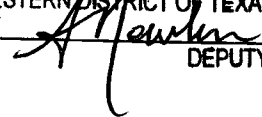


FILED**MAR 10 2017****UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF TEXAS****JOHN PATRICK LOWE,
Chapter 7 Trustee,****Appellant,****v.****KATHY DEBERRY, *et al.*****Appellees.**CLERK, U.S. DISTRICT CLERK
WESTERN DISTRICT OF TEXAS
BY  DEPUTY**Case No: 5:15-cv-1135-RCL****MEMORANDUM OPINION****I. INTRODUCTION**

This case is on appeal from the Bankruptcy Court's October 28, 2015 Order granting the defendants'—appellees here—motions to dismiss. The Chapter 7 trustee, John Patrick Lowe, appeals. The debtors in this case initiated Chapter 7 bankruptcy proceedings and claimed their homestead as exempt under Texas law. After selling their home, the debtors failed to reinvest the proceeds from the sale in another home and made several transfers using the funds. The trustee initiated an adversary proceeding against the debtor, the debtor's wife, the law firm to whom one of the transfers was made, and individual attorneys from the firm to avoid and recover the transfers, arguing that when the homestead sale proceeds were not reinvested within six months, such proceeds became the property of the bankruptcy estate. The Bankruptcy Court granted the defendants' motions to dismiss, finding that the homestead sale proceeds did not lose their exempt character and therefore did not become property of the estate when the debtors failed to reinvest the proceeds.

The issue before this Court is whether the Bankruptcy Court erred in finding that homestead sale proceeds from a homestead claimed as exempt under Texas law and sold post-petition in a Chapter 7 case do not lose their exempt status when a debtor fails to reinvest such proceeds after six months, and therefore do not become property of the bankruptcy estate. The Bankruptcy Court found that the Fifth Circuit's decision in *In re Frost*, 744 F.3d 384 (5th Cir. 2014), did not apply to Chapter 7 cases. In *Frost*, the court held that when a Chapter 13 debtor sold his properly exempted homestead post-petition and failed to reinvest the sale proceeds in another homestead within six months, the proceeds became property of the estate. The Court finds that the Bankruptcy Court erred in holding that *Frost* does not apply to Chapter 7 cases and that the sale proceeds in this case did not become property of the bankruptcy estate when the debtor failed to reinvest them in another homestead within six months. The decision of the Bankruptcy Court will be reversed.

II. FACTS AND HISTORY

A. Underlying Facts

The facts of this case were summarized in the Bankruptcy Court's opinion and remain largely uncontested by the parties. The debtor in this case filed for Chapter 7 bankruptcy relief on February 10, 2014, listing their homestead as exempt under Texas law. *See* Tex. Prop. Code § 41.001(a). Texas law also provides, however, that if a debtor sells his home this exemption only lasts as long as the sale proceeds are reinvested in another homestead within six months of the sale. *See* Tex. Prop. Code § 41.001(c). This is known as the "Texas Proceeds Rule." No creditors filed objections to this exemption.

On September 12, 2014, the debtor filed a motion for authorization to sell the homestead, which was granted by the Bankruptcy Court. In the Order, the Court noted that nothing prohibited

the trustee from seeking to recover the proceeds from the sale to the extent that they were no longer exempt under Section 41.001(c). On September 26, 2014 the debtor received proceeds totaling \$364,592.21, and on September 29, 2014 made the following transfers, deposits, and payments: 1) the proceeds were deposited into a Wells Fargo savings account in the name of the debtor's wife, Kathy DeBerry; 2) Kathy DeBerry transferred \$85,000 from the savings account to a checking account titled in her name; and 3) Kathy DeBerry wrote a \$50,000 check to the law firm Goldstein, Goldstein & Hilley (for the benefit of Gerald Goldstein and Cynthia Orr, appellees here) who had represented the debtor in criminal matters.

The proceeds from the sale were not reinvested in another Texas homestead within six months. The trustee subsequently filed an adversary proceeding, alleging that the above listed transfers were unlawful and seeking to avoid the transfers. Section 549 allows trustee to avoid unauthorized transfers of property of the estate. *See* 11 U.S.C. § 549(a).

Several of the defendants in the adversary proceeding—the debtor and his wife, and Goldstein and Orr—filed motions to dismiss, arguing that proceeds from an exempt homestead's post-petition sale cannot become part of a debtor's estate, and therefore that the transfers were not unauthorized post-petition transfers. The trustee responded that the debtor's failure to reinvest the homestead sale proceeds within six months converted those proceeds into property of the estate, which the trustee was entitled to recover for the benefit of creditors.

B. Bankruptcy Court Decision

The Bankruptcy Court's decision, explained in greater detail below, turned on whether the proceeds became part of the bankruptcy estate after the debtor failed to reinvest them in a new Texas homestead. If so, the transfers were unlawful and avoidable under Section 549. If not, the transfers were not avoidable. The Bankruptcy Court issued its opinion on October 28, 2015

holding that “where a chapter 7 debtor sells his properly exempted Texas homestead post-petition, the proceeds of that sale are not subject to the Texas Proceeds Rule. Here, the Proceeds were never part of Debtor’s chapter 7 bankruptcy estate and thus, the Trustee cannot avoid the purported transfer under § 549.” *In re DeBerry*, No. AP 15-05054, 2015 WL 6528024, at *4 (Bankr. W.D. Tex. Oct. 28, 2015). The court dismissed the trustee’s adversary complaint.

C. Argument on Appeal

The trustee—the appellant here—raises several arguments on appeal, the most relevant of which is that the Bankruptcy Court erred in granting the defendants’ motions to dismiss because, under Fifth Circuit precedent, when the debtor failed to reinvest the homestead sale proceeds within six months, those proceeds became property of the estate. The trustee argues that the *Frost* decision, a Chapter 13 case examined below, applies to Chapter 7 cases such as this one, and that the Bankruptcy Court erred in adopting the reasoning of a pre-*Frost* case. Furthermore, the trustee argues that the trend in other jurisdictions is to allow recovery of proceeds of homestead sales that are not reinvested, just as the Fifth Circuit did in *Frost*. Finally, he argues that the Bankruptcy Court’s decision effectively nullifies Texas’s limits on the homestead exemption.

III. JURISDICTION AND STANDARD OF REVIEW

This Court has jurisdiction to hear this appeal pursuant to 28 U.S.C. § 158(a) which provides that district courts have jurisdiction to hear appeals from final judgments and orders of bankruptcy judges.

The Bankruptcy Court’s findings of fact are reviewed for clear error and conclusions of law are reviewed de novo. *In re Bass*, 171 F.3d 1016, 1021 (5th Cir. 1999). Mixed questions of law and fact are reviewed de novo. *Id.* The Court will review the Bankruptcy Court’s conclusion that *Frost* does not apply to Chapter 7 cases, and that in Chapter 7 cases, when a debtor exempts

his homestead and sells his homestead post-petition but fails to reinvest the sale proceeds within six months, the proceeds belong to the debtor instead of the bankruptcy estate, de novo.

IV. LEGAL STANDARDS

When a debtor files for bankruptcy, “an estate comprising all legal and equitable interests in property (including potentially exempt property) of the debtor as of that date” is created. *In re Zibman*, 268 F.3d 298, 302 (5th Cir. 2001). Debtors may however, claim property as exempt from the bankruptcy estate under either state or federal law. 11 U.S.C. § 522(b). Texas state law allows debtors to claim their homestead as exempt. *See* Tex. Prop. Code § 41.001(a). If a debtor sells his homestead, however, this exemption only lasts as long as the sale proceeds are reinvested in another homestead within six months of the sale. *See* Tex. Prop. Code § 41.001(c). This is known is the “Texas Proceeds Rule.” The issue here is whether, in a Chapter 7 case, the proceeds from the sale of a home, claimed as exempt but sold post-petition, retain their characterization as exempt when the debtor fails to reinvest the proceeds within six months of the sale, or whether those proceeds must be turned over to the trustee.

Because the issues here turn largely on whether a Chapter 13 case applies to Chapter 7 cases, the Court will first summarize the differences between the Chapters. It will then examine Fifth Circuit precedent, concluding with the Chapter 13 case of *Frost*. Finally, it will summarize how courts have interpreted *Frost* in Chapter 7 cases.

A. Chapter 7 vs. Chapter 13

Individual debtors may declare bankruptcy under either Chapter 7 or Chapter 13. Chapter 13 is “wholly voluntary,” benefitting both debtors and creditors by “allowing debtors to retain their assets and entitling creditors to a “debtor’s ‘disposable’ postpetition income.” *Harris v. Viegelahn*, 135 S. Ct. 1829, 1835 (2015). Chapter 7 on the other hand “allows a debtor to make a clean break

from his financial past, but at a steep price: prompt liquidation of the debtor's assets," which are immediately transferred to a bankruptcy estate overseen by a trustee who sells the property and distributes the proceeds to creditors. *Id.* Thus, Chapter 13 and Chapter 7, while similar in certain respects, differ in following ways:

Chapter 7 authorizes a discharge of prepetition debts following the liquidation of the debtor's assets by a bankruptcy trustee, who then distributes the proceeds to creditors. Chapter 13 authorizes an individual with regular income to obtain a discharge after the successful completion of a payment plan approved by the bankruptcy court. Under Chapter 7 the debtor's nonexempt assets are controlled by the bankruptcy trustee; under Chapter 13 the debtor retains possession of his property.

Marrama v. Citizens Bank of Massachusetts, 549 U.S. 365, 367 (2007).

In both circumstances, property of the estate is broadly defined in Section 541, and includes, with certain exceptions, property of the debtor at the time of commencement of the bankruptcy case. *See* 11 U.S.C. § 541(a). In Chapter 13 cases, property of the estate also includes property acquired by the debtor after commencement of the bankruptcy case (post-petition). *See* 11 U.S.C. § 1306(a). Chapter 7 does not contain a companion provision to Section 1306(a)(1); the "property of the estate consists solely of property in existence as of the date of the filing of the Chapter 7 petition." *In re Smith*, 514 B.R. 838, 845 (Bankr. S.D. Tex. 2014).

B. Fifth Circuit Precedent

Four Fifth Circuit cases that have addressed the Texas homestead exemption frame this inquiry: *In re England*, *In re Zibman*, *In re Morgan*, and *In re Frost*. The Court will examine each in turn.

1. *In re England: Ascertaining the Purpose of the Texas Homestead Rules*

Although the Fifth Circuit's decision in *In re England*, 975 F.2d 1168 (1992), did not address the precise issue at hand—whether the proceeds from a post-petition sale of an exempted homestead pass to the bankruptcy estate if not reinvested within six months—it did examine the

policies underlying the Texas homestead exemption and the Texas Proceeds Rule. The court first noted that from its inception, Texas has taken care to provide homestead protection to its residents. *England*, 975 F.2d at 1172. The purpose of the current Texas homestead law “is to secure a place of residence against financial disaster,” thereby preventing homelessness. *Id.* at 1174. The legislature, recognizing that people would at times need to sell their homesteads, passed the six months proceeds exemption statute to temporarily extend this homestead protection in such situations. *Id.* The purpose of the proceeds exemption, however, “was *solely* to allow the claimant to invest the proceeds in another homestead, not to protect the proceeds, in and of themselves.” *Id.* at 1174–84.

2. *In re Zibman: Determining Exemptions Under the Snapshot Rule*

Next, in *In re Zibman*, the Fifth Circuit considered whether debtors could claim as exempt proceeds from the sale of their home completed three months prior to filing their Chapter 7 petition, when they did not reinvest the proceeds in a new home within six months of the date of the sale. *In re Zibman*, 268 F.3d at 300–01. Explaining the “‘snapshot’ approach to determining the extent of the bankruptcy estate and the scope of the exemptions,” the court found that “[a]ny exemptions claimed . . . are determined by the facts and the law as they exist on the date of filing the bankruptcy petition,” but noted that the courts must apply the entire applicable state law. *Id.* at 302, 304. When a debtor claims a state law exemption, “he agrees to take the fat with the lean; he has signed on to the rights . . . but also to the limitations . . . integral in those exemptions as well.” *Id.* at 304.

Thus, the court found that under Texas law, “the 6-month limitation is inextricably intertwined with the exemption the state has chosen to provide for proceeds from the sale of the homestead.” *Id.* It is “an integral feature of Texas’s statutory exemption for proceeds from the sale of a homestead.” *Id.* at 300. When the debtors commenced their Chapter 7 case, they had

already sold their home three months prior and were in possession of the proceeds from the sale. But, when they failed to reinvest the proceeds within the allotted six months, they lost the benefit of the exemption. *Id.* at 305. The court concluded that “[a]llowing the intervening bankruptcy petition to improve the [debtors’] pre-petition exemption by expurgating the 6-month clock and thereby freezing the exemption permanently would not only require a fragmented reading of state law, but would contravene the purpose of the exemption, transforming it into a protection of the proceeds, in and of themselves.” *Id.*

3. *In re Morgan: Applying Zibman*

Next, in *In re Morgan*, the Fifth Circuit considered whether a Chapter 7 debtor properly claimed the exemption when he sold his home post-petition and claimed the exemption post-sale. *See In re Morgan*, 481 F. App’x 183, 184 (5th Cir. 2012). The debtor sold his home on August 6, 2010, and claimed the exemption on February 11, 2011, more than six months later and without reinvesting the proceeds in a new home. *Id.* The debtor argued that “at the time he filed his bankruptcy petition, he owned his homestead, and therefore, the Texas homestead exemption, which has no temporal limitation [Texas Prop. Code § 41.001(a)]—as opposed to the state’s proceeds exemption, which is limited to six months [Texas Prop. Code. § 41.001(c)]—permanently exempt[ed] [his] homestead from the bankruptcy estate.” *Id.* at 185. He argued that when he filed his bankruptcy petition, he owned an interest in his home, not the proceeds of a sale of the home, “and therefore, his homestead was forever exempt . . . regardless of whether he subsequently sold the home before he was discharged in bankruptcy.” *Id.*

The court rejected the debtor’s arguments, finding that “he overlook[ed] the fact that he did not claim a homestead exemption until after he sold his home, and even then, he did not claim any value of his home as exempt until he amended his bankruptcy schedules nearly seven months

after filing his petition, and more than six months after he had sold his homestead.” *Id.* at 185–86. Therefore, when the debtor filed his petition without claiming the Texas homestead exemption, that property became the property of the bankruptcy estate, and when he later sold the home, the proceeds of the sale were the property of the estate. *Id.* at 186. When he then claimed the homestead exemption, “it was against *those proceeds* that [the debtor] had to make his exemption claim.” *Id.* Turning to whether the proceeds were limited by the six month Texas Proceeds Rule, the court, relying on *Zibman*, concluded that the proceeds lost their exempt status after the debtor failed to reinvest the proceeds within six months. *Id.* at 187.

4. *In re Frost: The Proceeds from a Post-Petition Sale of a Homestead not Reinvested within Six Months Becomes Property of the Estate in Chapter 13 Cases*

Finally, in *In re Frost*, the court considered whether proceeds from the sale of a homestead exempted at the time of the petition, and sold post-petition, but which had not been reinvested within six months retained their exempt status or passed to the bankruptcy estate. *See In re Frost*, 744 F.3d 384, 385 (5th Cir. 2014). The court first revisited the “snapshot rule” discussed in *Zibman*, which “holds that all exemptions are determined at the time the bankruptcy petition is filed, and that they do not change due to subsequent events.” *Id.* at 386. It then found that, although the character of the asset as a homestead was “an essential element of the exemption [that] must continue in effect even during the pendency of the bankruptcy, . . . [o]nce [the debtor] sold his homestead, the essential character of the homestead changed from ‘homestead’ to ‘proceeds,’ placing it under section 41.001(c)’s six month exemption.” *Id.* at 387. Thus, when the debtor did not reinvest the proceeds from the sale, they were removed from the protection of the law and no longer remained exempt. *Id.*

The court rejected the debtor’s argument that *Zibman* was distinguishable because it concerned proceeds obtained prior to filing the bankruptcy petition, whereas he sold his home after

declaring it exempt at the time of the petition. *Id.* It found that “[t]he court’s insistence that an ‘essential element of the exemption must continue in effect even during the pendency of the bankruptcy case’ indicates that a change in the character of the property that eliminates an element required for the exemption voids the exemption, even if the bankruptcy proceedings have already begun.” *Id.* at 388. Therefore, the sale of the home voided the homestead exemption in Section 41.001(a), and the failure to reinvest voided the proceeds exemption in Section 41.001(c). *Id.* The court held that the proceeds from the sale of the debtor’s homestead that had not been reinvested within six months passed to the bankruptcy estate. *Id.* at 384.

C. Application of *Frost* to Chapter 7 Cases

Although not mentioned in the opinion itself, *Frost* was a Chapter 13 case. Courts encountering the same issue present in *Frost*—whether a debtor, who has claimed the Texas homestead exemption at the time of the petition, and who has sold his or her home after claiming the exemption, may retain the proceeds of the sale if they have not been reinvested within six months—have failed to agree on whether *Frost* controls in a Chapter 7 case. *See In re Wiggains*, 535 B.R. 700, 709 (Bankr. N.D. Tex. 2015), *aff’d sub nom. Matter of Wiggains*, No. 15-11249, 2017 WL 598507 (5th Cir. Feb. 14, 2017) (“The issue is somewhat murky and appears to be unsettled in the chapter 7 context—at least where the house is: (a) timely scheduled as exempt; and (b) then sold postpetition.”).¹ Two cases have considered this question and have come to opposite conclusions. Before examining these cases, the Court will list the provisions of the

¹ Although acknowledging that the issue was “murky,” the *Wiggains* court found it “[did] not ultimately need to determine this difficult issue of whether the Texas Proceeds Rule applies in Chapter 7, where such homestead has been timely scheduled as exempt and then sold postpetition, since the court believes that the time period for the NonFiling Spouse to reinvest into a new Texas homestead any Homestead Net Sale Proceeds to which she was entitled was *equitably tolled* pursuant to the terms of the Sale Order that was entered on September 11, 2013.” *Wiggains*, 535 B.R. at 709–10 (emphasis in original).

Bankruptcy Code that these decisions reference or rely on. Sections 1306 and 1327 are only applicable to Chapter 13 cases.

- Section 541(a)(1): “The commencement of a case . . . creates an estate. Such estate is comprised of all the following property, wherever located and by whomever held: (1) . . . all legal or equitable interests of the debtor in property as of the commencement of the case.” 11 U.S.C. § 541(a)(1).
- Section 541(a)(6): “The commencement of a case . . . creates an estate. Such estate is comprised of all the following property, wherever located and by whomever held: . . . (6) Proceeds, product, offspring, rents, or profits of or from property of the estate.” 11 U.S.C. § 541(a)(6).
- Section 522(c): “[P]roperty exempted under this section is not liable during or after the case for any debt of the debtor that arose . . . before the commencement of the case.” 11 U.S.C. § 522(c).
- Section 1306(a): “Property of the estate includes, in addition to the property specified in section 541 of this title . . . all property . . . that the debtor acquires after the commencement of the case.” 11 U.S.C. § 1306(a).
- Section 1306(b): “Except as provided in a confirmed plan or order confirming a plan, the debtor shall remain in possession of all property of the estate.” 11 U.S.C. § 1306.
- Section 1327(b): “Except as otherwise provided in the plan or the order confirming the plan, the confirmation of a plan vests all of the property of the estate in the debtor.” 11 U.S.C. § 1327(b).

In sum, the commencement of a bankruptcy case under either Chapter 7 or 13 creates an estate consisting of the debtor’s property as of commencement of the case (Section 541(a)(1)). This also includes proceeds from property of the estate (Section 541(a)(6)). Debtors may claim exemptions, under either state or federal law, and property that is exempted is not liable for the payment of debts that arose prior to commencement of the bankruptcy case (Section 522(c)). In Chapter 13 cases, property of the estate includes property acquired by the debtor after commencement of his or her bankruptcy case (Section 1306(b)). In addition, in Chapter 13 cases, debtors remain in possession of all property of the estate and confirmation of a bankruptcy plan

vests all property of the estate in the debtor, unless provided otherwise in the plan or in a court order (Sections 1306(b), 1327(b)).

The Court now turns to the two cases that have addressed the question at hand, as well as the decision of the Bankruptcy Court below.

1. In re Smith: Frost Applies to Chapter 7 Cases

First, the court in *In re Smith*, 514 B.R. 838 (Bankr. S.D. Tex. 2014) held that *Frost* applies to Chapter 7 cases. The *Smith* court first reviewed the history and policies of the Texas Proceeds Rule, finding that “[t]he termination of the safe harbor period after six months . . . reflects the Texas legislature’s attempt to balance two competing public policies—the need to minimize homelessness versus the need to afford creditors the opportunity to collect on their debts.” *In re Smith*, 514 B.R. at 843. The court then turned to the debtor’s argument that because Chapter 7 does not contain a provision similar to Section 1306(a)(1), which states that property of the estate includes property acquired post-petition, there is no way that property exempted after a Chapter 7 petition could later become property of the estate. The court first examined application of the snapshot rule, finding that although the debtor timely and properly exempted his homestead pursuant to Section 41.001, that exemption contains a condition: the six month rule, which provides that the proceeds from the sale of a homestead lose their exempt status if not reinvested within six months. *Id.* at 847–48. Therefore, “on the date of the filing of the Debtor’s Chapter 7 petition, the property of his bankruptcy estate *included a non-exempt asset that was both prospective and contingent*; namely, all proceeds from any future sale of the Property that the Debtor did not use within six months of the sale to purchase a new homestead.” *Id.* at 848 (emphasis added). The court thus concluded, given that the property of the estate did in fact include a non-exempt asset under the snapshot rule, that “the Debtor’s argument that the Proceeds

are not ‘property of the estate’ because Chapter 7 lacks a companion provision to § 1306(a)(1) is unavailing.” *Id.*

Furthermore, the *Smith* court found that *Frost* on its face is not limited to Chapter 13 cases. *Frost* did not mention Section 1306(a)(1) as a basis on its decision, but rather focused on the meaning of Section 41.001 of the Texas Property Code, which is equally applicable in Chapter 7 cases. *Id.* As previously explained by the Fifth Circuit in *Zibman*, “if a debtor chooses to exempt his homestead under Texas law, he must accept § 41.001 in its entirety,” which includes the six month rule. *Id.* at 848–49. The *Smith* court found that the Fifth Circuit, in both *Zibman* and *Morgan* (summarized above), “had already held that the 6–Month Rule applies in Chapter 7 cases.” *Id.* at 849. The court therefore concluded that both *Frost* and *Zibman* applied to the Chapter 7 case before it, that the six month rule applies in such Chapter 7 cases, and that the trustee was entitled to recover the sale proceeds from the debtor. *Id.* at 850.

2. *In re Montemayor: Frost Does Not Apply to Chapter 7 Cases*

The Court in *In re Montemayor*, 547 B.R. 684, 706 (Bankr. S.D. Tex. 2016), came to the opposite conclusion. After surveying the Fifth Circuit cases above, as well as several pre- and post-*Frost* district court decisions,² the court found that the “cases demonstrate a dichotomy of holdings within Texas bankruptcy courts, but show a consistent approach by the Fifth Circuit in a variety of differing factual scenarios.” *In re Montemayor*, 547 B.R. at 706. The consistent approach, as summarized by the *Frost* court is that “(i) the sale of the homestead void[s] the homestead exemption and (ii) the failure to reinvest the proceeds within six months void[s] the proceeds exemption, regardless of whether the sale occurred pre- or post-petition.” *Id.* However, the *Montemayor* court then found that both *Zibman* and *Morgan* were distinguishable because in

² The Court notes that one such opinion relied on by the *Montemayor* court was the decision of the Bankruptcy Court in this case, which this Court now reverses.

Zibman the debtors sold their home pre-petition, and then tried to exempt the proceeds, and in *Morgan* the debtor attempted to exempt the homestead proceeds after selling the home. *See id.* In *Montemayor*, the debtor property exempted his homestead, not the proceeds from the sale. *See id.*

The Court then found that *Frost* was also distinguishable based on facts from the underlying bankruptcy case. *Id.* *Frost* was a Chapter 13 bankruptcy, and Chapter 13 bankruptcies have rules and features different from Chapter 7. *See id.* at 707–08. Specifically, Section 1327 states that “[e]xcept as otherwise provided in the plan or the order confirming the plan, the confirmation of a plan vests all of the property of the estate in the debtor.” 11 U.S.C. § 1327(b). Thus, the debtor in *Frost*’s “exempted homestead, while proper, remained property of the estate until the exempted homestead fully vested back in [the debtor] upon discharge.” *Montemayor*, 547 B.R. at 708.

Next, the court considered the appropriate code section to analyze the impact of the Texas Proceeds Rule on the debtor’s homestead sales proceeds: Section 1306, as after-acquired property, or Section 541(a)(6), as proceeds of property of the estate. *Id.* at 709. It found that the implied analysis in *Frost* derived from 11 U.S.C. § 541(a), which states that the commencement of a case creates an estate comprised in part of proceeds from property of the estate, because “the homestead, despite its exemption, had not vested in the debtor and was still property of the chapter 13 estate at the time the exemption was claimed through the time the statutory six-month provision terminated.” *Id.* at 709. Considering Section 1327, which provides that the confirmation of a plan vests all property of the estate in the debtor, 11 U.S.C. § 1327(b), under this Section 541(a) framework, the court found that “the outcome of *In re Frost* becomes a much clearer standard to apply.” *Id.* Under Section 1327, “the homestead never truly left the chapter 13 estate, because it was exempt but would not vest in the debtor until the resolution of either an order granting plan

confirmation *or*, . . . completion of all plan payments under the plan and the entry of an order of discharge.” *Id.* at 710. The proceeds from the sale thus “did not revert to the bankruptcy estate as much as the exemption “evanesced by operation of law,” like the debtor’s exempted proceeds in *Zibman*, and, as such became non-exempt property of the estate rather than exempt property of the estate.” *Id.* In sum, once the six month limitation expired, the proceeds “reverted to their initial status as property of the chapter 13 estate and . . . [were] eligible for distribution to creditors.” *Id.* at 711. The *Montemayor* court concluded that, under this framework, the *Frost* holding does not apply in Chapter 7 cases. *Id.* at 713. It also rejected the *Smith* court’s analysis regarding Section 1306 due to its own finding that the appropriate provision to analyze was Section 541:

[Section] 1306 is not the only avenue for Frost’s distributed proceeds to have reverted to property of the chapter 13 estate. In this Court’s opinion, the more persuasive argument is that Frost’s distributed proceeds were exempted, but, pursuant to the chapter 13 plan, remained property of the estate, having not fully reverted in the debtor, until the point at which the temporal exemption expired. At the moment the exemption lapsed, the distributed proceeds were simply reclaimed by the chapter 13 estate by operation of § 541(a)(6). Furthermore, the key section that permitted this retention to occur is § 1327(b) and, importantly, there is no similar provision applicable in a chapter 7 bankruptcy that constrains the transfer of property from the bankruptcy estate back to the debtor upon exemption or the loss thereof. . . . Thus, Frost’s proceeds, once the exemption had lapsed, are no different than those of the debtors in *Zibman*, *Morgan*, or *England*, where each had been effectively only, at best, contingently exempt by operation of the Proceeds Rule and compliance thereto.

Id. at 712.

The *Montemayor* court thus held that because the debtor sold his homestead that had been properly exempted without objection, “the exemption of the homestead was final and, giving the full effect to § 522(c), the homestead was exempted from pre-petition liability because, unlike the debtor in *Frost*, the homestead was no longer property of the chapter 7 estate.” *Id.* at 713 (citing 11 U.S.C. § 522(c), which states “property exempted under this section is not liable during or after the case for any debt of the debtor that arose . . . before the commencement of the case”). Thus, under Section 522(c), regardless of the fact that the debtor violated the requirements of Section

41.011(c), the “[d]ebtor’s exempted homestead, and necessarily its proceeds, [were] ‘withdrawn from the estate (and hence its creditors),’” and therefore the debtors were free to retain the proceeds from the post-petition, post-exemption sale. *Id.* at 713.

3. *In re DeBerry: The Bankruptcy Court Below Holds that Frost Does not Apply to Chapter 7 Cases*

The Bankruptcy Court in this case, which issued its decision after *Smith* but before *Montemayor*, came to the same ultimate conclusion as the *Montemayor* court, holding that “where a chapter 7 debtor sells his properly exempted Texas homestead post-petition, the proceeds of that sale are not subject to the Texas Proceeds Rule,” and therefore do not become property of the bankruptcy estate. *In re DeBerry*, 2015 WL 6528024, at *4.

The court first summarized the same Fifth Circuit precedent this Court has examined—*England*, *Zibman*, *Morgan*, and *Frost*. *Id.* at *2–3. It found, however, that none of these cases constituted controlling precedent. *Frost* was a Chapter 13 case, and, under Chapter 13, “post-petition property is included in property of the estate—even if the funds are received from exempt sources.” *Id.* at *3. Therefore, because *Frost* concerned a Chapter 13 debtor, and because *Zibman* and *Morgan* concerned debtors who exempted the proceeds of a Texas homestead rather than the homestead itself, they were all distinguishable. *Id.*

Therefore, the Court examined two Texas bankruptcy court decisions that considered whether the Texas Proceeds Rule applies in Chapter 7 cases where the debtor sold his homestead post-petition. *Id.* First, in *In re D’Avila*, a pre-*Frost* case, the court “held that when a Texas homestead itself is held as of the petition date and as of the date exemption is claimed, the Texas Proceeds Rule is not implicated and the proceeds are not subject to later recovery by the bankruptcy estate.” *Id.* (citing *In re D’Avila*, 498 B.R. 150, 159 (Bankr. W.D. Tex. 2013)). As explained

above, the court in *In re Smith* applied *Frost* to Chapter 7 cases and came to the opposite conclusion. *Id.* (citing *In re Smith*, 514 B.R. at 840).

The Bankruptcy Court below adopted the *D'Avila* reasoning, comparing Section 1306(a), which states that “[p]roperty of the estate includes . . . all property . . . that debtor acquires after the commencement of the case,” with Section 541(a)(1), which states that “[a]n estate is comprised of ‘all legal and equitable interests of the debtor in property as of the commencement of the case,’” and concluding that “[u]nlike in a chapter 13, property of the chapter 7 bankruptcy estate does not include funds acquired post-petition.” *Id.* Because “the homestead itself was held as of the petition date and as of the date the exemption was claimed. As such, the Texas Proceeds Rule is not implicated—it is not ‘necessarily pictured’ in the post-petition snapshot.” Therefore the Court held that *Frost* did not apply and that the proceeds of a post-petition sale of an exempted homestead are not subject to the Texas Proceeds Rule in Chapter 7 cases. *Id.* at *4.

V. ANALYSIS

This Court finds persuasive the reasoning of the *Smith* court and holds that *Frost* applies in Chapter 7 cases such as this one. First, nothing in *Frost* itself limits its holding to Chapter 13. Chapter 13 is not mentioned at all in the opinion, nor are any Chapter 13 provisions relied on by the court in coming to its conclusion. The only section of the Bankruptcy Code examined by the *Frost* court is Section 522, which applies to both Chapter 7 and Chapter 13 cases. The court found that interpreting Section 522(c) under *Zibman* to mean that “the failure to reinvest the proceeds within six months voided the proceeds exemption, regardless of whether the sale occurred pre- or post-petition” was in accordance with the policies underlying the Texas Proceeds Rule. *See Frost*, 744 F.3d at 388. There is no indication that Section 522 was or should be interpreted differently based on whether a case is brought under Chapter 7 or 13.

In addition, the *Frost* opinion analyzes Section 41.001 of the Texas Property Code, finding that when the debtor “sold his homestead, the essential character of the homestead changed from ‘homestead’ to ‘proceeds,’ placing it under section 41.001(c)’s six month exemption. Because he did not reinvest those proceeds within that time period, they are removed from the protection of *Texas bankruptcy law* and no longer exempt from the estate.” *Frost*, 744 F.3d at 387 (emphasis added). Again, there is no indication that this provision of Texas law should be applied differently in Chapter 7 cases.

Furthermore, the Court finds that the snapshot rule, as explained in *Zibman*, directs the same outcome even where the homestead is sold post-petition. As explained by the *Smith* court, the Texas homestead exemption contains an explicit exception: although the homestead is exempt, and the proceeds from a sale of the homestead retain that exemption temporarily, the sale proceeds lose their exempt status if not reinvested within six months. *See Smith*, 514 B.R. at 847–48. *Zibman* instructs that “it is the *entire* state law applicable on the filing date that is determinative” and that “[c]ourts cannot apply a juridical airbrush to excise offending images necessarily pictured in the petition-date snapshot.” *In re Zibman*, 268 F.3d at 304. The state law here—Section 41.001 of the Texas Property Code—contains the following “inextricably intertwined” and “integral component”: if the homestead sale proceeds are not reinvested in another homestead within six months, they lose their status as exempt. *See id.* at 300, 304. At the time of the petition “snapshot” in this case, the debtor had claimed the Texas homestead exemption, which necessarily includes the six month sale proceeds limitation. As the *Smith* court found, “on the date of the filing of the [d]ebtor’s Chapter 7 petition, the property of his bankruptcy estate *included a non-exempt asset that was both prospective and contingent*; namely, all proceeds from any future sale of [his

homestead] that the [d]ebtor did not use within six months of the sale to purchase a new homestead.” *Smith*, 514 B.R. at 848 (emphasis added).

Finally, the Court finds that the policy goals underlying the Texas statute direct this result. Although the Texas homestead exemption seeks to prevent homelessness, the six month period during which the proceeds remain exempt is meant “*solely* to allow the claimant to invest the proceeds in another homestead, *not to protect the proceeds*, in and of themselves.” *England*, 975 F.2d at 1174–75 (emphasis added). The termination of exemption after six months thus “reflects the Texas legislature’s attempt to balance two competing public policies—the need to minimize homelessness versus the need to afford creditors the opportunity to collect on their debts.” *Smith*, 514 B.R. at 843. Allowing a Chapter 7 debtor to retain the proceeds of a homestead sale in direct contravention of Section 41.001(c) would defeat such a policy and produce inequitable results, particularly when Chapter 13 debtors in identical situations are not permitted to retain such proceeds. It would effectively read the six month limitation out of the statute in Chapter 7 cases.


For these reasons, the Court finds that *Frost* applies to Chapter 7 cases and that where a debtor claims his homestead as exempt under Section 41.001 of the Texas Property Code, then sells that homestead post-petition and fails to reinvest the proceeds in another homestead within six months, the homestead proceeds lose their exempt status and become part of the bankruptcy estate reachable by the trustee. The Court therefore finds that the Bankruptcy Court erred in holding otherwise and will reverse the decision of the Bankruptcy Court.

VI. CONCLUSION

For the foregoing reasons, the Court finds that the Bankruptcy Court erred in holding that *Frost* does not apply to Chapter 7 cases, and that where a Chapter 7 debtor sells his exempted Texas homestead post-petition, the proceeds of that sale not reinvested in another homestead

within six months belong to the debtor. The complaint states a claim plausible on its face and the Bankruptcy Court erred in granting the defendants' motions to dismiss. The Court will reverse the decision of the Bankruptcy Court. A separate Order accompanies this Memorandum Opinion.

Date: March 10, 2017



Royce C. Lamberth
United States District Judge