Post-Petition Asset Appreciation

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Introduction

The question of who benefits from an asset's post-petition appreciation has as many moving parts as there are judicial circuits. Including, without limitation:

- Is the post-petition appreciation being determined pre or post confirmation?
- Why is the post-petition appreciation being determined? Is it due to conversion to Chapter 7 or the sale of the asset during Chapter 13?
- What is the basis of the exemption (if any)? Is the asset itself exempt or is the value or equity in the asset exempt?
- Is the asset (or value of the asset) Property of the Estate under 11 USC § 541?
- Does the post-petition appreciation impact the "Best Interest of the Creditor" test under 11 USC § 1325(a)(4)?
- Does the post-petition appreciation impact the debtor's "Ability to Pay" under 11 USC §1325(b)?

Currently, there is no agreement amongst the circuits.

Approaches by Circuit

Eighth Circuit

Post-Confirmation Conversion to Chapter 7

The most recent case addressing whether post-petition appreciation of a debtor's homestead belongs to the debtor or the estate upon conversion from a chapter 13 to a chapter 7 is *Goetz v. Weber* (*In re Goetz*), 95 F.4th 584 (8th Cir. 2024). In *Goetz*, the Bankruptcy court

converted the debtor's chapter 13 case to chapter 7. Between the petition date and conversion, the debtor's residential property value increased, and the debtor made payments on the mortgage. The debtor moved for the Bankruptcy Court to compel the trustee to abandon the property, arguing that "the residence was of 'inconsequential value and benefit to the estate' under 11 U.S.C. § 554(b)," asserting that the post-petition, pre-conversion increase in equity must be excluded from the calculation of her residence's value to the estate." *Id*. at 588. The trustee argued that under § 348(f) of the Bankruptcy Code, "the bankruptcy estate in a converted case includes post-petition, pre-conversion increases in equity…" *Id*. The Bankruptcy Court held the post-petition, pre-conversion increase in equity belonged to the estate, not the debtor. The Bankruptcy Appellate Panel affirmed the decision of the Bankruptcy Court. The debtor appealed to the Eighth Circuit.

The Eighth Circuit affirmed the lower courts, holding that the post-petition, pre-conversion equity increase in the debtor's residence was property of the estate. The Eighth Circuit reached this decision by first defining "property of the estate" under section 541 of the Bankruptcy Code. The court looked to § 541(a)(6) and found that proceeds of or from the estate are included in property of the estate. The court then held that the post-petition, pre-conversion equity increase in the debtor's residence constitutes "proceeds" from the estate. Therefore, the increased equity is property of the estate because "it is the amount of money that the estate would receive from a sale of the residence before sale expenses." *Id*. at 590.

Post-petition Appreciation in Chapter 13—Sale

Prior to the Eighth Circuit's decision in *Goetz*, the Bankruptcy Court for the Western District of Missouri considered whether the debtor or the estate is entitled to sale proceeds resulting from the post-confirmation appreciation of real property. *In re Marsh*, 647 B.R. 725 (Bankr. W.D. Mo. 2023). In *Marsh*, the debtors sold their property post-confirmation and filed motions to retain

the proceeds, which the trustee opposed, arguing the proceeds were property of the estate. *Id* at 728-29.

The Bankruptcy Court analyzed five approaches used by various circuits to determine whether post-confirmation proceeds belong to the estate or the debtor. *Id* at 730. The first approach examined was the estate termination approach, which concludes that § 1327 "vests all property in the debtor at confirmation, and the chapter 13 estate terminates at confirmation except as provided in the debtor's plan." *Id* at 730-731. The Court rejected this approach, reasoning that the trustee's post-confirmation authority to administer the estate supports the estate continuing after confirmation. *Id*.

Next, the court considered the estate preservation approach, under which the estate "continues after confirmation, retains all pre-confirmation property, and also includes any property the debtor acquires after confirmation." *Id*. The Court rejected this approach, finding that it undermines § 1327 by failing to recognize that § 1327 gives the debtor "an immediate, absolute interest in vested property." *Id* at 732.

The third approach, the conditional vesting approach, provides that the debtor does not obtain an immediate and fixed right to the future enjoyment of estate property until they have fulfilled all plan requirements. *Id*. The Court rejected this approach for similarly diminishing the importance of § 1327. *Id*.

The fourth approach, the estate transformation approach, asserts that the estate includes the property and all future earnings of the debtor that are dedicated to fulfilling the chapter 13 plan, regardless of when the property was acquired. *Id*. The Court rejected this approach, finding no support for it in the plain language of the Bankruptcy Code. *Id* at 733.

Finally, the Court examined the estate replenishment approach, under which pre-confirmation property becomes property of the debtor at confirmation, but post-confirmation property becomes property of the estate. *Id* at 734. The Court adopted this approach, finding it preferable because it (1) avoids creating a distinction between post-confirmation property when the Bankruptcy Code does not support a distinction, (2) honors the "free and clear" language of § 1327, (3) gives effect to § 1306 by including all property acquired post-petition but before case closure, dismissal, or conversion, and (4) clearly distinguishes pre- and post-confirmation property, making it easier to determine property of the debtor and property of the estate. *Id*.

Since the Bankruptcy Court adopted the estate replenishment approach, it held that proceeds from the post-confirmation sale of property were property of the estate. *Id* at 735. The court differentiated sale proceeds from the property sold, reasoning that "treating proceeds as separate property logically results from the differences between sale proceeds and unrealized appreciation." *Id*. Therefore, the proceeds were classified as post-confirmation property and, under the estate replenishment approach, belonged to the estate. *Id*. While *Goetz* and *Marsh* took two very different paths to answer the same question, both resulted in post-petition property appreciation belonging to the estate in the case of conversion to chapter 7 and post-confirmation while remaining in chapter 13.

Ninth Circuit

Post-Confirmation Conversion to Chapter 7

In *Castleman v. Burman* (*In re Castleman*), 75 F.4th 1052 (9th Cir. 2023), the Ninth Circuit determined that post-petition, pre-conversion asset appreciation belongs to the estate under § 348(f)(1)(A). The facts of *In re Castleman* are the same as those of *In re Goetz*, however, the chapter 13 plan in *Castleman* had been confirmed at the time of conversion. Before conversion,

the value of the debtors' home increased, and the debtors argued that the additional equity belonged to them, not the estate. *Id* at 1054-55.

The Ninth Circuit examined this issue by analyzing the plain text of section 348(f)(1)(A). *Id* at 1055. The Ninth Circuit held that section 348 dictates "property of the estate at the time of the original filing that is still in debtor's possession at the time of conversion once again becomes part of the bankruptcy estate," and case law supports that any increases in value are also property of the estate. *Id* at 1058.

Post-petition Appreciation in Chapter 13—Sale

Conversely, in 2019, the Bankruptcy Appellate Panel for the Ninth Circuit ruled that a debtor selling property post-confirmation in a chapter 13 did not have to turn the proceeds over to the estate. *Black v. Leavitt* (*In re Black*), 609 B.R. 518 (B.A.P. 9th Cir. 2019). In *Black*, the debtor's confirmed chapter 13 plan required him to pay $45,000 to unsecured creditors when he sold or refinanced his rental property. *Id*. The property appreciated post-confirmation, the debtor sold the property and proposed to pay the $45,000 to creditors while keeping the excess proceeds. *Id* at 520. The trustee objected, arguing that the proceeds were property of the estate. *Id*. The trustee moved to modify the debtor's chapter 13 plan to require him to turn the excess proceeds over to the estate. *Id*. The Bankruptcy Court held that proceeds from the sale of the debtor's property were property of the estate and must be turned over. *Id* at 521. The Court explained that under § 541(a), proceeds are not exempt from the bankruptcy estate. *Id*.

On appeal, the BAP determined that the proceeds were not disposable income and thus belonged to the debtor, and that the debtor was not required to "commit the excess proceeds from the sale of the Property to pay his general unsecured creditors." *Id* at 527. The BAP explained that precedent in the Ninth Circuit established that "so long as the debtors commit all of their

postpetition disposable income to the plan and meet the other plan confirmation requirements, they get to retain their capital assets, and creditors cannot reach the proceeds." *Id*. Since the debtor met this standard, the court ruled that the debtor was not required to turn over the sale proceeds to the estate. *Id*.

Conversion to Chapter 7 versus Post-Confirmation Sale in Chapter 13

It is interesting to note that the Bankruptcy Court for the Western District of Missouri and the Eighth Circuit Court of Appeals reached the conclusion that post-petition appreciation was property of the estate regardless of whether the analysis was triggered by conversion to chapter 7 or post-confirmation sale of the property. The Ninth Circuit and the Ninth Circuit BAP, on the other hand, reached opposite conclusions finding that the post-petition appreciation at conversion belonged to the estate whereas post-petition appreciation belonged to the debtor in the context of a post-confirmation sale.

Tenth Circuit

Post-Confirmation Conversion to Chapter 7

In *Rodriguez v. Barrera (In re Barrera)*, 22 F.4th 1217 (10th Cir. 2022), the Tenth Circuit allowed the debtor to retain post-petition appreciation upon conversion to chapter 7. In Barrera, the debtor confirmed a chapter 13 plan, but later sold his residence, on which he claimed a homestead exemption, and realized significant non-exempt proceeds as a result of the property's post-petition appreciation. The debtor then converted his case to chapter 7 and the trustee sought to recover the sale proceeds beyond the exempted amount. The Tenth Circuit held that the chapter 7 estate is comprised of the property the debtor had as of the petition date and therefore does not include post-petition appreciation. The Circuit acknowledged a potential conflict between sections

1306 and 1327 of the Bankruptcy Code, but did not address whether the post-petition proceeds would have become part of the estate had the debtor remained in chapter 13.

Post-petition Appreciation in Chapter 13—Sale of Business Interests

In re Klein, 2022 WL 3902822, No. 17-19106 (Bankr. D. Colo. Aug. 23, 2022), the Bankruptcy Court for the District of Colorado addressed head on the conflict between section 1306 and section 1327 with respect to the treatment of post-confirmation property appreciation. The debtors filed for chapter 13 relief scheduling a 12.9% interest in an LLC that owed commercial property. After rounds of objections and plan amendments, the debtors and trustee agreed upon a $15,000 value for the LLC interest. *Id.* at *3. Post-confirmation, the LLC sold the property and the debtors realized over $76,000. The trustee sought turnover of the proceeds and to compel the debtors to modify their plan. *Id.*

Section 1306(a)(1) provides that property of the estate includes property the debtor acquires after the commencement of the case, but before the case is closed. Section 1327(a) provides that once a plan is confirmed, all parties are bound by its terms, and property of the estate vests in the debtor "free and clear of any claim or interest of any creditor provided for by the plan." *Id.* at *4. The trustee argued that the court should apply the "estate replenishment theory" under which the chapter 13 estate continues to exist after the plan is confirmed and is continually replenished by any property acquired postpetition pursuant to § 1306. The court disagreed and followed other courts in the district adopting the "estate termination theory." Under the "estate termination theory," once a plan is confirmed, all estate property revests in the debtor and is no longer part of the bankruptcy estate. *Id*. at 4-5.

While the trustee urged for a different result given that these proceeds resulted from the sale of business interests as opposed to a primary residence, the Court nevertheless found that the

proceeds were from the sale of prepetition property rather than "business earnings" that could be characterized as post-petition income. *Id*. at *6. The Court observed that "[a]ny other conclusion would lead to the absurd result that post-confirmation increases in asset values are required to be paid into a Chapter 13 plan while decreases in asset values do not result in a corresponding reduction of the amount paid into a Chapter 13 plan." *Id*. at *7.

Eleventh Circuit

The Eleventh Circuit has not yet weighed in on the post-petition appreciation of property, but two courts within the Circuit have ruled that post-petition appreciation is not property of the estate.

Post-petition Appreciation Upon Conversion to Chapter 7

The issue of post-petition appreciation upon conversion to chapter 7 was addressed by the Bankruptcy Court for the Northern District of Alabama *Leo v. Burt* (*In re Burt*), Case No. 01-43254-JJR-7, A.P. No. 09-40016-JJR, 2009 WL 2386102 (Bankr. N.D. Ala. July 31, 2009). In *Burt*, the Court held that under the plain meaning of § 348(f)(1), increased equity in property is not property of the estate. *Id*. at 16-17. The court explained that debtors commonly purchase homes and automobiles with post-petition purchase-money secured debt. *Id*. In the event of a conversion, the homes and automobiles purchased are not "property of the estate in the converted case, and any equity, no matter how large, may not be claimed by the Chapter 7 trustee." *Id*. at 17. Therefore, the court explained, "equity in a post-petition asset created by a debtor's payment of a secured debt…[and]… equity in property owned on the filing date" should not be treated differently under section 348(f)(1)(A) and (B). *Id*.

Post-petition Appreciation in Chapter 13—Refinance

The Southern District of Florida was presented the issue of post-petition appreciation in *In re Montenegro*, 655 B.R. 607 (Bankr. S.D. Fla. 2023). The Bankruptcy Court did not address whether the appreciation of debtor's home was an asset of the estate, but instead focused on whether the use and application of said appreciation was permitted as part of a plan modification. The issue before the court was whether the debtor could use the newly appreciated value of her property to refinance and pay off the plan early while keeping the remaining proceeds. *Id*. at 609. The chapter 13 trustee argued that the proceeds were property of the estate and should be distributed to creditors. The court declined to analyze to whom the appreciated value belonged under section 348(f) of the Bankruptcy Code. *Id* at 612. The Court instead found that the refinance met the "best interest of creditors" test, and, therefore, the appreciation belonged to the debtor. *Id* at 613. Accordingly, the Court allowed the debtor to modify her chapter 13 plan to pay off the plan early using proceeds from refinancing her non-exempt real property. *Id*.

It is noteworthy that the Southern District of Florida Bankruptcy Court and the Ninth Circuit BAP both ruled that excess proceeds from post-petition appreciation, either through a sale or refinancing, were not property of the estate and could be retained by a debtor in chapter 13.

First Circuit

Post-petition Appreciation in Chapter 13—Sale Following Strip Down

The First Circuit's decision in *Barbosa v. Soloman*, 235 F.3d 31 (1st Cir. 2000), cited by the *Black, Marsh,* and *Montenegro* courts, involves a confirmed chapter 13 plan that "stripped down" the mortgage on a non-homestead property bifurcating the lender's claim. *Id*. The debtors sought to sell the property post-confirmation and retain the sale proceeds attributable to the post-petition appreciation of the property. The trustee objected, contending that the proceeds belonged

to the estate and should be used to pay unsecured creditors. *Id*. The Bankruptcy Court utilized the "best interest of creditors" test to determine whether the debtor should be entitled to keep proceeds from the sale of their home when the property has appreciated in value post-petition, assessing whether the plan modification was made in good faith. *Id* at 34. The Bankruptcy Court held that the modification did *not* meet the best interest test and was not proposed in good faith if the debtor intended to keep the proceeds while paying less than 10% to unsecured creditors after "obtaining the broad discharge afforded by § 1328(a)." *Id* at 41. The debtor appealed to the District Court and the District Court affirmed. *Id* at 35. The debtor again appealed to the First Circuit Court of Appeals. *Id*.

The First Circuit agreed with the Bankruptcy Court that allowing the debtor to keep the sale proceeds after stripping down the mortgage, "underpay[ing] the unsecured creditors, and obtain[ing] a super discharge under Section 1328(a), … selling the property mortgaged for a price of two times its estimated value for purposes of the 'strip down,' and keeping to himself the excess of the proceeds" would be an abuse of the bankruptcy system. *Id* at 41. The First Circuit held that allowing debtors to keep sale proceeds in this scenario would defeat "Congress' intention to extend the application of the 'ability-to-pay' standard throughout the duration of the plan." *Id*. The First Circuit therefore held that the sale proceeds were property of the estate. *Id*.

Conclusion

The issue of entitlement to post-petition appreciation is currently a "hotter" topic than in the past due to higher, and in some instances still rising, property values than pre-pandemic. Courts at all levels have taken a variety of paths to reach equally varied results, with the only common theme being that the result depends on the precise situation before the court. It generally appears that courts are inclined to find that post-petition appreciation is property of the estate upon

conversion to chapter 7 whereas courts may be more likely to determine that such appreciation is not property of the estate in a chapter 13 sale context.