

# COMMERCIAL LAW AND BANKRUPTCY SECTION NEWSLETTER

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## EXTRATERRITORIAL APPLICATION OF STATES' HOMESTEAD EXEMPTION WITHIN THE NINTH CIRCUIT

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When a debtor seeks relief under the bankruptcy code<sup>1</sup> a bankruptcy estate is created.<sup>2</sup> Included in the estate are all of the debtor's legal and equitable interests.<sup>3</sup> The debtor may exclude certain interests or property from the estate by taking advantage of state law or federal exemptions, whichever is applicable in the particular case.<sup>4</sup>

Assuming that a debtor cannot or does not choose the federal exemptions, it must be determined what state's exemption law applies. § 522 (b)(3)(A) reads:

[The State] in which the debtor's domicile has been located for the 730 days immediately preceding the date of the filing of the petition or if the debtor's domicile has not been located at a single State for such 730-day period, the place in which the debtor's domicile was located for 180 days immediately preceding the 730-day period or for a longer portion of such 180-day period than in any other place.<sup>5</sup>

Therefore, if a debtor is domiciled in a state for 730 days that state's law will apply. If the debtor has not resided in the state for 730 days, then the debtor's domicile will be determined by the location of the debtor for the 180 days immediately preceding the 730 days or for a longer portion of such 180-day period than anywhere else.

This article will discuss whether a debtor attempting to use the domicile state's homestead exemption may exempt real property located in another state. This article only discusses statutes and cases concerning the states within the Ninth Circuit Court of Appeals geographical jurisdiction. Some of the cases cited to contain multiple issues and holdings. Each case and statute should be read completely for a full understanding of the issues and the court's reasoning and holding(s).



### Ninth Circuit Court of Appeals

In *In re Arrol*,<sup>6</sup> the debtor purchased a home in Michigan in 1982, and moved to California without selling the home in October 1994.<sup>7</sup> He then moved back to Michigan in November of 1996, and filed a Chapter 7 bankruptcy petition in the Northern District of California as he resided longer in that jurisdiction during the preceding 180 days before filing his petition.<sup>8</sup>

In California homestead is defined as:

the principal dwelling (1) in which the judgment debtor or the judgment debtor's spouse resided

on the date the judgment creditor's lien attached to the dwelling, and (2) in which the judgment debtor or the judgment debtor's spouse resided continuously thereafter until the date of the court determination that the dwelling is a homestead.<sup>9</sup>

On his bankruptcy schedules Mr. Arrol claimed a \$75,000 exemption in his Michigan home that he owned free of any secured claims under the California homestead exemption.<sup>10</sup> Federal exemptions were unavailable to Mr. Arrol, as California opts out of the federal exemption laws provided by the Bankruptcy Code.<sup>11</sup>

The *Arrol* court reasoned that Mr. Arrol could claim the \$75,000 exemption for his Michigan homestead, because the California exemption statute does not limit the homestead exemption to dwellings within California.<sup>12</sup> The court found nothing in the California exemption statute or interpretation of California case law to limit the application of the homestead exemption to dwellings in California.<sup>13</sup>

In construing the exemption statutes liberally in favor of the debtor the court analogized the homestead statute to the automobile exemption statute that allows for an exemption up to the amount of \$1900 for an automobile located outside the state.<sup>14</sup> Although

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## A Word From the Editor

Set the date! The 30th Annual Bankruptcy Seminar and Annual Meeting of the Commercial and Bankruptcy Law Section will be held at Sun Valley Resort, February 16, 17 and 18, 2012. Watch for the registrations and then make your room reservations early.

Update on Bankruptcy Clinic. Idaho Legal Aid Service, Fourth District bankruptcy bar members, and United States Trustee's Office have served at least 70 consumer debtors between April 2010 and November 3, 2011. All of the consumer surveys have indicated that the services were good or excellent – there were no negative reports. Attorneys have requested assistance with bankruptcy forms online, and consumers would like to see direct one-on-one pro bono legal services in some cases in which the consumer faces extreme hardship, and presumably where cases are more complex than normal. Thanks to all who have supported this noble effort!

### EXTRATERRITORIAL APPLICATION OF STATES' HOMESTEAD EXEMPTION WITHIN THE NINTH CIRCUIT

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automobiles are movable the court held the exemption reflects a concern for the basic need of transportation and that the homestead exemption law serves the basic need for housing.<sup>15</sup> The court also applied the California Court of Appeals precedent set in *Strangman v. Duke*<sup>16</sup> that articulated the legislative goal of “provid [ing] a place for the family and its surviving members, where they may reside and enjoy the comforts of a home, freed from any anxiety that it may be taken from them against their will....”<sup>17</sup> Mr. Arrol was thus allowed to exempt \$75,000 from his homestead located in Michigan.

#### Alaska

Alaska's homestead statute 09.38.010 states in that “(a) An individual is entitled to an exemption as a homestead of the individual's interest in property in this state used as the principal residence of the individual or the dependents of the individual, but the value of the homestead exemption may not exceed \$54,000.”<sup>18</sup> “Alaska's homestead statute's plain language explicitly limits its application to property within the state.”<sup>19</sup> While there is no case law on point the language of the statute is clear and unambiguous. The Alaska homestead exemption will not apply extraterritorially.

#### Washington

The District of Idaho Bankruptcy Court has interpreted the Washington homestead exemption statute.<sup>20</sup> The Revised Code of Washington section 6.13.010 defines a

homestead as a “real or personal property that the owner uses as a residence...the homestead consists of the dwelling house or the mobile home in which the owner resides or intends to reside...Property included in the homestead must be actually intended or used as the principal home for the owner.”<sup>21</sup> The exemption amount for a homestead in Washington State is the “lesser of (1) the total net value of the lands, manufactured homes, mobile home, improvements, and other personal property, or (2) the sum of one hundred twenty-five thousand dollars.”<sup>22</sup> The statute is silent as to whether it will apply extraterritoriality.

Debtors Richard and Kelli Harris grew up and formerly lived in Washington State.<sup>23</sup> In May, 2001, they purchased a home and property in Concrete, Skagit County, Washington with the intention of fixing up and selling it.<sup>24</sup> Debtors paid off the mortgage on the property and rented it out occasionally without ever residing in the home.<sup>25</sup> Near the end of 2001, the family moved to Idaho and resided there continuously and filed their bankruptcy petition on December 1, 2009.<sup>26</sup> On November 5, 2009, Debtors signed a Declaration of Homestead concerning the Washington property.<sup>27</sup> On schedule C, Debtors claimed the Washington Property exempt as their homestead pursuant to Idaho Code §§ 55-1001-1003, and Washington's Revised Code, citing §§ 6.13.010 through 6.13.030.<sup>28</sup>

A creditor objected to the exemption of the Washington property and correctly argued that Idaho homestead law does not permit Debtors to claim a homestead exemption for property located in another state.<sup>29</sup> Relying on previous cases earlier discussed in this article, the court concluded that the Idaho homestead exemption does not permit debtors to claim a homestead in another state.<sup>30</sup> The court sustained the creditors objection.

Although Idaho was unmistakably the domicile and the proper venue for this bankruptcy case, the Harris court looked at whether Washington exemption law could be construed to favor the debtors. The Revised Code of Washington § 6.13.010 provides that a “homestead consists of the dwelling house ... in which the owner resides or intends to reside .... Property included in the homestead must be actually intended or used as the principal home for the owner.”<sup>31</sup>

Although the debtors had family in Washington, paid bills related to the property, and filed a homestead declaration, they did not reside in the residence.<sup>32</sup> The debtors also had very strong ties to the Boise area as Ms. Harris held a job and was finishing her degree there.<sup>33</sup> The court concluded that the debtors could not prove that they intended to reside at the Washington property and thus the debtors would not qualify under for the Washington exemption law.<sup>34</sup> Because the debtors did not reside at the property they could not establish the property as a homestead and thus could the Washington homestead exemption could not be applied.<sup>35</sup>

## Oregon

*In Re Stratton*<sup>36</sup> is an Oregon case that stems from a debtor who attempted to exempt property in California pursuant to the Oregon State homestead exemption law.<sup>37</sup> Oregon Revised Statute § 23.240 states,

A homestead shall be exempt from sale on execution, from the lien of every judgment and from liability in any form for the debts of the owner to the amount in value of \$25,000, except as otherwise provided by law... When two or more members of a household are debtors whose interests in the homestead are subject to sale on execution, the lien of a judgment or liability in any form, their combined exemptions under this section shall not exceed \$33,000...<sup>38</sup>

Thus language of Oregon's homestead exemption law is silent as to its extraterritorial effect. The court then looked to state law to determine whether the exemption statute could be applied extraterritorially, and found a case from 1898 where the Oregon Supreme Court expressly stated that, "exemptions statutes are...confined in their operation to the state in which they are enacted."<sup>39</sup> According to the Stratton Court, this language appeared "to be mere dicta."<sup>40</sup>

The court relied heavily on a Ninth Circuit decision *In re Arrol*,<sup>41</sup> (see *infra*), and also pointed to several other Oregon State Supreme Court cases that fell in line with *Arrol*, reasoning that, "the object of the homestead exemption law is well understood" and that the object "is to assure to the unfortunate debtor, and his equally unfortunate but more helpless family, the shelter and the influence of home; and, in its promotion, courts may well employ the most liberal and humane rights of interpretation."<sup>42</sup> Lastly the court reasoned that since the parties agreed that the property if located in Oregon would qualify for the Oregon homestead exemption, the debtor may claim the property located in California exempt under the Oregon exemptions. Thus the debtor was able to exempt that statutory allowed amount from her estate.<sup>43</sup>

## Nevada

In *In re Fernandez*<sup>44</sup> the debtor owned a home in El Paso, Texas, and later relocated to Nevada after he was laid off from his job



in Texas.<sup>45</sup> He never sold his Texas home and continued to make his mortgage payments on the home for the seven years while he was in Nevada.<sup>46</sup> Roughly one year before this bankruptcy filing Mr. Fernandez moved back to his home in El Paso, where he filed his bankruptcy case on December 31, 2009.<sup>47</sup>

Mr. Fernandez originally claimed his Texas home as exempt pursuant to the Texas homestead laws and then amended his Schedule C, in order to claim his Texas home exempt under Nevada's homestead exemption laws.<sup>48</sup> The trustee objected, arguing that Mr. Fernandez could not use the Nevada homestead law to exempt his Texas property.<sup>49</sup>

In Nevada, a homestead is defined as

(a) quantity of land, together with the dwelling house thereon and its appurtenances; (b) a mobile home whether or not the underlying land is owned by the claimant; or (c) a unit, whether real or personal property . . . With any appurtenant limited common elements and its interest in the common elements of the common-interest community.<sup>50</sup>

The Nevada homestead exemption statute is silent as to whether it applies only to property located in the State of Nevada, or whether it can be applied extraterritorially.

The court took note that the purpose of the homestead exemption is to "preserve the family home despite financial distress, insolvency or calamitous circumstances, and to strengthen family security and stability for the benefit of the family, its individual members, and the community and state in which the family resides."<sup>51</sup> The court then

held that former residents are no longer part of the group of persons for whose benefit Nevada enacts its laws.<sup>52</sup>

The *Fernandez* court also looked to Nevada state court decisions including *Smith v. Stewart* a case from 1878. In *Smith* the Supreme Court of Nevada explained that the Nevada exemption was, "designed to shelter Nevada residents from execution in Nevada..." and therefore, "although the Nevada homestead does not expressly say that its reach is limited to property in Nevada, it is as a practical matter so limited..."<sup>53</sup> Because the court disallowed the exemption, Mr. Fernandez was unable to exempt any value from his homestead from his bankruptcy estate.

## California

Ms. Arrendondo-Smith filed a Chapter 7 petition in Texas and correctly claimed California exemptions as she was domiciled in California during the 730 days immediately preceding the filing of her bankruptcy petition.<sup>54</sup> She continued to reside in California for the longer portion of the 180-day period under § 522(b)(3)(A).<sup>55</sup>

The court first looked to the plain language of California's homestead statute. Homestead in California is defined as:

the principal dwelling (1) in which the judgment debtor or the judgment debtor's spouse resided on the date the judgment creditor's lien attached to the dwelling, and (2) in which the judgment debtor or the judgment debtor's spouse resided continuously thereafter until the date of the court determination that the dwelling is a homestead.<sup>56</sup>

The court relied heavily on and followed the reasoning of the *In re Arrol* court (supra).<sup>57</sup> The court stated that it was mindful of the strong policy underlying both California law and federal bankruptcy law to interpret exemption statutes liberally in favor of the debtor.<sup>58</sup> The court found that the California exemption law may apply extraterritorially to property located in the State of Texas.<sup>59</sup>

### Arizona

The Arizona Revised Statute § 33-1101 states that, “(a) Any person the age of eighteen or over, married or single, who resides within the state may hold as a homestead exempt from attachment, execution and forced sale, not exceeding one hundred fifty thousand dollars in value...”<sup>60</sup> It appears that there is no case law on this issues but the exemption clearly will not apply extraterritorially as the statute on its face requires the debtor to reside in the state to qualify for the exemption amount. The Arizona homestead exemption will not be applied extraterritorially.

### Montana

The Montana State Constitution provides that “[t]he Legislature shall enact liberal homestead exemption laws.”<sup>61</sup> In Montana a “homestead consists of the dwelling house or mobile home, and all appurtenances, in which the claimant resides and the land, if any, on which the same is situated...”<sup>62</sup> The amount of homestead exemption “may not exceed \$250,000 in value.”<sup>63</sup>

Although the homestead exemption statute is silent as to extraterritorial effect, to qualify for the exemption a debtor must execute a homestead declaration and the declaration must be recorded in the office of the country clerk.<sup>64</sup> Although it appears that this issue has never been litigated, the state of Montana would seemingly have no interest in recording homestead declarations for a person’s homestead located in another state. Thus, the exemption may be interpreted by courts as to not have any extraterritorial effect.

### Idaho

The first case on point in Idaho is *In re Halpin*.<sup>65</sup> Stephen Halpin resided in Idaho for more than 180 days, the then appropriate time to qualify to use the Idaho state exemptions.<sup>66</sup> Idaho opts out of the federal exemption scheme.<sup>67</sup> The chapter 13

petition was filed in the District of Idaho on November 9, 1993, and the debtor invoked Idaho Code §55-1003 to claim an exemption for the family homestead that was located in Geneva, Ohio.<sup>68</sup>

Section 55-1001 of the Idaho Code defines homestead as the “dwelling house or the mobile home in which the owner resides or intends to reside, with appurtenant buildings, and the land on which the same are situated...”<sup>69</sup> Section 55-1003 provides an exemption of “(i) the total net value of the lands, mobile home, and improvements as described in section 55-1001, Idaho Code, or (ii) the sum of one hundred thousand dollars (\$100,000).”<sup>70</sup> The statute is silent as to whether the exemption could be applied outside of the state.

The court denied the debtor’s homestead exemption in a very brief decision that failed to discuss the pertinent Idaho code sections, but instead relied on secondary authority and simply determined that, “absent local decisional support to the contrary homestead statutes can have no extraterritorial force; they must be construed to apply solely to homesteads within the states.”<sup>71</sup> The court cited to *In re Peters* from the Western District of Texas that held that exemptions laws have no extraterritorial force and are only local in nature.<sup>72</sup> The court also reasoned that the holding “makes sense as a matter of public policy because it would discourage forum shopping for debtors seeking Idaho’s liberal exemption allowance.”<sup>73</sup>

Several years later the same issue resurfaced in *In re Capps*.<sup>74</sup> There the debtor moved from Colorado to Idaho in December of 2006.<sup>75</sup> While in Idaho, the debtor rented an apartment in Rigby and continued to own her home in Colorado.<sup>76</sup> Because the Debtor had continuously resided in Idaho for more than 730 days when she filed her bankruptcy case the domiciliary requirement was fulfilled and Idaho exemption law applied under § 522(b)(3).<sup>77</sup> In reliance on the Idaho’s homestead exemption, the debtor claimed an exemption in the amount of \$48,882.53 for her homestead located in Colorado.<sup>78</sup>

The court determined that it must look to the specific language of the statute in order to decide whether the statute could be applied extraterritorially.<sup>79</sup> The court looked at the specific language of § 55-1001 of the Idaho Code and determined that the code section was silent as to extraterritorial effect.<sup>80</sup> The court then looked to state law to see if existing interpretations of the statute existed.<sup>81</sup>

Despite the courts’ acknowledgment that the Idaho exemption statutes are to be construed liberally in favor of the debtor the court relied on its predecessor *In re Halpin* supra, and reasoned that the statute’s silence, public policy discouraging exemption shopping, and protecting creditors’ expectations all pointed to the disallowance of the exemption statute to apply extraterritorially.<sup>82</sup> As a result the debtor was unable to exempt the \$48,882.53 from her bankruptcy estate.<sup>83</sup>

These two cases show that Idaho will not apply its homestead exemption statute to property located outside of the state, despite the fact that the statute is silent as to the extraterritorial effect.<sup>84</sup>

### Hawaii

Like many of the states located in the Ninth Circuit the Hawaii homestead exemption is not silent as to whether it will apply to property located out of the state. Hawaii Revised Statute § 651-92 allows an exemption for one parcel of real property in the State of Hawaii of a fair market value not exceeding \$30,000 if the real estate is owned by a head of household or a person sixty-five years of age or older.<sup>85</sup> If the person who owns the real estate is not a head of household or over the age of sixty-five then they will receive an exemption in one parcel of real property in the State of Hawaii of a fair market value not exceeding \$20,000.<sup>86</sup>

Although there appears to be no case law on point the statutory language is clear and unambiguous. The homestead exemption in Hawaii is limited to property located in the state of Hawaii and will not be applied extraterritorially.

### Conclusion

When a state homestead statute is silent as to its extraterritorial effect, the Court must look to that state’s case law to see if the appellate courts of that state have interpreted their homestead statute to apply extraterritorially.<sup>87</sup> If there is no state case law in existence to determine whether the exemption has extraterritorial application and given the fact that most state courts generally require homestead exemptions to be liberally construed in favor of debtors, the exemption may be given extraterritorial effect absent a limitation placed on the exemption by either the statute itself or a case interpreting that statute.

## ENDNOTES

- 1 *11 U.S.C. 101 et seq.* Unless otherwise indicated all code chapter and section references in this article refer to bankruptcy code 11 U.S.C. §§ 101.
- 2 § 541(a)(1).
- 3 *Id.*
- 4 § 522(b)(2).
- 5 § 522(b)(3)(A).
- 6 *In re Arrol*, 170 F. 3d 934, 935 (1999).
- 7 *Id.* at 935..
- 8 *Id.* See also 28 U.S.C.§1408(1).
- 9 Cal. C.C.P. § 704.710(c) (1983).
- 10 Cal. C.C.P. § 704.730(a) (1982).
- 11 *Id.*
- 12 *In re Arrol*, at 936 (1999).
- 13 *Id.*
- 14 *Id.*
- 15 *Id.*
- 16 *Strangman v. Duke* 295 P.2d 12 (1956).
- 17 *Id.* at 17.
- 18 Alaska Stat. § 09.38.010 (1982).
- 19 *In re Jevne*, 387 B.R. 301, 303 (Bankr. S.D.Fla. 2008). The court provided several examples of states' statutes that on their face expressly limit the homestead exemption to property within the state.
- 20 *In re Harris*, 2010 WL 2595294, at\*1 (Bankr. D. Id. 2010).
- 21 Wash. Rev. Code § 6.13.010 (1999).
- 22 Wash. Rev. Code. § 6.13.030 (2007).
- 23 *In re Harris*, 2010 WL 2595294, at \*1 (Bankr. D. Id. 2010).
- 24 *Id.*
- 25 *Id.*
- 26 *Id.*
- 27 *Id.* at \*2.
- 28 *Id.*
- 29 *Id.* at \*3.
- 30 *Id.* at 5
- 31 Wash. Rev. Code §6.13.010 (1999).
- 32 *In re Harris*, 2010 WL 2595294, at \*3.
- 33 *Id.* at\*4.
- 34 *Id.* at \*5.
- 35 *Id.*
- 36 *In re Stratton*, 269 B.R.716 (Bankr. D. Or. 2001).
- 37 *Id.* at 717.
- 38 Or. Rev. Stat. § 18.395 (2009). Formerly cited as OR ST § 23.240.
- 39 *Bond v. Turner* 33 Or. 551, 553, 54 P. 158 (1898).
- 40 *In re Stratton*, 269 B.R. 716, 718.
- 41 *In re Arrol*, 170 F. 3d 934 (1999).
- 42 *Id.* See also *Strangman v. Duke*, 295 P.2d 12 (1956), *Banfield v. Schulderman*, et al. (*In re Banfield's Estate*), 137 Or. 167, 298 P. 905 (1931).
- 43 *Id.* at 719.
- 44 *In re Fernandez*, 2011 WL 238442, (Bankr. W.D.Tex. 2011).
- 45 *Id.* at \*1.
- 46 *Id.*
- 47 *Id.*
- 48 *Id.*
- 49 *Id.*
- 50 Nev. Rev. Stat. § 115.005 (2003).
- 51 *In re Fernandez*, at \*2. Quoting *Jackman v. Nance*, 109 Nev. 716, 718, 857 P.2d 7 (1993).
- 52 *Id.*
- 53 *Id.* at\*3.
- 54 *In re Arrendondo-Smith*, 436 B.R. 412, 415 (Bankr. W.D.Tex. 2010).
- 55 *Id.*
- 56 Cal.C.C.P. § 704.710(c) (1983).
- 57 *In re Arrendondo-Smith*, 436 B.R. 412, 415 (Bankr. W.D.Tex. 2010).
- 58 *Id.*
- 59 *Id.* The court ultimately denied the debtor's exemption because she had declared her "homestead" in California but had abandoned it and therefore could not claim a homestead different than the family homestead that she and her former spouse previously established. See also *In re Roberts*, 2010 WL 5462516, (Bankr.N.D.Ia. 2010).
- 60 Ariz. Rev. Stat. § 33-1101 (2004).
- 61 *Amundson v. Wortman*, 796 P.2d 105, 106, (1990) quoting Mont. Const., Art. XIII, § 5
- 62 Mont. Code. Ann.§70-32-101 (1985).
- 63 Mont. Code. Ann §70-32-104 (1985).
- 64 Mont. Code. Ann §70-32-107 (1895).
- 65 *In re Halpin*, 1994 WL 594199 at \*1 (Bankr. D. Idaho 1994).
- 66 *Id.*
- 67 *Id.*
- 68 *Id.*
- 69 Id. Code § 55-1001 (1989).
- 70 Id. Code § 55-1003 (1989).
- 71 *In re Halpin*, 1994 WL 594199 at\*2.
- 72 *Id.* quoting *In re Peters*, 91 B.R. 401, 403 (Bankr. W.D. Tex. 1998).
- 73 *Id.*
- 74 *In re Capps*, 438 B.R. 668 at 669 (Bankr. D. Idaho, 2010).
- 75 *Id.*
- 76 *Id.*
- 77 § 522(b)(3).
- 78 *In re Capps*, 438 B.R. 668 at 670.
- 79 *Id.* at 672.
- 80 *Id.* quoting *Stephens v. Holbrook*, (*In re Stephens*) 402 B.R. 1, 6 (10th Cir. B.A.P. 2009); *In re Jevne*, 387 B.R. 301, 304 (S.D. Fla. 2008).
- 81 *Id.*
- 82 *Id.*
- 83 *Id.* at 675.
- 84 *Id.* quoting *Stephens v. Holbrook*, 402 B.R. 1, 6 (B.A.P.10<sup>th</sup> Cir. 2009); *In re Jevne*, 387 B.R. 301, 304 (Bankr. S.D. Fla. 2008).
- 85 Haw. Rev. Stat. § 651-92 (1978).
- 86 *Id.*
- 87 *In re Arrendondo-Smith*, 436 B.R. 412 (Bankr. W.D.Tex.2010). Quoting *In re Stephens* 402 B.R. 1, (B.A.P. 10th Cir. 2009).

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# EXEMPT PROPERTY - SOME CHOICE OF LAW ISSUES

By Jon Cottrell

Prior to the 2005 amendments to the Bankruptcy Code,<sup>1</sup> the task of identifying which property exemptions were available to a bankrupt debtor was somewhat simpler than it is today. Under former §522(b)(2)(A), the debtor's exemptions were governed by the law of the state in which the debtor had been domiciled for the longest portion of the 180-day period prior to the filing. Because this closely parallels the domicile or residence period for proper venue under 28 USC §1408(1), cases in which a debtor filing bankruptcy in one state would be required to use the exemptions of another state were comparatively rare.

Since the effective date of BAPCPA, however, many cases are now filed in which the debtor's exemptions derive from the law of a state in which the debtor no longer lives, and may not have lived in for two years or more. Under current §522(b), the debtor's exemption choices include:

(a) May use federal bankruptcy exemptions provided in §522(d), unless the "state law that is applicable to the debtor" specifically does not so authorize, the so-called State law "opt out" of federal exemptions. §522(b)(2).

(b) Under §522(3) may use

- non-bankruptcy federal law exemptions, plus
- state or local law exemptions that are "applicable on the date of the filing of the petition," plus
- certain interests held in tenancy by the entirety or joint tenancy, plus
- certain funds in tax deferred retirement accounts.

Under §522(b)(3)(A), the Bankruptcy Code choice of law rules governing which of the two choices above may be used, depend upon the debtor's history of domicile,<sup>2</sup> in the following order:

1. The place where the debtor has been domiciled for all of the two years (730) days immediately before the bankruptcy filing.
2. If not domiciled in a single state for all of that two year period, the place where the debtor was domiciled for the

full 180 days that ended two years prior to the bankruptcy filing.

3. If neither 1 nor 2 apply, the state in which debtor was domiciled for the largest part of the 180-day period that ended two years prior to the bankruptcy filing.

4. And, finally, under the "hanging" or "independent" sentence at the end of §522(b)(2) if the debtor does not qualify for any exemption under 1, 2 or 3 above, then the debtor may use federal bankruptcy exemptions.

Although somewhat Byzantine, this formula looks like it is sufficient in itself to identify which exemptions are available to any given debtor. In fact, that is often not the case.

## The Foreign State Opt-Out Statute

One of the first things to look at is whether the applicable state designated under §522 is an opt-out state. But if it is an opt-out state, one cannot necessarily assume that federal bankruptcy exemptions are not available. A number of opt-out statutes apply only to debtors who are either residents of or domiciled in the state.<sup>3</sup> For example, the opt-out statutes of Colorado, Oregon and Florida<sup>4</sup> exclude only a person who is a "resident" of that state from using federal bankruptcy exemptions. The Georgia opt-out statute<sup>5</sup> bars the use of federal Bankruptcy Code exemptions for a person who is "an individual whose domicile is in Georgia," which the statute defines as "an individual whose domicile has been located in Georgia for the 180 days immediately preceding the date of the bankruptcy petition or for a longer portion of such 180 day period than in any other place."

For debtors directed by the provisions of §522(b) to use the "state or local law that is applicable on the date of the filing of the petition," courts have held that non-resident or non-domiciliary debtors who are referred to a foreign state whose opt-out statute applies only to residents or domiciliaries are not barred from using the federal bankruptcy exemptions. *In Re Battle*, 366 B.R. 635 (Bky. W.D. Tex. 2006); *In Re Volk*, 26 B.R.

457 (Bky. S.D. 1983); *In Re Underwood*, 342 B.R. 358 (Bky. N.D. Fla. 2006) *In Re Chandler*, 362 B.R. 723 (Bky. N.D. W.Va 2007) . The rationale employed by these courts has been that the "state or local law that is applicable" under §522(b)(3)(A) includes the entire state law on the subject of exemptions in the foreign state, not just the array of state exemptions available to persons who are residents or domiciliaries of that state. In other words §522(b) applies to the situation as it actually exists at the date of filing. It does not amend state exemption law. It does not create a new definition of "resident" or "domicile." And it is not to be construed as if the debtor were still domiciled in the foreign state.

One bankruptcy court has held that a state opt-out statute (in this case Florida's), which expressly applies only to residents of that state, could not be applied only to residents. *In re Camp*, 396 BR 194 (Bky.W.D. Tex 2008). Disagreeing with *Battle*, the judge reasoned that by enacting §522(b)(2), which allows states to opt-out, Congress created a specific choice of law rule, with the intent of forcing debtors who are referred back to an opt-out state to use the state law exemptions of that state. The judge, therefore, held that under the doctrine of preemption, the federal statute trumped any state choice of law statute which would lead to a different result. This decision has been reversed at the circuit level. *In Re Camp*, 631 F.3d 757 (5<sup>th</sup> Cir. 2011).

## Foreign State Exemption Choice of Law Statutes

In addition to limitations contained in the foreign state's opt-out statute, in many states exemptions are available only to persons who are either residents of or domiciled in that state.

There are many cases where something like this becomes the issue with respect to a homestead exemption. For example: (1) the case in which a debtor in Idaho seeks to use another state's homestead exemption on property located in the other state; (2) the case where the Idaho debtor seeks to apply a foreign state's homestead exemption to property located in Idaho; or (3) where the Idaho debtor seeks to apply Idaho's

homestead to property in another state. Rather than turning upon choice of law issues, these cases have usually been decided based upon other factors such as: (1) whether the homestead statute in question requires that the “home” property be occupied as the principal residence of the debtor, which may not be the case where he/she is now residing in a different state where the bankruptcy is filed; (2) whether the homestead statute in question may be given “extraterritorial” application beyond the boundaries of the state where it was enacted; or (3) a fact-law determination as to where the debtor was domiciled either at the petition date or at some other relevant date in the past.

The decisions in these cases are both interesting and important. But because they are generally not choice of law cases I will not discuss them here, other than to note that presumably the federal Bankruptcy Code homestead exemption under §522(d)(1) may be used if the applicable state designated under §522(b)(3)(A) either is not an opt-out state, or is one where the opt-out statute does not apply to debtors residing in another state on the petition date.

Instead, the focus here is upon the effect of those foreign state exemption statutes which by their express language provide exemptions only to persons who are residents of or domiciled in that state. In Kansas, for example, the state statutes provide personal property exemptions to “every person residing in this state.”<sup>6</sup> This provision was construed in *In re Fabert*, 2008 WL 104104 (Bky Kan. 2008) as excluding debtors who live in another state. In that case, the debtor was residing in Missouri when the petition was filed, but was required under §522(b)(3)(A) to use exemptions applicable under Kansas law. The debtor had no real property. She was held not to be entitled to use Kansas exemptions on her personal property, because at the time of filing she was not a resident of that state. Kansas has opted out of federal §522(d) exemptions. This left the debtor with no exemptions. Therefore, the court held that she was allowed to use federal §522(d) exemptions under the “saving” sentence at the end of §522(b)(3).<sup>7</sup> On similar facts, the bankruptcy court of Missouri reached the same conclusion. See *In re Nickerson*, 375 BR 869 (Bky WD Mo. 2007), in which the court rejected the trustee’s argument that the “applicable” state law under §522(b)(3)(A), “on the date of the petition” creates a

federal law redefining the debtor’s domicile so as to make state exemptions apply “as if” the debtor were still residing in the foreign state. See also *In re Underwood*, 342 BR 358 (Bky. N.D. Fla. 2006), Colorado state exemptions not available to debtor residing in Florida at the date of filing.

The exemption statutes in some other states go even farther, not only barring non-residents from use of their exemptions, but also incorporating a state choice of law rule for non-resident debtors. For example, the Alaska, Idaho, and Wisconsin statutes redirect non-resident debtors to claim exemptions under the law of the state where they reside.<sup>8</sup> To date, it appears that no bankruptcy court has issued a reported decision determining how these state choice of law statutes are to be construed in applying the §522(b)(3)(A) choice of law rule. But, in view of the rationale expressed in cases such as *Camp*, *Fabert*, and *Nickerson* cited above, i.e. that the exemption law of the foreign state is to be applied to the facts as they exist on the petition date, not as if the debtor actually lived in that state, the argument may be made that the foreign state choice of law rule, conferring upon the debtor the right to use the exemptions applicable in his resident state, should apply. Thus, it would appear that a debtor residing in Idaho but required under §522(b)(3)(A) to look to Alaska exemption laws, would be required under the Alaskan statute to use Idaho state exemptions.

### Joint Cases

Lest the foregoing be thought to be in any way complex, I turn now to issues that may come up in a husband and wife joint filing. The four Bankruptcy Code rules which apply here are:

1. Husband and wife may file jointly. §302(a)
2. Districts in which a case may be properly filed include those in which “the person ... that is the subject of such case” has been domiciled, has resided, or had his/her principal place of business or assets during the longest portion of the 180 days before filing, or where there is an affiliate, partner or partnership case already pending. 28 USC §1408.<sup>9</sup>
3. In a joint case, §522 applies separately to each debtor. §522(m).

2. In a joint case, one debtor may not elect federal Bankruptcy Code exemptions and the other debtor elect state law exemptions. §522(b)(1).

4. If the joint debtors cannot agree on the election, they shall be deemed to elect Bankruptcy Code exemptions, where such election is allowed under state law where the case is filed. §522(b)(1).

Applications of these rules are illustrated by two cases. In *In re Connor*, 419 BR 304 (Bky E.D. N.C. 2009), the husband was domiciled in North Carolina, an opt-out state. The wife was also domiciled in North Carolina at the time of filing, but had not lived there for the full two years required by §522(b)(3)(A). Due to her prior domicile history, Florida was her applicable state. Florida is also an opt-out state. But the opt-out statute applies only to resident debtors, so this did not apply to the wife. Florida provides state exemptions, but only for resident debtors. So as a non-resident, the wife could not use Florida state exemptions. The court held that the husband must use North Carolina state exemptions, and that the wife must use federal §522(d) exemptions. The court concluded that this result did not violate the §522(b)(1) prohibition on conflicting election of exemptions, because neither spouse had any choice—the use of state exemptions by one spouse and federal exemptions by the other was compelled by operation of law rather than as a result of any election made by the debtor spouses. And, because neither had any choice, the result also was not due to their failure to agree on a choice.

In *In re Hassen*, 432 BR 343 (Bky Dist. Col. 2010), the husband was domiciled in the District of Columbia, which is not opt-out. The wife was domiciled in Virginia, which is opt-out. Thus, the husband had a federal or state choice; the wife did not. The court held that the husband must use District of Columbia “state” exemptions and the wife must use Virginia state exemptions. The debtors argued that federal §522(d) exemptions applied to both under the last sentence of §522(b)(1)—see Rule 4 above—because the husband who had a choice wanted to elect federal exemptions while the wife would elect state exemptions, thus creating a disagreement. As in *In re Connor*, the court concluded that the deemed-to-elect

provision at the end of §522(b)(1) does not come into play when *either* spouse is barred from using federal exemptions by the opt-out statute of his/her applicable state. Again, where one spouse cannot choose, there cannot be any disagreement of choice.

Questions for the future: (1) If in a joint case it is possible (or required) for one spouse to use federal §522(d) exemptions while the other uses state exemptions, will it then be possible to “stack” the federal of one spouse and the state homestead exemption of the other spouse on a single home property? (2) If in a joint case it is possible (or required) for each to use the exemptions of different states, will it be possible to claim homestead exemptions on more than one property, i.e. one property in each state?

**PRACTICE TIP:** When filing a joint case in Idaho where one of the debtors resides in another state, the petition should designate the resident as the “debtor” and the non-resident as the “joint debtor.” The ECF system selects the location for the §341 meeting based on the county in which the “debtor” spouse resides. For example, if the spouse designated as the “debtor” lives in Adams County, Colorado, the ECF system will assign the case for 341 meeting in Boise.

## ENDNOTES

1 All references herein to statutes by section number only are to the Bankruptcy Code.

2 “Domicile” and “residence” are not equivalent terms. See discussion in *In re Kline*, 350 BR 497 (Bky. Id. 2005). A debtor may have more than one residence, but at any given time only one domicile. The meaning of “domicile” as used in a federal statute is determined under federal common law. *In re Donald*, 328 BR 192 (9<sup>th</sup> Cir. BAP 2005). The meaning of “domicile” or “residence” under state exemption statutes is an issue of state law. *In re Fabert*, 2008 WL 104104 (Bky. Kan. 2006).

3 Under state opt-out and exemption statutes, the meaning of “residence” and “domicile” are governed by state law, in many cases the meaning of these terms may be conflated either in the statute itself or by judicial interpretation.

4 Colo. Rev. Stat. §13-54-107; Or. Rev. Stat. §18.300; Fla. Stat. Ann. §222.20. The Florida statutes also contain what may be a unique approach, only partially opt-out. F.S.A. §222.201 allows the use of the federal Bankruptcy Code exemptions contained in §522(d)(10) as an exception to the general opt-out in F.S.A. §222.20.

5 Ga. Code §44-13-100(b).

6 KSA §§60-2304, 60-2313.

7 The “undesigned” or “hanging” sentence at the end of §522(b)(3) provides that a debtor may use the §522(d) federal bankruptcy exemptions, “If the effect of the domiciliary requirement under subparagraph (A) is to render the debtor ineligible for any exemption.” This provision has been strictly construed to apply only if the debtor is ineligible for any exemption at all; the availability of *any* exemption under state law would defeat a claim of federal exemptions. *In re Katseanes*, Idaho Bky. case no. 07-40168, 2007 WL 2962637 (2007).

8 Alaska, AS§09.38.120, which defines “resident” in language equivalent to the usual definition of “domiciliary”; Idaho Code §11-602, which defines “resident” as “one who *intends* to maintain his home in this state”; Wisconsin WSA §815.18(5).

9 Although this statute refers to the debtor (“the person”) in the singular, there are a number of cases in which joint debtors hold none of the 28 USC §1408 requirements in common. There appears to be no reported case which has held this to be improper.



# STOP ME IF YOU'VE HEARD THIS ONE

By Ken Anderson

If you have heard any of my presentations at the Idaho and Montana Bankruptcy Seminars, you may have heard this already but it bears repeating. Call it practical advice for your practice from a practicing practitioner.

Many years ago I had a middle-age couple in my office requesting a Chapter 13 bankruptcy. They knew exactly what they wanted. But that was long before BAPCPA and I determined they had a choice between Chapters 7 and 13. Since I didn't see any benefit to them with a 13, I recommended a 7.

The reason for my advice was that, beside the usual assortment of credit cards and medicals, they had a large judgment against their home, much of which I could not avoid under Section 522(f). And they did not have the disposable income to pay that non-avoidable portion of the judgment so either way they would lose their home. But they doggedly insisted on saving the house with a 13 and said they would make it work.

So I proposed and obtained confirmation of a Ch. 13 Plan with payments that were sufficient to pay the non-avoidable portion of the judgment lien but which seemed to me to be beyond their funding ability. Sure enough, a few months after confirmation they were back in the office with a trustee's motion to dismiss for failure to keep up their payments. I again tried to talk them into going 7 and surrendering the house. No soap. So I modified the plan to 48 months to reduce the payments and re-started things. A few months later, they were again back in the office. Again failing to "talk sense" into them, I obtained a plan modification to 60 months and advised them this was all that could be done; it was do or die (or take my advice and convert). A few months later, again, they were back in with a trustee's motion. Utterly frustrated with them, I lost my cool and asked them in an exasperated tone of voice just what it was about that house that made them risk a much-needed financial rehabilitation in a hopeless attempt to save it. The woman burst into tears and her husband lowered his gaze to the desk and remained still. At that point I realized I had touched a nerve so just kept quiet for a minute. After recomposing herself and drying her eyes, the woman looked right at me and said quietly, "Mr. Anderson, from my kitchen window I can see my baby daughter's grave." I realized that all along, I had totally failed to find out just what were my clients'

objectives in this bankruptcy. It was more than just keeping a roof over their heads. The judgment creditor was the local credit bureau and I knew the managing partner. So I walked over to his office and explained the situation. He was cooperative so I again modified the plan to reduce the term back down to 36 months with realistic payments and a special provision that any amount left unpaid on the non-avoidable portion of the judgment lien would not be discharged and the debtors would then pick up regular monthly payments on it post-closure. My clients then were able to complete their Chapter 13 filing and also keep their home and their view from the kitchen window.

As bankruptcy practitioners, we tend to get into a rut. We routinely ask about the types of debt to advise as to dischargeability and about property with a view toward planning exemptions. But it requires thinking outside the box to reach the human needs involved. Ever since the Initial Conference, I have made a point to inquire as to the clients' expectations as to what they wished to achieve by filing bankruptcy. Sometimes there are needs that go beyond the numbers.



## DO YOU HAVE SOMETHING TO SUBMIT?

The Commercial Law and Bankruptcy Section Newsletter is produced quarterly. If you would like to include an item in the upcoming newsletter, please contact Katie Dullea at [katied@nctv.com](mailto:katied@nctv.com).

# THE ABSOLUTE PRIORITY RULE HELD APPLICABLE IN INDIVIDUAL CHAPTER 11 CASES IN THE DISTRICT OF IDAHO

By Noah Hillen

The addition of Section 1115 and the reference to that statute in Section 1129(b)(2)(B)(ii) has caused considerable debate among bankruptcy courts and practitioners as to whether the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (“BAPCPA”) abrogated the absolute priority rule in individual chapter 11 bankruptcies. In *In re Borton*, 2011 WL 5439285 (Bankr. D. Idaho, November 9, 2011), Judge Myers clarified that in the District of Idaho, the absolute priority rule applies in such cases and requires that debtors pledge prepetition property to any plan when invoking cramdown under Section 1129(b). This decision will significantly impact individual chapter 11 bankruptcies and negotiations between debtors and creditors.

## 1. The Absolute Priority Rule and BAPCPA.

The absolute-priority rule has been an integral part of the Chapter 11 process and its predecessor in the Bankruptcy Act since Justice Douglas concluded under an absolute priority regime, those with superior non-bankruptcy rights must be paid in full before those junior to them, meaning that senior creditors are paid ahead of junior creditors and junior creditors ahead of equity. *Case v. L.A. Lumber Prods. Co.*, 308 U.S. 106 (1939). Prior to BAPCPA, the Ninth Circuit held that the absolute priority rule applied equally to individual debtors and debtors that were entities. *Everett v. Perez* (In re Perez), 30 F.3d 1209, 1212-144 (9th Cir. 1994). Because individual chapter 11 debtors could not retain any property without paying their unsecured creditors in full, debtors could be compelled to devote exempt property to a chapter 11 plan. See *In re Gosman*, 282 B.R. 45 (Bankr. S.D. Fla. 2002) (holding that exempt property must be devoted to an individual debtor’s chapter 11 plan).

BAPCPA appeared to resolve this issue with new Section 1115, which seemingly abrogated the absolute-priority rule in individual chapter 11 cases. However, the majority of bankruptcy courts most recently addressing this issue have concluded the

absolute-priority rule still applies in individual chapter 11 cases, including in the District of Idaho. See *In re Borton*, 2011 WL 5439285 (Bankr. D. Idaho, November 9, 2011); *In re Kamell*, 451 B.R. 505 (Bankr. C.D. Cal. 2011); *In re Gbadebo*, 431 B.R. 222 (Bankr. N.D. Cal. 2010); *In re Draiman*, 2011 WL 1486128, at \*37 (Bankr. N.D. Ill., April 19, 2011); *In re Walsh*, 447 B.R. 45 (Bankr. D. Mass. 2011); *In re Stephens*, 445 B.R. 816 (Bankr. S.D. Tex. 2011); *In re Karlovich*, 2010 WL 5418872, at \*4-5 (Bankr. S.D. Cal., Nov. 16, 2010); *In re Gelin*, 437 B.R. 435 (Bankr. M.D. Fla. 2010); *In re Steedley*, 2010 WL 3528599, at \*1-2 (Bankr. S.D. Ga., Aug. 27, 2010); *In re Mullins*, 435 B.R. 352 (Bankr. W.D. Va. 2010); *In re Maharaj*, 449 B.R. 484, 491-94 (Bankr. E.D. Va. 2011).

At the heart of the dispute whether the absolute priority rule applies in an individual chapter 11 case is an ambiguity over what Congress meant in Section 1129(b)(2)(B)(ii) by the language, “included in the estate under section 1115.” In order to confirm a plan over the rejection of an impaired class, a debtor must resort to the cramdown provisions of Section 1129(b). Cramdown may be accomplished under Section 1129(b)(1) only if compliance with Section 1129(a)(8) is lacking and the plan does not discriminate unfairly and is fair and equitable, with respect to each class of claims or interest that is impaired under and has not accepted the plan. “Fair and equitable” treatment, when applied to a dissenting class of impaired unsecured creditors, is defined under Section 1129(b)(2)(B) as:

With respect to a class of unsecured claims—

(i) the plan provides that each holder of a claim of such class receive or retain on account of such claim property of a value, as of the effective date of the plan, equal to the allowed amount of such claim; or

(ii) the holder of any claim or interest that is junior to the claims of such class will not receive or retain under the plan on account of such junior claim or interest any property, except that in a case in which the debtor is an individual, the debtor may

retain property included in the estate under section 1115, subject to the requirements of subsection (a)(14) of this section.

Section 1115 in turn provides:

(a) In a case in which the debtor is an individual, property of the estate includes, in addition to the property specified in section 541—

(1) all property of the kind specified in section 541 that the debtor acquires after the commencement of the case but before the case is closed, dismissed, or converted to a case under chapter 7, 12, or 13, whichever occurs first; and

(2) earnings from services performed by the debtor after the commencement of the case but before the case is closed, dismissed, or converted to a case under chapter 7, 12, or 13, whichever occurs first.

(b) Except as provided in section 1104 or a confirmed plan or order confirming a plan, the debtor shall remain in possession of all property of the estate.

## 2. The Borton Decision

As noted in *Borton*, courts have generally adopted either a “broad view” or “narrow view” regarding the absolute priority rule in individual chapter 11 cases. Courts adopting the “broad view” have concluded that Congress eliminated the absolute priority rule with the addition of Section 1115 and the reference to Section 1115 in Section 1129(b)(2)(B)(ii). *In re Shat*, 424 B.R. 854 (Bankr. D. Nev. 2010). Courts ascribing to the “narrow view” have disagreed and determined the addition of Section 1115 and the reference to Section 1115 in Section 1129(b)(2)(B)(ii) only abrogates the absolute priority rule as to post-petition earnings and other property acquired after the commencement of a case. (*Walsh*, 447 B.R. at 48-49).

Finding that the language set forth in Sections 1115 and 1129(b)(2)(B)(ii) was unambiguous, the *Borton* court concluded the “narrow view” was the correct view. Accordingly, in the District of Idaho, the absolute priority rule applies to individual chapter 11 bankruptcies. That rule,

however, excepts property included in the estate under Section 1115. Pursuant to Section 1115, in an individual chapter 11 case, the estate includes the debtor's post-petition earnings and property acquired after the commencement of a case, in addition to the property specified in Section 541. According to the court in Borton, Section 1115 "therefore supplements Section 541, but it does not supplant or subsume Section 541 as suggested by those courts adopting a broad interpretation of Section 1115."

### 3. The Impact of Borton

The absolute priority rule of Section 1129(b)(2)(B)(ii) remains effective in individual chapter 11 cases as to prepetition

property retained by the debtor. Therefore, the price of invoking cramdown in an individual chapter 11 bankruptcy over the rejection of an entire class of unsecured creditors is the debtor's prepetition property. In other words, a debtor is required to pledge prepetition property under a plan when proceeding to confirm a chapter 11 plan under Section 1129(b). An individual debtor, however, is not required to pledge post-petition property and earnings above the "projected disposable income" required by Section 1129(a)(15)(B) when invoking cramdown. The absolute priority rule and the requirement that prepetition property be pledged to creditors under a plan will most likely deter individual chapter 11 debtors

from invoking cramdown. In cases where one single creditor dominates the class of unsecured creditors, this creditor will have additional bargaining power in gaining more favorable plan treatment from individual chapter 11 debtors.

### ENDNOTES

1. Courts ascribing to the narrow view either view Sections 1115 and 1129(b)(2)(B)(ii) as unambiguous, Walsh, 447 B.R. at 48-49; or find the language ambiguous but conclude that the Code requires application of the absolute priority rule through the rules of statutory interpretation, Kamell, 451 B.R. at 509.

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