

**UNITED STATES DISTRICT COURT FOR THE CENTRAL DISTRICT OF
CALIFORNIA**

In re Marcus Albert Romero and Natalia Victoria Romero

In re Romero · No. 5:23-cv-01010-FLA; 5:23-cv-01907-FLA; bankruptcy case 6:22-bk-12942-WJ · Decided
March 27, 2025

OPINION

In Re: Marcus Albert Romero and Natalie Victoria Romero
PER CURIAM.

1 JS-6 2 3 4 5 6 7

8 UNITED STATES DISTRICT COURT

9 CENTRAL DISTRICT OF CALIFORNIA

10 11 IN RE MARCUS ALBERT ROMERO Case No. 5:23-cv-01010-FLA AND NATALIA
VICTORIA Case No. 5:23-cv-01907-FLA 12 ROMERO, Case No. 6:22-bk-12942-WJ 13
Appellants.

ORDER AFFIRMING

14 BANKRUPTCY COURT’S MAY 2

15 AND SEPTEMBER 8, 2023 ORDERS

16

17 RULING

18 Appellants and Debtors Marcus Albert Romero and Natalia Victoria Romero 19 (“Appellants”
or “Debtors”) appeal Orders by the United States Bankruptcy Court for 20 the Central District of
California (the “Bankruptcy Court”) in Case No. 6:22-bk- 21 12942-WJ (the “Bankruptcy
Action,” or “Bankr. Case 22-12942”). Dkts. 8, 26. The

22 Chapter 7 Trustee of Appellants’ Bankruptcy Estate, Todd A. Frealy (“Appellee” or
23 the “Trustee”), requests this court affirm the Bankruptcy Court’s Orders. Dkts. 9, 27. 24 On
October 12, 2023, the court consolidated these two appeals, with Case 5:23-cv- 25 01010-FLA
designated the lead case. Dkt. 21.1 The court finds these appeals 26 27 1 All citations to the
docket shall be to Case 5:23-cv-01010-FLA unless specified 28 otherwise. 1 appropriate for
resolution without oral argument. Fed. R. Civ. P. 78(b); Local Rule 7- 2 15. 3 For the reasons
stated herein, the court AFFIRMS the Bankruptcy Court’s May 4 2 and September 8, 2023 Orders
and DISMISSES the subject appeals.

5 BACKGROUND

6 On August 4, 2022, Debtors filed a Voluntary Petition for Bankruptcy 7 (“Bankruptcy Petition”),
requesting relief under chapter 7 of the United States 8 Bankruptcy Code.² Bankr. Case 22-12942,
Dkt. 1. Debtors’ Official Form 106A/B 9 (Schedule A/B) listed assets including a single-family
home located at 45119 10 Riverstone Court, Temecula, California (the “Residence”), which they

valued at 11 \$1,254,300. EOR 00022.3 Pursuant to California Code of Civil Procedure § 704.730 12 (“CCP § 704.730”), Debtors claimed a homestead exemption on their Official Form 13 106C (Schedule C) of \$53,464.40, EOR 00031, which they amended to \$558,000, on 14 February 17, 2023, EOR 00297.

15 Debtors’ Official Form 106D (Schedule D) identified the following creditors 16 with secured claims against the Residence, in order of priority: 17 1. Chase Bank: first deed of trust of \$521,585.60; 18 2. Cenlar Mortgage: second deed of trust of \$258,223.00; 19 3. Financial Casualty and Surety (“FCS”): third deed of trust of 20 \$250,000.00; 21 4. Internal Revenue Service: first federal tax lien of \$48,673.00; and 22 5. Internal Revenue Service: second federal tax lien of \$122,354.00. 23 EOR 00033–35, 93; Dkt. 8 (Debtors’ Opening Br.) at 5; Dkt. 9 (Tr. Answering Br.) at 24 7–8. The parties additionally state the Riverside County Tax Collector is owed 25 2 All statutory references shall be to title 11 of the United States Code (the 26 “Bankruptcy Code”) unless specified otherwise. 27 3 The Excerpts of Record (“EOR”) were filed as Dkts. 8-1 through 8-4, 10, 26-1, and 28 28. 1 \$6,625.25 in property taxes. Dkt. 8 at 5; Dkt. 9 at 10. These liens total 2 \$1,207,460.60. 3 On February 10, 2023, the Trustee filed in the Bankruptcy Action: (1) a Motion 4 to Approve Stipulation with Secured Creditor Financial Casualty Surety, Inc. 5 Regarding Treatment of Secured Claim in Connection with Sale of Estate Property ... 6 (the “Compromise Motion,” EOR 00149–55); and (2) an Objection to Debtors’ Claim 7 of Exemption (the “Objection to Exemption,” EOR 00156–217). In the Compromise 8 Motion, the Trustee stated he had reached an agreement with FCS whereby FCS 9 consented to a sale of the Residence on the condition that FCS receive 60% of the 10 proceeds encumbered by FCS’ deed of trust from the sale of the Residence, after the 11 first and second deeds of trust, the costs of sale, and any unpaid real property taxes 12 were paid, with the remaining 40% to be a carve-out for the benefit of the bankruptcy 13 estate. EOR 00150. The Objection to Exemption sought to disallow Debtors’ claim 14 of a homestead exemption concerning the Residence, on the grounds that California’s 15 exemption laws do not protect property from the enforcement of consensual liens. 16 On February 14, 2023, Debtors filed a Motion for Order to Compel 17 Abandonment of Property of the Estate (the “Abandonment Motion”), requesting the 18 Bankruptcy Court compel the Trustee to abandon the Residence on the grounds there 19 was no remaining equity after payment of the secured claims and tax liens, and that 20 the Residence was of inconsequential value and benefit to the bankruptcy estate. EOR 21 00218–94. 22 These matters came to hearing on March 7 and May 2, 2023. EOR 00002, 572– 23 621. After considering the parties’ arguments, the Bankruptcy Court issued a tentative 24 ruling granting the Compromise Motion, denying the Abandonment Motion, and 25 sustaining in part the Objection to Exemption. EOR 00592–603, 615–20. The 26 Bankruptcy Court noted Debtors over-encumbered the Residence with three 27 mortgages voluntarily, such that there was no remaining equity to which the 28 homestead exemption could attach. EOR 00592–93. The Bankruptcy Court further 1 noted the Trustee acted within his fiduciary duties by entering into the agreement with 2 FCS to recover money for the benefit of

unsecured creditors, that FCS acted within its 3 rights by assigning a portion of the proceeds of its secured lien to the bankruptcy 4 estate, and that the assignment would provide a meaningful recovery for the unsecured 5 creditors. EOR 00593–96, 599–600, 615–17. 6 On May 2, 2023, the Bankruptcy Court issued an order adopting the findings of 7 fact and conclusions of law from the March 7 and May 2, 2023 hearings and: (1) 8 granting the Trustee’s Compromise Motion; (2) denying Debtors’ Abandonment 9 Motion; and (3) sustaining in part the Trustee’s Objection to Exemption, finding 10 “[t]he homestead exemption of the Debtors attaches to any and all net sales proceeds 11 of the home (after payment of all secured claims, real estate taxes, closing costs, etc.) 12 but does not attach to any sales proceeds attributable to the portion of the consensual 13 lien of [FCS] which FCS assigned to the bankruptcy estate for the benefit of creditors 14 pursuant to the stipulation approved by the [Bankruptcy] Court.” EOR 00002. 15 On August 15, 2023, the Trustee filed a Motion for Order: (1) Authorizing Sale 16 of Estate’s Right, Title and Interest in Real Property Free and Clear of Liens...; (2) 17 Approving Overbid Procedure; (3) Approving Payment of Real Estate Brokers’ 18 Commissions and Related Closing Costs; and (4) Finding Purchasers are Purchasers in 19 Good Faith (the “Sale Motion”). EOR 00634–753. The Sale Motion came to hearing 20 on September 5, 2023, and the Bankruptcy Court granted the Sale Motion on 21 September 8, 2023. EOR 00780–81, 785–807.

22 Debtors appeal the Bankruptcy Court’s May 2 and September 8, 2023 Orders.

23 MAY 2, 2023 ORDER

24 I. Issues 25 1. Whether there was a compromise between the Trustee and FCS under Fed. 26 R. Bankr. P. 9019 (“Rule 9019”), and whether the Bankruptcy Court abused its discretion in approving the compromise. 27

2. Whether Debtors’ homestead exemption attaches to the portion of FCS’

28 recovery from the sale of the Residence that FCS carved out/assigned to the 1 bankruptcy estate under its compromise with the Trustee. 2 3. Whether the Residence should have been abandoned given the Residence was over-encumbered and Debtors’ homestead exemption, or whether the 3 Trustee was able to sell the Residence lawfully based on the compromise 4 with FCS.

5 Dkt. 8 at 10; Dkt. 9 at 2–3.

6 II. Legal Standard 7 On appeal, a district court “review[s] the bankruptcy court’s findings of fact 8 under the ‘clearly erroneous’ standard and its conclusions of law de novo.” *In re A & 9 C Props.*, 784 F.2d 1377, 1380 (9th Cir. 1986). A bankruptcy court’s decision to 10 approve or deny a compromise or to authorize or deny abandonment is reviewed for 11 abuse of discretion. *Id.*; *In re Johnston*, 49 F.3d 538, 540 (9th Cir. 1995). “The 12 determination of a homestead exemption based on undisputed facts is a legal 13 conclusion interpreting statutory construction which is reviewed de novo.” *In re 14 Chappell*, 373 B.R. 73, 76 (B.A.P. 9th Cir. 2007). “Whether property is included in a 15 bankruptcy estate is a question of law also subject to de novo review.” *Id.* 16 “A bankruptcy court abuses its discretion when it applies the incorrect legal rule 17 or its

application of the correct legal rule is ‘(1) illogical, (2) implausible, or (3) without support in inferences that may be drawn from the facts in the record.’” In re 19 20 4 Debtors identify this Issue as: “Whether the bankruptcy court erred in entering an order on the Chapter 7 trustee’s objection to the Debtors’ homestead exemption when 21 the motion stated no actual objection to the exemption claimed and the ruling was 22 nothing more than an advisory opinion from the bankruptcy court about how funds should be dispersed upon a future sale of the Debtors’ residence which was in 23 violation of the Code, Tillman, and Jevic by ruling that the Trustee did not have to pay 24 the Debtors’ homestead exemption from the sale proceeds.” Dkt. 8 at 10. Debtors’ statement does not accurately describe the Issue presented, for reasons including that 25 Debtors do not provide any argument or legal authority to support their assertions that 26 the Objection to Exemption “stated no actual objection to the exemption claimed” and the Bankruptcy Court’s ruling on the Objection to Exemption was an advisory 27 opinion. See Dkts. 8, 11. This encapsulation of the Issue more properly captures the 28 issue raised and argued by the parties in this appeal. 1 KVN Corp., 514 B.R. 1, 5 (B.A.P. 9th Cir. 2014) (quoting *United States v. Loew*, 593 F.3d 1136, 1139 (9th Cir. 2010)). A determination by the bankruptcy court that rests 3 on an erroneous interpretation of law constitutes an abuse of discretion per se. In re 4 Debbie Reynolds Hotel & Casino, Inc., 255 F.3d 1061, 1065 (9th Cir. 2001). 5 III. Discussion 6 A. The Basic System of Priority for Distributing Assets of the Estate, the 7 Homestead Exemption, and Carve-Out Agreements 8 “Under § 704(a)(1), a chapter 7 trustee has the duty to ‘collect and reduce to 9 money the property of the estate for which such trustee serves....’” KVN, 514 B.R. at 10 5 (citing 11 U.S.C. § 704(a)(1)). “To fulfill this duty, the trustee’s primary job is to 11 marshal and sell the assets, so that those assets can be distributed to the estate’s 12 creditors.” Id. (quotation marks and citations omitted). “Indeed, a core power of a 13 bankruptcy trustee under § 363(b) is the right to sell ‘property of the estate’ for the 14 benefit of a debtor’s creditors.” Id. 15 A bankruptcy trustee may sell property of the estate “free and clear of any 16 interest in the property of an entity other than the estate” if: 17 (1) applicable nonbankruptcy law permits sale of such property free 18 and clear of such interest;

(2) such entity consents;

19

(3) such interest is a lien and the price at which such property is to be

20 sold is greater than the aggregate value of all liens on such property; 21

(4) such interest is in bona fide dispute; or

22 (5) such entity could be compelled, in a legal or equitable proceeding, 23 to accept a money satisfaction of such interest. 24 11 U.S.C. § 363(f). 25 “The [Bankruptcy] Code ... sets forth a basic system of priority, which 26 ordinarily determines the order in which the bankruptcy court will distribute assets of 27 the estate.” *Czyzewski v. Jevic Holding Corp.*, 580 U.S. 451, 457 (2017) (erroneously 28 cited by Debtors as *Cryzewski v. Jevic Holding Corp.* (see, e.g., Dkt. 8 at 3)). 1 “Secured creditors are highest on the priority list, for they must receive the proceeds 2 of the

collateral that secures their debts.” Id. (citing 11 U.S.C. § 725). “Special 3 classes of creditors, such as those who hold certain claims for taxes or wages, come 4 next in a listed order.” Id. (citing 11 U.S.C. §§ 507, 726(a)(1)). “Then come low- 5 priority creditors, including general unsecured creditors.” Id. (citing 11 U.S.C. 6 §726(a)(2)). 7 “[I]n some circumstances, a debtor may exempt property from the bankruptcy 8 estate, thereby removing it from the bankruptcy estate.” In re Tillman, 53 F.4th 1160, 9 1163 (9th Cir. 2022). “In such circumstances, the debtor generally retains the exempt 10 property, and the exempt property cannot be used by the bankruptcy estate to satisfy 11 the claims of unsecured creditors.” Id. (citing Owen v. Owen, 500 U.S. 305, 308 12 (1991)). “Section 522 of the Bankruptcy Code enumerates exemptions available to an 13 individual debtor in bankruptcy, but § 522(b)(1) also authorizes state legislatures to 14 ‘opt out’ of the § 522 exemption scheme and provide their own exemption schemes.” 15 Id. “‘If a State opts out, then its debtors are limited to the exemptions provided by 16 state law.’” Id. (quoting Owen, 500 U.S. at 308). 17 “California has opted out of the federal bankruptcy exemption scheme, so its 18 debtors claim exemptions under state law.” In re McKee, 90 F.4th 1244, 1247 (9th 19 Cir. 2024) (citing Cal. Code Civ. Proc. § 703.130). “California’s homestead 20 exemption laws are set forth in Article 4 (§§ 704.710 through 704.850) and Article 5 21 (§§ 704.910 through 704.995) of Title 9 (Enforcement of Judgments), Division 2, 22 Chapter 4 of the [California Code of Civil Procedure].” In re Kelley, 300 B.R. 11, 17 23 (B.A.P. 9th Cir. 2003). Debtors claim the Article 4 “automatic” homestead exemption 24 here, pursuant to California Code of Civil Procedure § 704.730. EOR 00031; Dkt. 8 25 at 18. “That exemption protects a debtor who resides (or who is related to one who 26 resides) in the homestead property at the time of a forced judicial sale of the 27 dwelling.” McKee, 90 F.4th at 1247 (quotation marks omitted) (citing Cal. Code Civ. 28 Proc. § 704.720(a)). “The filing of a bankruptcy petition constitutes a forced judicial 1 sale for this exemption.” Id. The “automatic” homestead exemption is entitled to 2 lower priority than secured claims and tax liens, and higher priority than unsecured 3 claims. Cal. Code Civ. Proc. §§ 703.010(b), 704.850. 4 “It is universally recognized ... that the sale of a fully encumbered asset is 5 generally prohibited.” KVN, 514 B.R. at 5 (collecting cases). “In that instance, the 6 trustee’s proper function is to abandon the property, not administer it, because the sale 7 would yield no benefit to unsecured creditors.” Id. at 6. “Despite the general rule 8 prohibiting the sale of fully encumbered property, chapter 7 trustees may seek to 9 justify the sale through a negotiated carve-out agreement with the secured creditor.” 10 Id. “A carve-out agreement is generally understood to be an agreement by a party 11 secured by all or some of the assets of the estate to allow some portion of its lien 12 proceeds to be paid to others, i.e., to carve out its lien position.” Id. (quotation marks 13 and citation omitted). 14 “There is no per se rule that bans this type of contractual arrangement: Creditors 15 are generally free to do whatever they wish with the bankruptcy dividends they 16 receive, including to share them with other creditors.” Id. (cleaned up). Such 17 agreements, however, “have been reviewed under a standard of heightened scrutiny 18 due to past abuses,” and a rebuttable presumption of

impropriety applies. Id. at 7–8. 19 “To rebut the presumption, the case law directs the following inquiry: Has the trustee 20 fulfilled his or her basic duties? Is there a benefit to the estate; i.e., prospects for a 21 meaningful distribution to unsecured creditors? Have the terms of the carve-out 22 agreement been fully disclosed to the bankruptcy court? If the answer to these 23 questions is in the affirmative, then the presumption of impropriety can be overcome.”

24 Id. at 8.

25 B. The Compromise Motion

26 Rule 9019(a) provides in relevant part: “On the trustee’s motion and after notice
27 and a hearing, the court may approve a compromise or settlement.” Fed. R. Bankr. P. 28
9019(a). “The purpose of a compromise agreement is to allow the trustee and the 1 creditors to avoid the expenses and burdens associated with litigating sharply 2 contested and dubious claims.” A & C Props., 784 F.2d at 1380–81. “The law favors 3 compromise and not litigation for its own sake, and as long as the bankruptcy court 4 amply considered the various factors that determined the reasonableness of the 5 compromise, the court’s decision must be affirmed.” Id. at 1381 (citations omitted). 6 “Thus, on review, [appellate courts] must determine whether the settlement entered 7 into by the trustee was reasonable, given the particular circumstances of the case.” Id. 8 In determining the fairness, reasonableness and adequacy of a 9 proposed settlement agreement, the court must consider: (a) The probability of success in the litigation; (b) the difficulties, if any, to be 10 encountered in the matter of collection; (c) the complexity of the 11 litigation involved, and the expense, inconvenience and delay necessarily attending it; [and] (d) the paramount interest of the 12 creditors and a proper deference to their reasonable views in the 13 premises. 14 Id. (citation omitted). 15 As stated in the Compromise Motion, FCS consented to the sale of the 16 Residence “on the condition that FCS receives 60% of the proceeds encumbered by 17 FCS’s deed of trust from the sale of the Property after payments to satisfy, in full, the 18 first priority mortgage in favor of JP Morgan Chase Bank, the next priority lien in 19 favor of Pentagon Federal Credit Union, estimated sale costs of \$90,000, insurance 20 costs and any unpaid real property taxes.” EOR 00089. FCS further “agree[d] to a 21 carve-out in the amount of 40% of the proceeds encumbered by its lien that encumbers 22 the [Residence] from the sale of the [Residence], for the benefit of the Debtor[s]’ 23 bankruptcy estate,” and “to subordinate the general unsecured portion of its proof of 24 claim in the amount of \$657,245.75, to allowed general unsecured claims.” EOR 25 00089–90. The Trustee agreed to “ensure that a minimum of 50% of the net proceeds 26 received by the bankruptcy estate from the sale [would] be paid to non-administrative 27 unsecured creditors.” EOR 00090. 28 / / / 1 Debtors contend that, “from a simple review of the Trustee’s analysis of the 2 factors applicable to a usual ‘9019 Motion[,]’ there is no compromise at issue.” Dkt. 8 3 at 30. According to Debtors, “without a compromise of controversy that gives rise to 4 a ‘recovery’ under the Code, there is no authority for the Trustee to sell the Debtors’ 5 Residence and not pay the Debtors’ homestead exemption... through only a voluntary 6 assignment of a portion of the 3rd deed of trust.” Id. 5 7 The Trustee notes “FCS filed

a claim against the estate seeking payment of 8 \$900,000, \$250,000 of which was secured,” and argues that a compromise exists 9 because FCS agreed to carve out and assign a portion of its secured deed of trust to the 10 bankruptcy estate and subordinate the unsecured portion of its claim, “in exchange for 11 the Trustee’s agreement to seek a sale of the Property and to prepare all necessary 12 pleadings to obtain court approval for the same.” Dkt. 9 at 16, 26–27. In the 13 underlying Bankruptcy Action, the Trustee additionally argued the compromise 14 satisfied the heightened scrutiny required under KVN and was fair, reasonable, and 15 adequate under the factors set forth in A & C Props. EOR 00592–603, 607–09. The 16 Bankruptcy Court considered the parties arguments at the March 7 and May 2, 2023 17 hearings, before granting the Compromise Motion and approving the compromise. 18 See Dkt. 8 at 29–30; EOR 00615–18. 19 The Bankruptcy Court’s determination that FCS and the Trustee reached a 20 compromise of FCS’ claims and its decision to approve the compromise were logical, 21 plausible, and supported by inferences that may be drawn reasonably from the facts in 22 the record. See KVN, 514 B.R. at 5. The Bankruptcy Court, thus, did not abuse its 23 24 5 Debtors’ arguments are difficult to follow and unclear as to what point exactly 25 Debtors are attempting to make. See Dkt. 8 at 29–36. For example, Debtors 26 acknowledge the Bankruptcy Court granted the Compromise Motion pursuant to Rule 9019, and that the Trustee stated he was not seeking to sell the Residence pursuant to 27 § 522(g), but spend six pages arguing the compromise is not valid because there is no 28 “recovery” under § 522(g). Dkt. 8 at 31–36. 1 discretion in finding the compromise agreement constituted an actual compromise of 2 FCS’ secured and unsecured claims and approving the compromise under Rule 9019. 3 Accordingly, the appeal is DENIED on this Issue. Having affirmed the 4 Bankruptcy Court’s ruling for the reasons stated, the court need not address the 5 parties’ remaining arguments on this Issue. See Dkt. 8 at 11, 31–36. 6 C. The Trustee’s Objection to Exemption 7 The second Issue raised by the parties concerns whether Debtors’ homestead 8 exemption attaches to the portion of FCS’ recovery from the sale of the Residence that 9 FCS carved out/assigned to the bankruptcy estate under its compromise with the 10 Trustee. Debtors present a number of arguments for why they believe the Objection 11 to Exemption should have been overruled, which the court will address in turn. 12 First, Debtors argue their homestead exemption should attach to the carve-out 13 “because the property which gives it cash value has been exempted.” Dkt. 8 at 14 14 (emphasis in original). While Debtors acknowledge “[t]here is no precedential 15 authority on whether a homestead exemption applies to a portion of a lien carved out 16 for the benefit of the estate,” they argue that “the cases which say the exemption does 17 apply to the carveout are better reasoned and should be persuasive to this court.” Id. 18 at 14, 24–27. The court disagrees. 19 “California does not permit a debtor to exempt his entire interest in a 20 homestead, but specifically limits the dollar amount up to which a homestead 21 exemption can be claimed.” *In re Reed*, 940 F.2d 1317, 1321 (9th Cir. 1991) (citing 22 Cal. Code Civ. Proc. § 704.730(a)). “The statutory scheme implementing the 23 [homestead exemption] ... is said to provide protection for a portion of the equity in 24 the debtor’s home

against creditors who seek satisfaction by forced sale of the home.” 25 *In re Hyman*, 123 B.R. 342, 345 (B.A.P. 9th Cir. 1991) (cleaned up, italics in 26 original). “The language of the relevant statutes makes it clear that the ‘homestead 27 exemption’ in California is merely a debtor’s right to retain a certain sum of money 28 when the court orders sale of a homestead in order to enforce a money judgment; it is 1 not an absolute right to retain the homestead itself.” *Reed*, 940 F.2d at 1321 (citing 2 Cal. Code Civ. Proc. § 704.720(b)). 3 It is undisputed the Residence was over-encumbered, “which, based on the 4 Debtors’ valuation of the Residence, left no realizable equity in the property even 5 without taking into consideration the Debtors’ homestead exemption.” E.g., *Dkt. 8* at 6 5. Because FCS’ secured lien commands higher priority than Debtors’ homestead 7 exemption, FCS is entitled to recover on its secured deed of trust from a sale of the 8 Residence before Debtors are paid. See Cal. Code Civ. Proc. §§ 703.010(b), 704.850. 9 As stated, “[c]reditors are generally free to do whatever they wish with the bankruptcy 10 dividends they receive.” *KVN*, 514 B.R. at 6. The carve-out, thus, does not violate 11 the basic system of priority for distribution of assets of the estate, and the Bankruptcy 12 Court did not abuse its discretion in sustaining in part the Objection to Exemption and 13 finding Debtors’ homestead exemption does not attach to the carve-out funds. 14 Second, Debtors contend *Jevic*, 580 U.S. at 451, forbids a secured creditor from 15 assigning or carving out a portion of its recovery to pay unsecured creditors who are 16 lower in priority than Debtors’ homestead exemption. *Dkt. 8* at 15. According to 17 Debtors, “[t]he Trustee’s carveout creates ... freed up equity, because FCS has given 18 up a portion of its secured value to the unsecured creditors,” which must be distributed 19 to Debtors because of their homestead exemption. *Id.* Debtors further argue *Jevic* 20 prohibits a high-priority creditor from “do[ing] whatever it wants with the proceeds of 21 its loan.” *Id.* The court disagrees, as Debtors seek to extend *Jevic* beyond the facts 22 and reasoning of that case. 23 In *Jevic*, 580 U.S. at 454, 460, the bankruptcy court dismissed a debtor’s 24 chapter 11 bankruptcy petition pursuant to a settlement agreement between the debtor 25 and certain creditors, without restoring the pre-petition status quo. Under the 26 structured dismissal proposed, the petitioners, who were mid-priority creditors with a 27 priority wage claim, would receive nothing while higher-priority secured creditors and 28 lower-priority general unsecured creditors would be paid. *Id.* at 460–61. The 1 Supreme Court reversed the dismissal, holding bankruptcy courts do not have “the 2 legal power to order this priority-skipping kind of distribution scheme in connection 3 with a Chapter 11 dismissal.” *Id.* at 455 (emphasis omitted). 4 The structured dismissal proposed in *Jevic* violated the basic priority system 5 because it deprived the mid-priority creditors of property interests with actual value.

6 *Id.* at 464 (“[T]he Bankruptcy Court’s approval of the structured dismissal cost [the 7 mid-priority creditors] something. They lost a chance to obtain a settlement that 8 respected their priority. Or, if not that, they lost the power to bring their own lawsuit 9 on a claim that had a settlement value of \$3.7 million.”). 10 Here, in contrast, Debtors’ property interests and position remain unaffected by 11 the bankruptcy court’s approval of the compromise because Debtors have

no 12 realizable equity in the Residence to protect. FCS' decision to carve out a portion of 13 its recovery on the third deed of trust for the bankruptcy estate does not reduce in any 14 way Debtors' expected recovery under the homestead exemption. The distribution 15 approved by the Bankruptcy Court does not deviate from or violate the basic priority 16 rules for distribution. If anything, Jevic would support affirming the Bankruptcy 17 Court's ruling, since requiring FCS to give up a portion of its recovery on its secured 18 lien to Debtors, without FCS' consent, would violate the ordinary rules of priority. 19 Jevic neither considered nor discussed whether a high-priority secured creditor 20 can assign or carve out a portion of its own recovery for the benefit of the bankruptcy 21 estate and low-priority general unsecured creditors, and does not support Debtors' 22 contention that a high-priority secured creditor may not agree to carve out a portion of 23 its recovery for the bankruptcy estate. Debtors' argument, thus, fails. 24 Third, Debtors contend the language and policies stated in *Tillman* establish 25 that the Residence has been withdrawn from the estate because of their homestead 26 exemption. Dkt. 8 at 19–20. Debtors note the Ninth Circuit recognized “‘an 27 exemption is an interest withdrawn from the estate (and hence from the creditors) for 28 the benefit of the debtor,’” *id.* at 19 (citing *Tillman*, 53 F.4th at 1168 (emphasis in 1 original)), and argue their homestead exemption withdraws the Residence from the 2 estate, “subject to the three trust deeds and the [United States Internal Revenue 3 Service (“IRS”)] tax liens, which the Debtors must deal with outside of the bankruptcy 4 proceedings.” *Id.* at 20. 5 In *Tillman*, 53 F.4th at 1163, the Ninth Circuit held that a trustee may not avoid 6 a tax lien on property subject to Arizona's homestead exemption and preserve the 7 value of the lien for the benefit of the bankruptcy estate under §§ 551 and 724(a). 8 Neither §§ 551 nor 724(a) are at issue in the subject appeal, and *Tillman* is 9 inapposite.⁶ 10 Even if the court were to assume *arguendo* that *Tillman* established a policy 11 whereby Debtors' homestead exemption withdraws their property interest from the 12 estate, such a policy would be irrelevant here since Debtors admit the Residence is 13 over-encumbered and there is no realizable equity to which the homestead exemption 14 could attach. See Dkt. 8 at 5, 10–11. Because Debtors have no realizable property 15 interest in the Residence, there is nothing to withdraw from the estate based on the 16 homestead exemption. Debtors' argument, thus, fails. 17 18 6 In *Tillman*, 53 F.4th at 1164–65, the trustee filed an adversary proceeding, seeking leave to avoid the federal tax lien on the debtor's property, pursuant to § 724(a), and 19 preserve the value of the avoided federal tax lien for the benefit of the bankruptcy 20 estate, pursuant to § 551. Unlike California law, Arizona's homestead exemption “does not provide for any reduction in the exemption amount for tax liens.” *Tillman*, 21 53 F.4th at 1163 (emphasis in original). Nevertheless, the bankruptcy court held that 22 the debtor was entitled to exempt only equity beyond the mortgage and tax lien because Arizona's exemption laws were “ineffective” against the federal tax lien, and 23 granted summary judgment in the trustee's favor. *Id.* at 1165. After examining the 24 statutory text of § 724(a) in context with other provisions of the Bankruptcy Code, the Ninth Circuit held that “§ 724(a) concerns the trustee's avoidance of qualifying liens 25 attached to the property of the estate at the time of

distribution.” Id. at 1169 26 (emphasis in original). The Ninth Circuit “conclude[d] that § 724(a) does not permit a trustee to avoid a tax lien secured by exempt property because such securing property 27 is not property of the estate,” and reversed the bankruptcy court’s ruling. Id. at 1171. 28 Tillman is inapposite to the appeal at hand. 1 Fourth, Debtors argue the court may use similar reasoning as stated in *In re 2 Christensen*, 561 B.R. 195 (Bankr. D. Utah 2016), *aff’d In re Bird*, 577 B.R. 365 3 (B.A.P. 10th Cir. 2017), “to deny the Compromise and the distribution scheme it 4 contemplates from a proposed sale which ignores the homestead exemption on 5 property withdrawn from the estate.” Dkt. 8 at 23. Christensen is a non-binding 6 bankruptcy court opinion from outside this Circuit, which involves Utah state law, and 7 which is distinguishable from the facts at hand. 8 In Christensen, 561 B.R. 197–98, the trustee and the IRS entered into an 9 agreement whereby “the trustee agreed to market and sell the debtors’ homes despite 10 the fact that they were over-encumbered” and “the IRS agreed to subordinate its lien 11 insofar as necessary to provide \$10,000 to each estate, while the trustee and his 12 counsel would use 11 U.S.C. § 724(b) to have their fees and costs paid in full from the 13 sale proceeds prior to the IRS.” Christensen, 561 B.R. 197–98. The bankruptcy court 14 denied the trustee’s application for compensation and reimbursement of expenses, 15 finding the trustee’s services were neither necessary to the administration of the case 16 nor likely to benefit the estate. Id. at 217–18. In particular, the bankruptcy court 17 noted that it was problematic for the trustee to negotiate a sale that would benefit the 18 secured creditor and trustee primarily, while prejudicing junior lien holders and the 19 debtor. Id. at 210–17; see also id. at 211 (“Some courts have held that a secured 20 creditor and the trustee may agree that the trustee may receive a ‘tip’ or ‘incentive 21 bonus’ for doing a secured creditor’s dirty work. The Court finds these cases 22 unpersuasive. ... A debtor is not permitted to negotiate a short sale with a secured 23 creditor and retain proceeds when the property is subject to a junior lien, and neither is 24 the trustee. Even if the ‘tip’ or ‘incentive bonus’ results from the trustee’s exercise of 25 his authority as trustee, it is unavoidably proceeds of property of the estate.”). 26 Unlike in Christensen, 561 B.R. at 212, the compromise here does not inure 27 primarily to FCS and the Trustee’s benefit, with “[a]ny benefit to unsecured creditors 28 [being] purely incidental.” FCS did not agree to subordinate a portion of its secured 1 lien—it agreed to assign a portion of its recovery from its secured claim to the 2 bankruptcy estate while subordinating its unsecured claims to ensure that other 3 unsecured creditors received the transferred funds. EOR 00090. The Trustee, in turn, 4 agreed to “ensure that a minimum of 50% of the net proceeds received by the 5 bankruptcy estate from the sale [would] be paid to non-administrative unsecured 6 creditors.” Id. 7 In the underlying proceedings, the Trustee argued that this agreement would 8 provide a meaningful benefit to the unsecured creditors and satisfied the requirements 9 of KVN. E.g., EOR 00510–11, 578–80. Debtors did not dispute the value of the 10 distribution and argued only that the carve out would not benefit the estate because 11 Debtors were entitled to the funds because of their homestead exemption. E.g., EOR 12 00568. At the hearings on the Compromise Motion, the Bankruptcy Court found the 13 Trustee “clearly

satisfied” the KVN factors, noting the compromise provided “a 14 spectacularly good result for creditors” and “frankly, a better result for creditors than 15 is achieved in most Chapter 7 bankruptcy cases.” EOR 00594, 617–18. Christensen 16 is distinguishable, and the court will not grant the appeal on this basis. 17 Finally, Debtors contend “Bankruptcy Code section 105, longstanding 18 policies[,] and equity weigh against a trustee selling fully encumbered property and 19 evicting debtors.” Dkt. 8 at 37 (cleaned up). According to Debtors, the court should 20 exercise its powers under §§ 105(a) or 522 “to deny the Trustee’s ‘Compromise’ and 21 abolish the order of distribution orchestrated by the Trustee and FCS ... because this 22 outcome is an abomination, to be struck down, not admired.” Dkt. 8 at 37.7 The court 23 24 7 Debtors state they “were aware when they filed their chapter 7 petition that their home was underwater when the tax liens were taken into account” and were advised 25 “they could expect to discharge their dischargeable debts and receive a fresh start 26 from the bankruptcy, which would then allow them to address the secured debts while maintaining their residence.” Dkt. 8 at 37. The Trustee states, and Debtors do not 27 dispute, that Debtors have not made mortgage payments since the Petition Date and 28 1 disagrees for the reasons stated, and declines to reverse the Bankruptcy Court’s 2 rulings on this basis.8 3 In sum, the court finds the Bankruptcy Court did not abuse its discretion in 4 sustaining in part the Trustee’s Objection to Exemption, and DENIES the appeal on 5 this Issue. 6 D. The Abandonment Motion 7 “On request of a party in interest and after notice and a hearing, the court may 8 order the trustee to abandon any property of the estate that is burdensome to the estate 9 or that is of inconsequential value and benefit to the estate.” 11 U.S.C. § 554(b). 10 “[T]he principle of abandonment was developed to protect the bankruptcy estate from 11 the various costs and burdens of having to administer property which could not 12 conceivably benefit unsecured creditors of the estate.” KVN, 514 B.R. at 6 (cleaned 13 up). “[A]n order compelling abandonment is the exception, not the rule. 14 Abandonment should only be compelled in order to help the creditors by assuring 15 some benefit in the administration of each asset. Absent an attempt by the trustee to 16 churn property worthless to the estate just to increase fees, abandonment should rarely 17 be ordered.” In re Vu, 245 B.R. 644, 457 (B.A.P. 9th Cir. 2000) (cleaned up). A 18 party seeking abandonment of estate property bears the burden of showing by a 19 preponderance of the evidence that the property is burdensome or of inconsequential 20 21 are in default under their consensual mortgages. Dkt. 27 at 37. Debtors chose voluntarily to file a petition for chapter 7 bankruptcy and render the Residence an 22 asset of the bankruptcy estate, subject to the provisions of the Bankruptcy Code. 23 Their expectation that the Residence would be abandoned and disappointment with the Bankruptcy Court’s rulings, while understandable, do not establish a legally 24 protectable interest. 25 8 The Trustee cites Law v. Siegel, 571 U.S. 415, 421 (2014), to argue § 105(a) cannot 26 be used to contravene specific statutory provisions of the Bankruptcy Code. Dkt. 9 at

40. As the court finds reversal is not warranted here, the court declines to consider

27 whether a court could exercise its powers under § 105(a) to reverse a bankruptcy 28 court’s

approval of a carve-out under different circumstances. 1 value and benefit to the estate. See *id.* at 650. 2 Debtors contend the Bankruptcy Court erred in denying the Abandonment 3 Motion because the Residence was over-encumbered and of inconsequential value and 4 benefit to the estate due to Debtors' homestead exemption. Dkt. 8 at 11–12, 28. The 5 Trustee responds the Bankruptcy Court did not abuse its discretion in denying the 6 Abandonment Motion because the Residence has substantial value and benefit for the 7 estate, which is expected to receive \$100,000 from the carve-out, with at least 50% of 8 the net proceeds to be paid to non-administrative unsecured creditors. Dkt. 9 at 41. 9 For the reasons stated, the Bankruptcy Court did not abuse its discretion in 10 finding that the compromise was of substantial benefit to the estate and denying the 11 Abandonment Motion. The appeal is DENIED on this Issue. 12 IV. Conclusion Regarding May 2, 2023 Order 13 In sum, the court AFFIRMS the Bankruptcy Court's rulings and the May 2, 14 2023 Order in its entirety.

15 SEPTEMBER 8, 2023 ORDER

16 Debtors' appeal of the September 8, 2023 Order centers on the following Issue: 17 Whether the Trustee can sell the Residence and pay general unsecured creditors and 18 administrative expenses from the proceeds of the sale, pursuant to the stipulation 19 approved by the Bankruptcy Court, before Debtors are paid their homestead 20 exemption. See Dkt. 26 at 11; Dkt. 27 at 2. As Debtors repeat many of the arguments 21 they raised in connection with their appeal of the May 2, 2023 Order (see Dkt. 26 at 22 11–24, 28–31), the court will address only the new arguments raised in connection 23 with this appeal. 24 First, Debtors contend the Trustee makes the same argument in his Sale Motion 25 as was raised in *in re Traverse*, 753 F.3d 19 (1st Cir. 2014). Dkt. 26 at 25. While 26 Debtors admit *Traverse* involved “a slightly different scenario,” they argue the First 27 Circuit's reasoning precludes the Trustee from being able to sell the Residence here.

28 *Id.* at 25–28. *Traverse* is a non-binding decision from outside this Circuit that is

1 distinguishable from the facts here. 2 In *Traverse*, 753 F.3d at 23, the trustee sought to avoid and preserve an 3 unrecorded mortgage and to sell the debtor's residence as property of the bankruptcy 4 estate. The First Circuit held that the trustee could not sell the residence because “the 5 preservation of a lien entitles a bankruptcy estate to the full value of the preserved 6 lien--no more and no less.” *Id.* at 31. As the First Circuit explained: 7 Where this lien is an undefaulted mortgage on otherwise exempted 8 property, the trustee may for the benefit of the estate enjoy the liquid market value of that mortgage, claim the first proceeds from a 9 voluntary sale, or wait to exercise the rights of a mortgagee in the 10 event of a default. But the trustee may not repurpose the mortgage to transform otherwise exempted assets, to which neither the estate nor 11 the original mortgagee boasted any ownership rights, into the property 12 of the bankruptcy estate. 13 *Id.* 14 *Traverse* does not establish that a trustee cannot sell real property that a debtor 15 has made property of the estate through a chapter 7 petition, as occurred here. 16 Furthermore, the Trustee contends, and Debtors do not dispute, that Debtors have not 17 made payments on the deeds of trust since the Petition Date and are in default under 18 their consensual mortgages. Dkt. 27 at 37.

Unlike in *Traverse*, FCS and the trustee 19 have an ownership interest that entitles the Trustee to sell the Residence. *Traverse* is 20 inapposite, and Debtors’ argument fails. 21 Second, Debtors argue that even if FCS’ compromise with the Trustee 22 constituted a valid settlement, it did not grant the Trustee the power to sell the 23 Residence without paying Debtors their homestead exemption because “nothing here 24 allows the Trustee to jump from receiving an assignment of a deed of trust, 26 which here, is to foreclose.” Dkt. 26 at 24. According to Debtors, “[b]ecause the 27 Trustee, here, did not ‘recover’ property pursuant to section 510(c)(2), which is the 28 only bridge that gets the Trustee from receiving an ‘assignment’ or ‘carveout’ from a 1 secured lender, and then to authority to 1) sell the property; and 2) not pay the 2 Debtors’ homestead exemption, which is section 522(g).” Id. (errors in original). 3 Debtors’ argument is again largely incomprehensible.⁹ For one, it is unclear 4 why Debtors are challenging the Trustee’s authority to sell the Residence under 5 § 522(g), given: (1) the Trustee brought the Sale Motion pursuant to § 105(a), 6 § 363(b), (f), and (m), and Federal Rule of Bankruptcy Procedure 6004(a)—not 7 § 522(g) (EOR 00640); and (2) the Bankruptcy Court did not identify § 522(g) as a 8 basis for its ruling (see EOR 000780–81, 798–807), or discuss that statute other than 9 to explain why “[t]he 522(g) issue isn’t relevant here” (EOR 00597). 10 Debtors do not explain clearly why the Trustee would need to “recover” 11 property under § 510(c)(2) to have the authority to sell the Residence or why the 12 transfer of funds pursuant to the carve-out agreement does not qualify as a recovery 13 even if the court were to assume *arguendo* that § 510(c)(2) applies.¹⁰ In contrast, the 14 Trustee argues he is authorized to sell the Residence because he satisfied the standards 15 for a sale under § 363(b). Dkt. 27 at 19–25. 16 The Bankruptcy Court found the Trustee satisfied the business judgment 17 standard for selling the Property under § 363. EOR 00798–804. Debtors do not 18 19 9 Debtors raised the same argument in their reply in support of their appeal of the May 20 2, 2023 Order. Dkt. 11 at 6–11. The argument was no clearer there. 21 10 Debtors contend KVN is distinguishable because that decision “relied on section 22 522(g) to proceed with a sale that subordinated the debtors’ homestead exemption.” Dkt. 26 at 24. According to Debtors, “[b]ecause [the] trustee in KVN ... recovered 23 property in litigation, and obtained a subordination from the lender under section § 24 510(c)(2), [the trustee] proceeded under 522(g) to sell and not pay the debtors’ homestead exemption on the subordinated portion of the lender’s claim in the hands of 25 the [t]rustee.” Id. KVN did not rely on §§ 510(c)(2) or 522 for any portion of its 26 reasoning, and cited § 522 only to distinguish a case in which the trustee sought to disallow an exemption under § 522(c)(1). KVN, 514 B.R. at 9. Debtors do not cite 27 any legal authority in support of their arguments, and it is unclear why they believe 28 KVN “relied on section 522(g).” Debtors’ argument, thus, fails. | | present any argument regarding the relevant factors and argue only that the Trustee 2 || cannot sell the Residence because exempt property is withdrawn from the estate under 3 | *Tillman*. Dkt. 26 at 28. This argument fails for the reasons stated. 4 In sum, Debtors fail to demonstrate the Trustee lacked the authority to sell the 5 ||

Residence or that there is any other valid basis to prevent the sale. The court, 6 | therefore, AFFIRMS the Bankruptcy Court's rulings and the September 8, 2023 Order 7 || in its entirety.

8 CONCLUSION

9 For the aforementioned reasons, the court AFFIRMS the Bankruptcy Court's 10 | May 2 and September 8, 2023 Orders and DISMISSES the subject appeals. 11 12 IT IS SO ORDERED. 13

14 | Dated: March 27, 2025

15 FERNANDO L. AENLLE-ROCHA

6 United States District Judge 17 18 19 20 21 22 23 24 25 26 27 28 21