
7 homestead exemption to offset the very high administrative costs  
8 incurred in overcoming the debtor's fraudulent  
9 misrepresentations. Id.

10 The Supreme Court ruled that the debtor was entitled to  
11 exempt the equity in his home under § 522 and California  
12 exemption law, and the exempted funds were deemed "not liable  
13 for payment of any administrative expense" under § 522(k). Id.  
14 at 1195. Because the attorney's fees incurred by the chapter 7  
15 trustee qualified as an administrative expense, the bankruptcy  
16 court's surcharge violated the express terms of § 522. Id.

17 Albeit in dicta, the Supreme Court found no equitable power  
18 in the bankruptcy court to deny an exemption as a remedy to  
19 debtor's bad faith conduct, Id. at 1196-97, and in so  
20 doing, implies that the judge-made exceptions of Michael do not  
21 survive Law v. Siegel.

22 The Supreme Court discerned no practical difference between  
23 disallowing an exemption and denying the debtor the right to  
24 amend an exemption: the Bankruptcy Code does not grant  
25 bankruptcy courts the "authority to disallow an exemption (or to  
26 bar a debtor from amending his schedules to claim an exemption,  
27 which is much the same thing)" based on a debtor's misconduct.  
28 Id. at 1196. The Supreme Court explicitly rejected the chapter

1 7 trustee's argument that Doan and other like cases reflect a  
2 general, equitable power in the bankruptcy courts. Id. Since  
3 the Ninth Circuit in Michael adopted the exceptions of bad faith  
4 and prejudice articulated in Doan, the effective abrogation of  
5 Doan necessarily extends to the use of these equitable grounds  
6 in Michael. In re Arellano, 517 B.R. 228, 232 (Bankr. S.D. Cal.  
7 2014) (finding that at least as to the bad faith and prejudice  
8 exceptions, Michael is effectively abrogated).

9 Supreme Court dicta is not to be taken lightly, and we must  
10 consider the rationale behind the holding, if sufficiently  
11 persuasive. Cnty. of Allegheny v. Am. Civil Liberties Union  
12 Greater Pittsburgh Chapter, 492 U.S. 573, 668 (1989) (Kennedy,  
13 J., concurring in judgment in part and dissenting in part) ("As  
14 a general rule, the principle of *stare decisis* directs us to  
15 adhere not only to the holdings of our prior cases, but also  
16 their explications of the governing rules of law."). The  
17 Supreme Court's definitive position that the Bankruptcy Code  
18 does not grant bankruptcy courts "a general, equitable  
19 power . . . to deny exemptions based on a debtor's bad-faith  
20 conduct" is clearly irreconcilable with the use of judicially  
21 created remedies either to bar amendments or to disallow amended  
22 exemptions. Law, 134 S. Ct. at 1196; Miller v. Gammie, 335 F.3d  
23 889, 893 (9th Cir. 2003) (holding prior circuit authority is  
24 effectively overruled where its reasoning or theory is clearly  
25 irreconcilable with the reasoning or theory of a higher  
26 authority).

27 Courts have long recognized that without the judge-made  
28 exceptions of Michael, bankruptcy courts have no discretion to



1 disallow amended exemptions. Magallanes, 96 B.R. at 256;  
2 Arnold, 252 B.R. at 784. Had debtor's entitlement to the  
3 exemption been at issue in Law v. Siegel, the Supreme Court  
4 dicta leaves no room to doubt how it would have ruled: "§ 522  
5 does not give courts discretion to grant or withhold exemptions  
6 based on whatever considerations they deem appropriate." Law,  
7 134 S. Ct. at 1196. The Supreme Court noted that sole  
8 discretion to invoke an exemption vests in the debtor, not the  
9 bankruptcy court, and observed that the bankruptcy court "may  
10 not refuse to honor the exemption absent a valid statutory basis  
11 for doing so." Id.

12 Here, but for the allegation of bad faith, the Amended  
13 Exemption is presumptively valid. Arizona opted out of the  
14 federal exemptions provided by the Bankruptcy Code. Ariz. Rev.  
15 Stat. Ann. § 33-1133(B). Debtors are entitled to exempt the  
16 \$900.00 of prepaid rent under Ariz. Rev. Stat. Ann.  
17 § 33-1126(C). Moreover, Trustee did not challenge the legal  
18 sufficiency of the Amended Exemption.

19 Thus, Law v. Siegel mandates the conclusion that the  
20 bankruptcy court is without federal authority to disallow the  
21 Amended Exemption or to deny leave to amend exemptions based on  
22 Debtors' bad faith. Law v. Siegel does recognize that when a  
23 debtor claims an exemption created under state law, the scope of  
24 the exemption is determined under state law which "may provide  
25 that certain types of debtor misconduct warrant denial of the  
26 exemption." Law, 134 S.Ct. at 1196-97. It does not appear that  
27 Arizona exemption law was considered in determining whether the  
28 Amended Exemption could be disallowed based on the Debtors'

1 conduct. Accordingly, the matter is remanded to give the  
2 bankruptcy court the opportunity to determine whether under  
3 Arizona law equitable considerations may be used to disallow  
4 exemptions.

5 **C. The Issue of Whether the Bankruptcy Court Abused Its**  
6 **Discretion by Not Holding an Evidentiary Hearing Is Moot.**

7 Because under federal law the bankruptcy court has neither  
8 the discretion to disallow amended exemptions nor deny leave to  
9 amend based on equitable grounds not specified in the Bankruptcy  
10 Code, we need not address this issue.

11 **VI. CONCLUSION**

12 For the reasons stated above, we VACATE and REMAND for  
13 further proceedings consistent with this opinion.