

**There's No Place Like Home in Debtor's Paradise:
The Tenth Circuit's Liberal Construction of the
Kansas Homestead Exemption and the
Doctrine of Equitable Conversion
[*Jenkins v. Hodes (In re Hodes)*,
402 F.3d 1005 (10th Cir. 2005)]**

Molly E. McMurray*

I. INTRODUCTION

In *Jenkins v. Hodes (In re Hodes)*,¹ the United States Court of Appeals for the Tenth Circuit incorrectly held that the doctrine of equitable conversion permits a debtor to convert nonexempt assets into exempt assets when the debtor pays a contractor a cash deposit for future home improvements, regardless of whether construction has begun.² This case is significant because the court interpreted Kansas's homestead exemption to include cash deposits that are allegedly intended to expand an existing homestead, departing from the traditional notion that only the homestead itself is protected from creditors.³ Further, the court's decision to apply equitable conversion to bankruptcy has opened the door for courts to use the doctrine in new and expansive ways.⁴ This case addressed an issue of first impression,⁵ which the Tenth Circuit used to create loopholes available for debtors in bankruptcy proceedings.

The Tenth Circuit's decision expands the Kansas homestead exemption by broadening the kinds of property deemed exempt.⁶ The court's application of the doctrine of equitable conversion in bankruptcy proceedings increases the avenues available for debtors who manipulate their assets to avoid their financial obligations by converting nonexempt assets into exempt assets.⁷ A debtor may now avoid creditors by making a cash deposit for an addition to the home-

* B.A. 2004, University of Kansas; J.D. Candidate 2007, Washburn University School of Law. I would like to thank all the editors of the *Washburn Law Journal*, particularly Roarke Gordon for his endless advice, encouragement, and friendship. I gratefully acknowledge Professor J. Lyn Entrikin Goering for her patience, guidance, and legal writing expertise on this project and so many others in law school. I thank my family and friends, especially my mom, for their support and love. I dedicate this work to my dad, whose undying belief in me provides me with the courage to pursue my dreams.

1. 402 F.3d 1005 (10th Cir. 2005).

2. *Id.* at 1013.

3. *Id.* at 1009-10, 1013.

4. See, e.g., *In re Stroble*, No. 03-24926, 2005 Bankr. LEXIS 1720, at *6-9 (Bankr. D. Kan. Sept. 7, 2005) (relying on *Hodes* to hold that a cash settlement was exempt from creditors because of equitable conversion).

5. *In re Hodes*, 402 F.3d at 1012.

6. *Id.* at 1013.

7. *Id.*

stead, unless a creditor can prove that the debtor's disposition of non-exempt property was made with the intent to hinder, delay, or defraud creditors.⁸

This comment examines the repercussions of the court's decision in *Hodes* as it applies to the Kansas homestead exemption. It explores the doctrine of equitable conversion and the possible ramifications of its application in bankruptcy proceedings. Finally, this comment analyzes the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA)⁹ and whether its provisions would have altered the court's decision in *Hodes* and similar cases.

II. CASE DESCRIPTION

In 1993, Lawrence Jenkins and Roger Hood sued Philip and Barbara Hodes regarding the sale of corporate stock.¹⁰ Jenkins and Hood prevailed in the action, receiving a \$4 million verdict against the Hodeses and other defendants.¹¹ Final judgment was entered in favor of Jenkins and Hood on November 17, 1997.¹² Shortly after Jenkins and Hood's victory,¹³ the Hodeses liquidated approximately \$500,000 in nonexempt assets, using the proceeds to acquire exempt assets.¹⁴

8. See Pub. L. No. 109-8, 119 Stat. 23, 308 (to be codified at 11 U.S.C. § 522(o)).

9. Pub. L. No. 109-8, 119 Stat. 23 [hereinafter BAPCPA] (to be codified as amended in several titles and scattered sections of U.S.C.). Although BAPCPA contains provisions that were effective in April 2005, the majority of the provisions took effect in October 2005. See, e.g., 11 U.S.C. § 1501(b). This legislation significantly alters bankruptcy proceedings, and its possible effects and interpretations are indeterminate at this point. See *id.* *Hodes* was decided on March 25, 2005, the month before BAPCPA was signed into law. *In re Hodes*, 402 F.3d at 1005.

10. *Id.* at 1008. The prior litigation between the Hodeses and Jenkins and Hood is quite extensive. The initial matter arose over the sale of T.S.I. Holdings, Inc., a Kansas company whose principal business was the "manufacture and installation of tanks on trucks." *T.S.I. Holdings, Inc. v. Jenkins*, 924 P.2d 1239, 1243 (Kan. 1996). Phillip Hodes owned twenty-five percent of TSI stock and his business partner, Melvyn Paul, owned seventy-five percent of the stock. *Id.* Hodes and Paul realized that they needed investors to keep the company prosperous and entered into negotiations with Jenkins and Hood. *Id.* In February 1993, after negotiations with the parties and the attorneys, Jenkins, Hood, Paul, and Hodes reached an agreement, which a jury later determined Hodes and Paul breached. *In re Hodes*, 402 F.3d at 1008. In *Jenkins*, the Kansas Supreme Court remanded the case for a new trial on Jenkins and Hood's claims for breach of contract. *Jenkins*, 924 P.2d at 1243-44.

The second trial resulted in a \$4 million judgment for Jenkins and Hood, after which a further appeal was taken. *Jenkins v. T.S.I. Holdings, Inc.*, 1 P.3d 891, 893 (Kan. 2000). Following the second trial, some of the defendants who were found to have breached the contract filed for Chapter 11 and Chapter 13 protection, and Jenkins and Hood filed an involuntary Chapter 7 petition against the Hodeses. *Id.* The appeal before the Kansas Supreme Court was initiated by all of the original sellers; however, after bankruptcy proceedings began, all sellers except the Hodeses settled out of court. *Id.* The Kansas Supreme Court found no merit to any of the Hodeses' claims and subsequently affirmed the jury's \$4 million verdict against the Hodeses. See *id.*

11. *In re Hodes*, 402 F.3d at 1008. Jenkins and Hood were also awarded \$500,000 in attorney's fees. *In re Hodes (Hodes III)*, Nos. 98-20039-7, 98-20040-7, 2003 WL 23807972, at *1 (Bankr. D. Kan. Apr. 17, 2003).

12. *In re Hodes*, 402 F.3d at 1008.

13. See *Hodes III*, 2003 WL 23807972, at *1. Before the final judgment was entered, the Hodeses met with an attorney specializing in bankruptcy. *Id.*

14. *In re Hodes*, 402 F.3d at 1008. Aside from the home addition that is the subject of this comment, the Hodeses also attempted to obtain certain life insurance policies, which they claimed as exempt from creditors. *Hodes III*, 2003 WL 23807972, at *1. In a separate proceed-

On December 7, 1997, the Hodeses paid \$225,000¹⁵ to a building contractor as a cash deposit for a 1,056 square-foot addition to their existing 3,700 square-foot home, which they purchased in 1989 for \$545,000.¹⁶

On January 6, 1998, just thirty days after payment of the deposit, Jenkins and Hood filed a Chapter 7 involuntary bankruptcy petition against the Hodeses.¹⁷ At that time, the builder had not begun construction and was holding the entire \$225,000 cash deposit.¹⁸ Construction of the new addition began shortly after the filing date.¹⁹ On February 23, 1998, Jenkins and Hood filed a motion to stop the construction of the addition and to prohibit the Hodeses and the builder from spending the cash deposit.²⁰ On March 2, 1998, the parties attempted to resolve their dispute with a settlement agreement that required the Hodeses to obtain a mortgage on their home and pay Jenkins and Hood the proceeds of that mortgage.²¹

While the parties argued in court, construction on the addition to the home continued.²² By the time the Hodeses consented to entry of an order for relief on April 16, 1998, the builder had expended approximately \$9,000 of the cash deposit.²³ Subsequently, the Hodeses

ing, the bankruptcy court ruled against the Hodeses and held that the \$29,646.13 paid to obtain a new policy on December 12, 1997, was nonexempt because it was paid within one year before the filing of the bankruptcy petition. *Id.* at *6. The bankruptcy court noted that the Hodeses' attempt to procure the policy was suspect, in part because "most 58 year old men with no dependents would find ownership of over \$2.25 million in insurance adequate, if merely maintaining adequate insurance was the true motive for this conversion of cash to insurance." *Id.* Also, the bankruptcy court held that the intent of the Kansas legislature included a "presumption of fraud if a debtor tries to exempt the cash value of insurance obtained within one year of bankruptcy." *Id.* The bankruptcy court ordered that the money paid for life insurance be turned over to the Chapter 7 Trustee for distribution to the judgment creditors. *Id.* On appeal, the Bankruptcy Appellate Panel reversed, holding that the bankruptcy court incorrectly interpreted the statute and that, because an involuntary bankruptcy petition was filed against the Hodeses as opposed to a voluntary petition, the life insurance policy should be exempt. *Hodes v. Jenkins (In re Hodes) (Hodes IV)*, 308 B.R. 61, 69-71 (B.A.P. 10th Cir. 2004).

15. At various points throughout the appeals, the amount for the contract was listed as \$250,000; however, the parties agreed that the actual value was \$225,000. *In re Hodes*, 402 F.3d at 1008.

16. *Id.* at 1009.

17. *Id.*

18. *Id.*

19. *Id.*

20. *Id.* The creditors filed a motion under 11 U.S.C. § 303(f), which allows the court to bar a debtor from controlling assets while a bankruptcy proceeding is pending, in an attempt to stop the construction and to prohibit the Hodeses and the builder from spending the cash deposit. *Id.* 11 U.S.C. § 303(f) provides as follows:

Notwithstanding section 363 of this title [11 U.S.C. § 363], except to the extent that the court orders otherwise, and until an order for relief in the case, any business of the debtor may continue to operate, and the debtor may continue to use, acquire, or dispose of property as if an involuntary case concerning the debtor had not been commenced.

11 U.S.C. § 303(f) (2000).

21. *In re Hodes*, 402 F.3d at 1009. The parties agreed to a \$290,000 settlement figure. *Id.*

22. *Id.*

23. *Id.*

failed to comply with the settlement agreement.²⁴ Jenkins and Hood filed a motion to compel settlement, at which time the builder had exhausted nearly \$165,000 of the deposit.²⁵

A. *Bankruptcy Court for the District of Kansas*

The bankruptcy court identified the fundamental issue as which date controls for purposes of exemptions: the date the involuntary petition was filed or the date the order for relief was entered.²⁶ The bankruptcy court concluded that the date of the order for relief should control and, therefore, the home improvements financed by the \$225,000 deposit should be exempt, even though construction was incomplete on that date.²⁷

Analyzing the issue, the bankruptcy court cited other Kansas cases illustrating the strong public policy of shielding the homestead from creditors.²⁸ In *Kessler v. Frost*,²⁹ for example, the Kansas Supreme Court held exempt money that the defendants had obtained by mortgaging their home and had deposited into an account for the purpose of paying for home improvements.³⁰ The bankruptcy court also relied on *First National Bank v. Dempsey*,³¹ in which the Kansas Supreme Court held that cash proceeds from the sale of a homestead, which the sellers intended to use in acquiring a new homestead, were exempt.³² The bankruptcy court reasoned that additions to an existing homestead should be treated the same as new homes under construction, which are exempt from creditors, but only if the new home is financed by cash proceeds from the sale of the old home.³³ Ultimately, the bankruptcy court denied Jenkins and Hood's objection to the exemption of the Hodeses' cash deposit.³⁴

B. *District Court of Kansas*

On appeal, the district court affirmed the bankruptcy court's exemption of the entire \$225,000 cash deposit, even though the deposit

24. *Id.*

25. *Id.* On October 28, 1998, Jenkins and Hood withdrew their motion to compel, although the record does not indicate the reasons for that action. *Id.* This voluntary withdrawal may have been in response to yet another assurance from the Hodeses that the judgment creditors would be paid. This is mere speculation because there is no journal entry regarding the withdrawal of the § 303(f) motion. Regardless, the failure to fully pursue the motion caused obstacles for Jenkins and Hood throughout the appellate process.

26. *In re Hodes (Hodes I)*, 235 B.R. 104, 105 (Bankr. D. Kan. 1999).

27. *Id.*

28. *Id.* at 109-10.

29. 175 P. 967 (Kan. 1918).

30. *Id.* at 967-68.

31. 11 P.2d 735 (Kan. 1932).

32. *Id.* at 736; *see also* *Int'l Harvester Credit Corp. v. Ross*, 538 P.2d 655 (Kan. 1975).

33. *Hodes I*, 235 B.R. at 110.

34. *Id.*

remained intact at the time of the Chapter 7 filing and only about \$9,000 had been expended by the time the order for relief was entered.³⁵ Under a mixed standard of review, the court concluded that exemptions in an involuntary proceeding are determined according to the date the order for relief is entered, not the date the involuntary petition is filed.³⁶ The district court held that the portion of the \$225,000 that was ultimately spent on the homestead addition was exempt.³⁷

The district court rejected many of Jenkins and Hood's arguments because they were raised for the first time on appeal.³⁸ The court relied on public policy to affirm other bankruptcy court findings, including that Jenkins and Hood failed to prove that the Hodeses participated in fraudulent conduct.³⁹ More specifically, the court stated that "the mere fact that [the Hodeses] used nonexempt assets to fund a \$225,000 addition to a \$545,000 home was not prima facie evidence of fraud."⁴⁰

C. Tenth Circuit Court of Appeals

Before the United States Court of Appeals for the Tenth Circuit, the Hodeses prevailed in a unanimous opinion delivered by Judge Robert H. Henry.⁴¹ The court affirmed on the basis of equitable conversion, an issue raised sua sponte by the Tenth Circuit, holding that

if a Kansas debtor enters into a valid, enforceable contract with a builder for improvements to an exempt homestead, prior to an involuntary petition being filed against the debtor, and the debtor puts down a deposit with the builder before the petition is filed, the deposit is *equitably converted* into construction at the moment the contract is executed and the not-yet-complete construction is equitably converted into an exempt asset. For that reason, the deposit is

35. Jenkins v. Hodes (*In re Hodes*) (*Hodes II*), 287 B.R. 561, 563, 571 (D. Kan. 2002).

36. *Id.* at 563, 565. The court explained that it would review factual findings under the clearly erroneous standard. *Id.* at 563. Because the findings of fact by the bankruptcy court were undisputed, the court's focus was a de novo review of the lower court's legal conclusions. *Id.*

37. *Id.* at 568. The district court noted that Jenkins and Hood failed to fully prosecute their § 303(f) motion to halt the construction of the addition. *Id.*

38. *See, e.g., id.* at 569. For example, the court dismissed the argument that the Hodeses violated an automatic stay, which was purportedly invoked when the involuntary petitions were filed or, alternatively, when the order for relief was entered. *Id.* The court would not hear this argument because it was raised for the first time on appeal. *Id.* Further, the court refused to hear the argument that the trustee had a "special interest" in the money used as a cash deposit to the builder because that claim was not presented to the bankruptcy court. *Id.* at 571.

39. *Id.* at 565. The court held that "involuntary debtors should be permitted to claim as exempt any funds used to improve a homestead, regardless of whether actual construction was completed before the involuntary petitions were filed or orders for relief entered." *Id.*

40. *Id.* The court further reasoned that "[t]he right to convert nonexempt assets into exempt assets is well settled in Kansas." *Id.* at 568 (quoting Douglas County Bank v. Fine (*In re Fine*), 89 B.R. 167, 174 (Bankr. D. Kan. 1988)).

41. Jenkins v. Hood (*In re Hodes*), 402 F.3d 1005, 1008 (10th Cir. 2005).

part and parcel of the homestead and is exempt to the extent that the debtor actually uses it to improve the homestead.⁴²

The court declined to address the issue of timing that was central to the lower courts' dispositions.⁴³

Noting the potential for abuse by applying equitable conversion to Kansas's homestead exemption, the Tenth Circuit tried to narrowly tailor its holding to exclude cases of fraud by wealthy debtors attempting to shield their assets.⁴⁴ The court listed potential misuses of the holding and then stated that only money actually used to improve the homestead should be exempt, a declaration that the court thought would limit abuse.⁴⁵ In addition, the court specifically stated that "[e]quitable conversion only has meaning if the contract between the debtor and the builder is valid in the first place."⁴⁶

Kansas courts have applied equitable conversion in other contexts, but never in a bankruptcy involving the exemption of a cash deposit paid to a homebuilder.⁴⁷ Nevertheless, the court concluded that "the equitable conversion doctrine . . . may be invoked in any case in which a party is under a legal duty to convey."⁴⁸ The court observed that the disproportionately lenient treatment of Kansas debtors, as compared to debtors in other states, was a direct result of Kansas's unlimited homestead exemption.⁴⁹ The Tenth Circuit noted that if Kansas desired to curb abuse of its generous laws in favor of

42. *Id.* at 1013 (emphasis added).

43. *Id.* The timing issue was whether the date of filing or the date the order for relief was granted controlled for purposes of determining exemptions. *In re Hodes (Hodes I)*, 235 B.R. 104, 105 (Bankr. D. Kan. 1999). It is interesting that the court did not address this issue, which was hotly contested in the lower courts. It is particularly significant because in bankruptcy proceedings, most exemptions are determined according to specific dates. *In re Hodes*, 402 F.3d at 1013. In this case, the bankruptcy was an involuntary action, and because the court avoided the question, the determination date for exemptions in involuntary bankruptcy cases remains unclear in the Tenth Circuit.

44. *In re Hodes*, 402 F.3d at 1013.

45. *Id.* For example, the court stated that if money were given to a contractor to "hold" until the completion of bankruptcy proceedings but never used for the projected purpose, then that money would not be exempt. *See id.*

46. *Id.* at 1014. The use of the word "valid" by the court is noteworthy. The court should not have needed to state that the contract must be valid because equity can never be used to defend fraud. *See, e.g.*, *Worden v. Cal. Fig Syrup Co.*, 187 U.S. 516, 529-30 (1903). The court's characterization of acceptable transactions as "valid" could suggest that it did not fully consider the ramifications of the use of equitable conversion in this context.

47. *In re Hodes*, 402 F.3d at 1012. The court cited several Kansas cases in which equitable conversion was used. In one case, the Kansas Supreme Court noted that when the doctrine of equitable conversion is applied to contracts for the sale of land, "the doctrine involves a change in the character of property so that realty is considered personalty and personalty is considered realty." *In re Hodes*, 402 F.3d at 1012 (citing *In re Estate of Hills*, 564 P.2d 462, 468-69 (Kan. 1977)). In another case, the Kansas Court of Appeals found that "a contract for sale of real estate worked equitable conversion of land into personalty for tax purposes." *In re Hodes*, 402 F.3d at 1012 (citing *Frisbie v. Dir. of Taxation*, 566 P.2d 29, 32 (Kan. Ct. App. 1977)).

48. *In re Hodes*, 402 F.3d at 1012 (quoting 1 DAN B. DOBBS, *LAW OF REMEDIES: DAMAGES, EQUITY, RESTITUTION* § 4.3(8) (2d ed. 1993)).

49. *Id.* at 1013.

debtors, then the legislature could amend its liberal homestead exemption.⁵⁰

III. BACKGROUND

Traditionally, Kansas courts have liberally construed homestead exemption laws in favor of debtors.⁵¹ These debtor-friendly laws protect families from complete impoverishment and, more generally, protect society from the negative effects of its citizens becoming destitute.⁵² Equitable conversion is not a new concept, but *Hodes* is the first to apply the doctrine to bankruptcy proceedings in which a cash deposit was given to a homebuilder.⁵³ To appreciate the ramifications of the court's decision in *Hodes*, it is important to understand both the Kansas homestead laws and the doctrine of equitable conversion. To fully evaluate the repercussions of *Hodes*, it is also necessary to examine the possible effects of BAPCPA.

A. *The Kansas Homestead Provision*

Generally, a homestead is defined as “[t]he house, outbuildings, and adjoining land owned and occupied by a person or family as a residence.”⁵⁴ The homestead represents a person's home and because of that special significance, it has traditionally been protected against forced sale by creditors.⁵⁵ In Kansas bankruptcy proceedings, the full value of a debtor's home is exempt from creditors.⁵⁶ Kansas is one of only five states with such an expansive provision and because of that unique role, is among the few havens for wealthy debtors looking for a place to shield their assets from creditors.⁵⁷

An “exemption” is generally defined as “[a] privilege given to a judgment debtor by law, allowing the debtor to retain certain property without liability.”⁵⁸ Upon filing for bankruptcy, all a debtor's assets

50. *Id.* at 1013-14.

51. *See, e.g., In re Mueller*, 71 B.R. 165, 167 (D. Kan. 1987); *Sullivan v. Dittmore (In re Estate of Dittmore)*, 106 P.2d 1056, 1058 (Kan. 1940).

52. *Anderson v. Shannon*, 73 P.2d 5, 10 (Kan. 1937).

53. *In re Hodes*, 402 F.3d at 1012.

54. BLACK'S LAW DICTIONARY 751 (8th ed. 2004). Although the definition does not specifically mention additions to an existing residence, the bankruptcy court noted that the ongoing construction of a new home would still constitute a homestead, and unfinished additions to existing homes should constitute part of the homestead and remain out of creditors' reach. *See In re Hodes (Hodes I)*, 235 B.R. 104, 110 (Bankr. D. Kan. 1999).

55. Ryan P. Rivera, *State Homestead Exemptions and Their Effect on Federal Bankruptcy Laws*, 39 REAL PROP. PROB. & TR. J. 71, 75 (2004).

56. KAN. STAT. ANN. § 60-2301 (1994). Kansas's exemption scheme is based on acreage rather than monetary value. *Id.*

57. Rivera, *supra* note 55, at 72. The five states without dollar limits on homestead exemptions are Florida, Iowa, Kansas, South Dakota, and Texas. Riva D. Atlas, *Enron's Collapse: Legislation; Democrats Review Changes in Bankruptcy*, N.Y. TIMES, Jan. 24, 2002, at C8, available at 2002 WLNR 4027715.

58. BLACK'S LAW DICTIONARY 612 (8th ed. 2004); *see also In re Hodes*, 402 F.3d at 1010 (citing *Holloway v. John Hancock Mut. Life Ins. Co.*, 81 F.3d 1062, 1063 (11th Cir. 1996)).

become known as the bankruptcy estate.⁵⁹ Typically, property in a bankruptcy estate is liquidated by a trustee who makes pro rata assignments of the proceeds to creditors.⁶⁰ The bankruptcy estate is subject to certain exemptions carved out for the debtor, the largest of which is usually the homestead.⁶¹ There is a strong public policy in favor of the purposes of bankruptcy exemptions, including

- (1) To provide the debtor with property necessary for his physical survival;
- (2) To protect the dignity and the cultural and religious identity of the debtor;
- (3) To enable the debtor to rehabilitate himself financially and earn income in the future;
- (4) To protect the debtor's family from the adverse consequences of impoverishment;
- (5) To shift the burden of providing the debtor and his family with minimal financial support from society to the debtor's creditors.⁶²

The presumption in favor of exemptions is so strong that even the purposeful transformation of nonexempt assets into exempt assets, in contemplation of filing for bankruptcy and with the intent to shield those assets from creditors, is not per se evidence of fraud.⁶³ The conversion of nonexempt assets to exempt assets before filing for bankruptcy is not, however, always legitimate. The United States Court of Appeals for the Fifth Circuit noted that

[i]t would constitute a perversion of the purpose of the Bankruptcy Code to permit a debtor earning \$180,000 a year to convert every one of his major nonexempt assets into sheltered property on the eve of bankruptcy with actual intent to defraud his creditors and then emerge washed clean of future obligation by carefully concocted immersion in bankruptcy waters.⁶⁴

It can be difficult for creditors to prevail in an exemption dispute because the objecting party bears the burden of proof to overcome the presumed validity of the exemptions.⁶⁵ Absent a clear showing of fraud, it is problematic for creditors to defeat claimed exemptions, particularly homestead exemptions in Kansas.⁶⁶ Kansas's expansive bankruptcy laws provide debtors with the opportunity to claim numerous exemptions.⁶⁷

The homestead provision was part of the original Kansas Constitution and was later codified by statute.⁶⁸ Pursuant to the statute,

59. See 11 U.S.C. § 541 (2000).

60. See § 363.

61. Rivera, *supra* note 55, at 72; see also *In re Hodes*, 402 F.3d at 1010 (citing *Holloway*, 81 F.3d at 1063).

62. *Norwest Bank Neb. v. Tveten*, 848 F.2d 871, 876 (8th Cir. 1988) (citing *In re Ellingson*, 63 B.R. 271, 277-78 (N.D. Iowa 1986)).

63. See *id.* at 875 (citing *Forsberg v. Sec. State Bank*, 15 F.2d 499, 501 (8th Cir. 1926)).

64. *First Tex. Sav. Ass'n v. Reed (In re Reed)*, 700 F.2d 986, 992 (5th Cir. 1983).

65. *Jenkins v. Hodes (In re Hodes)*, 402 F.3d 1005, 1010 (10th Cir. 2005).

66. *In re Hodes (Hodes III)*, Nos. 98-20039-7, 98-20040-7, 2003 WL 23807972, at *3 (Bankr. D. Kan. Apr. 17, 2003) (citing 11 U.S.C. § 522(b); FED. R. BANKR. P. 4003(c); *In re Zink*, 177 B.R. 713, 714 (Bankr. D. Kan. 1995)).

67. See, e.g., KAN. STAT. ANN. §§ 60-2301, 60-2304 (1994).

68. See KAN. CONST. art. 15, § 9; KAN. STAT. ANN. § 60-2301.

debtors may claim their entire homestead as exempt in a bankruptcy proceeding, regardless of its value.⁶⁹ Unlike Kansas, the majority of states with a homestead exemption impose a dollar limit on the amount a debtor can claim as exempt.⁷⁰ Kansas instead limits homestead exemptions by total acreage;⁷¹ thus, debtors may claim their entire home as exempt regardless of the value, so long as the acreage on which the home sits does not exceed the state's liberal limits.⁷²

B. *The Doctrine of Equitable Conversion*

Equitable conversion is generally defined as “the doctrine that, since equity regards as done what ought to be done, once parties have executed a binding contract for the sale of land, equitable title vests in the purchaser and the vendor holds legal title only as security for payment of the balance of the purchase price.”⁷³ Equitable conversion is commonly used in risk of loss cases.⁷⁴ For example, if two people enter into a contract to buy and sell wheat, it is important for liability purposes to establish when ownership is effectively transferred. If money changes hands before the wheat has been physically transferred, the buyer technically owns the wheat and is responsible for it. If tragedy strikes and the wheat is destroyed before the buyer takes possession, the doctrine of equitable conversion places the burden on the buyer because the moment the cash was transferred, he became the equitable owner of the wheat.

In *Hodes*, the Tenth Circuit defined equitable conversion as “a legal fiction devised in recognition of the maxim that equity regards as done that which ought to be done.”⁷⁵ Pursuant to the doctrine, in an executory contract for the sale of land, the interest of the buyer is deemed to be realty and the interest of the seller is the land.⁷⁶ This

69. KAN. STAT. ANN. § 60-2301.

A homestead to the extent of 160 acres of farming land, or of one acre within the limits of an incorporated town or city, or a manufactured home or mobile home, occupied as a residence by the owner or by the family of the owner, or by both the owner and family thereof, together with all the improvements on the same, shall be exempted from forced sale under any process of law, and shall not be alienated without the joint consent of husband and wife, when that relation exists; but no property shall be exempt from sale for taxes, or for the payment of obligations contracted for the purchase of said premises, or for the erection of improvements thereon. The provisions of this section shall not apply to any process of law obtained by virtue of a lien given by the consent of both husband and wife, when that relation exists.

Id.

70. See, e.g., Atlas, *supra* note 57.

71. Kansas debtors are limited to a homestead exemption of 160 acres in rural farmland areas and one acre inside city limits. KAN. CONST. art. 15, § 9; KAN. STAT. ANN. § 60-2301.

72. Jenkins v. Hodes (*In re Hodes*), 402 F.3d 1005, 1010 (10th Cir. 2005).

73. BLACK'S LAW DICTIONARY 538 (6th ed. 1990).

74. See *In re Hodes*, 402 F.3d at 1011.

75. *Id.* (citing 1 DAN B. DOBBS, LAW OF REMEDIES: DAMAGES, EQUITY, RESTITUTION § 4.3(8) (2d ed. 1993); 18 C.J.S. *Conversion* § 3 (1990)).

76. *In re Jones*, 768 F.2d 923, 928 (7th Cir. 1985).

doctrine is commonly applied to the transfer of real property under the terms most likely intended in the original contract before altering circumstances, such as marriage or change of heart, occurred.⁷⁷ Courts usually invoke the doctrine to “recognize the transfer of equitable title, including the right of possession, to the buyer when the contract [is] signed.”⁷⁸ For this reason, equitable conversion most commonly applies to contract disputes regarding the sale of land and estate matters.⁷⁹

Before *Hodes*, courts had never applied the doctrine of equitable conversion to a cash deposit for the construction of an addition to a home.⁸⁰ The Tenth Circuit, however, chose to do just that by allowing debtors in an involuntary bankruptcy proceeding to claim as exempt the cash deposit given to a builder immediately prior to bankruptcy for an addition to an existing homestead.⁸¹

C. Bankruptcy Basics

1. History and Scope of Bankruptcy Protection

The concept of bankruptcy was recognized under Roman law, adopted by the English, and acknowledged in the United States Constitution.⁸² Bankruptcy laws have evolved with time to meet the demands of an ever-changing world.⁸³ The drafters of the United States Constitution included bankruptcy provisions to ensure a uniform system of insolvency proceedings throughout the nation.⁸⁴ They reasoned that

[t]he power of establishing uniform laws of bankruptcy is so intimately connected with the regulation of commerce and will prevent so many frauds where the parties or their property may lie or be removed into the different states, that the expediency of it seems not likely to be drawn into question.⁸⁵

Debtor-creditor laws evolved in the United States from a system that occasionally imprisoned debtors to one that provided debtor-initiated

77. BLACK'S LAW DICTIONARY 356 (8th ed. 2004).

78. *Id.*

79. *See, e.g., Metz v. United States*, 933 F.2d 802, 805 (10th Cir. 1991) (holding that a house promised to pass intestate to a survivor in a term contract was not transferred under equitable conversion).

80. *In re Hodes*, 402 F.3d at 1012.

81. *Id.*

82. U.S. CONST. art. 1, § 8, cl. 4; NORTON BANKRUPTCY LAW AND PRACTICE 2d §§ 1:1-2 (1997) [hereinafter NORTON].

83. *See* NORTON, *supra* note 82, § 1:3. During some periods in history, debtors were jailed for failure to pay their debts. *Id.* (citing THE FEDERALIST NO. 42 (James Madison)). Such harsh treatment was cast aside as society evolved and embraced the idea of allowing debtors to financially recover from bankruptcy by retaining certain property, including the homestead. *See* Rivera, *supra* note 55, at 73. Essentially, indebtedness changed from a crime to a societal problem that was more likely to be fixed if the debtor were given a chance to start over. *See id.*

84. *See* NORTON, *supra* note 82, § 1:3.

85. *Id.* (citing THE FEDERALIST NO. 42 (James Madison)).

proceedings resulting in discharged debts.⁸⁶ Major bankruptcy reforms were implemented by Congress throughout the course of American history, the most recent of which was legislation enacted in April 2005.⁸⁷

After the commencement of a bankruptcy action,⁸⁸ a debtor's property becomes the property of the bankruptcy estate, excluding exempt assets listed in 11 U.S.C. § 522.⁸⁹ Kansas opted out of the federal exemption scheme;⁹⁰ thus, state law controls the exemptions allowed in Kansas.⁹¹ Federal courts in states with opt-out provisions are bound solely by the exemption schemes set forth by the respective state legislatures rather than the federal exemption scheme.⁹²

Upon filing for bankruptcy, the debtor must complete a statement of his financial affairs.⁹³ The debtor must disclose his general financial situation to creditors by listing assets and liabilities and declaring exemptions.⁹⁴ Exemptions are presumed valid until challenged by a creditor, who then bears the burden of proving that the debtor is not entitled to the exemption.⁹⁵

86. *Id.*

87. See BAPCPA, *supra* note 9; 1 COLLIER ON BANKRUPTCY § 1.01 (Alan N. Resnick et al. eds., 2005) [hereinafter COLLIER].

88. Bankruptcy courts have original and exclusive jurisdiction over bankruptcy proceedings, and bankruptcy judges receive their power under Article I of the United States Constitution. U.S. CONST. art. I, § 8, cl. 4; 28 U.S.C. § 1334 (2000). Decisions from a bankruptcy court may be appealed to either the federal district court in the district in which the bankruptcy court is sitting, or a bankruptcy appellate panel consisting of three bankruptcy judges. COLLIER, *supra* note 87, § 5.02. The parties may decide which appellate procedure to pursue. 28 U.S.C. § 158(c) (2000). Further, appeals from those decisions are heard by the applicable circuit court. COLLIER, *supra* note 87, § 5.02.

89. *Hodes v. Jenkins (In re Hodes) (Hodes IV)*, 308 B.R. 61, 65 (B.A.P. 10th Cir. 2004) (citing 11 U.S.C. §§ 522, 541).

90. *Jenkins v. Hodes (In re Hodes)*, 402 F.3d 1005, 1009 (10th Cir. 2005).

91. *Hodes IV*, 308 B.R. at 65 (citing KAN. STAT. ANN. § 60-2312 (1994); *Lampe v. Williamson (In re Lampe)*, 331 F.3d 750, 754 (10th Cir. 2003)).

92. See e.g., KAN. STAT. ANN. § 60-2312(a) (1994). The section states that “[e]xcept as provided in subsection (b), no person, as an individual debtor under the federal bankruptcy reform act of 1978 [(11 U.S.C. § 101 *et seq.*)], may elect exemptions pursuant to subsection (b)(1) of section 522 of such federal act.” *Id.*

93. 11 U.S.C. § 521(1) (2000); COLLIER, *supra* note 87, § 521.03.

94. COLLIER, *supra* note 87, § 521.03. The Hodeses completed an extensive statement of financial affairs, which they filed in April and May of 1998. Debtors' Schedules, *In re Hodes*, Nos. 98-20039-7-JAR, 98-20040-7-JAR (Bankr. D. Kan. May 27, 1998). Listed on their Schedule B—Personal Property were the following cash transactions: \$225,000 deposit to a homebuilder for the addition to their existing unmortgaged home, which was already valued at \$545,000; \$61,000 for attorney's fees; \$80,000 paid as a settlement fee in another case; cash paid for an additional life insurance policy; as well as \$40,000 for the purchase of two used Toyota Avalons. *Id.* Kansas caps auto exemptions at \$20,000 per car. KAN. STAT. ANN. § 60-2304(c) (1994). After the liquidation of assets and the procurement of services and debts with cash, the Hodeses were left with a mere \$300 cash on hand. Debtors' Schedules, *supra*. Virtually everything the Hodeses purchased was potentially exempt and paid for in cash after liquidating other assets. *Id.* Additionally, the Hodeses listed extravagant monthly expenses including, but not limited to: \$1,000 for home maintenance; \$1,000 for entertainment and recreation; \$850 for lawn care, beauty, and gifts; and \$400 for clothing. *Id.* Altogether, the Hodeses claimed a total of \$9,600 in monthly expenses, an amount that exactly coincided with their total monthly income at that time. *Id.*

95. *In re Hodes (Hodes III)*, Nos. 98-20039-7, 98-20040-7, 2003 WL 23807972, at *3 (Bankr. D. Kan. Apr. 17, 2003).

2. Chapter 7 and Involuntary Bankruptcy

Chapter 7 bankruptcy is “liquidation and fair distribution of the assets for the creditors, and a fresh start for the individual debtor through discharge.”⁹⁶ Liquidation in Chapter 7 provides that all non-exempt property of the debtor is collected and distributed to the creditors, after which the debtor is discharged from his debt.⁹⁷ Although most Chapter 7 cases are filed voluntarily by the debtor, involuntary filing may occur if certain prerequisites are met.⁹⁸

Creditors may force a debtor into involuntary bankruptcy under either Chapter 7 or Chapter 11 of the Bankruptcy Code.⁹⁹ Compulsory bankruptcy proceedings rarely occur.¹⁰⁰ In involuntary bankruptcy, the petitioner bears the burden of proving that the debtor is subject to the proceeding.¹⁰¹ If a creditor or other entity files an involuntary bankruptcy petition in bad faith, severe consequences may result, including dismissal of the action with possible punitive damages awarded to the debtor.¹⁰²

Involuntary petitions may be filed by entities that have claims against the debtor.¹⁰³ An “entity” includes “a person, estate, trust, [or] governmental unit,”¹⁰⁴ and a petitioner’s eligibility is determined as of the petition date.¹⁰⁵ Each entity must also show that it holds a “claim against the debtor that is not contingent as to liability nor the subject of a bona fide dispute.”¹⁰⁶ The Bankruptcy Code defines a “claim” as “a right to payment [including when] said right is reduced to judgment.”¹⁰⁷ Generally, in an involuntary proceeding, the rights of the parties are not fixed at the time the petition is filed; instead, they become fixed when the bankruptcy court’s final orders are entered.¹⁰⁸ Because filing dates are of particular importance in bankruptcy proceedings, understanding involuntary bankruptcy procedure is essential.

96. RICHARD I. AARON, *BANKRUPTCY LAW FUNDAMENTALS* § 1:8 (2004).

97. COLLIER, *supra* note 87, § 700.01.

98. BANKR. SERV., LAW. ED. (West) § 3A:11 (2004).

99. *BANKRUPTCY LAW AND PRACTICE* 2d § 3A:1 (2004) (citing 11 U.S.C.A. § 303(a)).

100. John E. Sullivan III, *New Rules, Old Game*, TRUSTS & ESTATES, June 2005, at 60. “According to U.S. Courts website, only 602 involuntaries were filed in 2004 compared to 1,618,987 total bankruptcy filings that year.” *Id.* Further, BAPCPA “will make involuntaries rarer still.” *Id.*

101. BANKR. SERV., LAW. ED., *supra* note 98, § 3A:11 (citing *In re Allen, Rogers & Co.*, 30 B.R. 27 (Bankr. S.D.N.Y. 1983)).

102. COLLIER, *supra* note 87, § 303.06.

103. BANKR. SERV., LAW. ED., *supra* note 98, § 3A:11.

104. *Id.*

105. *Id.*

106. *Id.* § 3A:17.

107. *Id.*

108. *Id.* § 3A:61. The “[o]perative date for determining [an] involuntary debtor’s exemption rights is not the date that [the] involuntary bankruptcy petition was filed, but [the] date of entry of [the] order for relief.” *Id.* § 13:276 (citing *In re Hodes (Hodes II)*, 287 B.R. 561 (D. Kan. 2002)).

D. *The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA)*

In April 2005, after almost eight years of unsuccessful attempts to implement reform, Congress enacted BAPCPA, creating sweeping changes to the Bankruptcy Code.¹⁰⁹ While portions of the law were effective immediately, several aspects of the reform did not take effect until October 2005.¹¹⁰ Over the years, different versions of bankruptcy legislation were proposed, but each failed to gain sufficient congressional support.¹¹¹ In the wake of Enron and other corporate scandals, however, bankruptcy reform once again became a high priority in Congress.¹¹² The public was outraged when corporate executives were able to shield their assets using homestead exemption laws in states like Kansas, with exemptions limited only by total acreage rather than value.¹¹³ It took several years after the corporate scandals before reform legislation was enacted, and even now its full impact is uncertain.¹¹⁴

The new law advances several changes, including a limited revision of homestead exemptions.¹¹⁵ Previously, states were allowed to opt out of certain bankruptcy provisions, and some states, including Kansas, exercised that option to preserve the homestead exemption.¹¹⁶ Under BAPCPA, debtors claiming the Kansas homestead exemption are required to live in Kansas for a period of time before the claimed exemption will be presumed valid.¹¹⁷ According to the amended law, a debtor must live in-state for 730 days to be eligible to claim the state's homestead exemption.¹¹⁸ To exempt a homestead worth more than \$125,000, the debtor will be required to live in-state for 1,215 days.¹¹⁹ Some debtors, including particular tortfeasors and felons, are ineligible for a homestead exemption exceeding \$125,000 in value, absent strict exceptions.¹²⁰

Perhaps the most significant change is that states are no longer able to opt out of these limitations.¹²¹ Newcomers to states that do

109. Ellen Florian Kratz, *Profiting from the Bankruptcy Bill*, FORTUNE, May 2005, at 134, available at 2005 WLNR 6043054.

110. See BAPCPA *supra* note 9.

111. Kratz, *supra* note 109.

112. Greg Hitt, *Enron Influences Compromise Plan on Bankruptcy Bill*, WALL ST. J., Apr. 24, 2002, at D2.

113. See *id.*

114. See *id.*

115. See 11 U.S.C. § 522 (2000), as amended by Pub. L. No. 109-8, 119 Stat. 23, 307-08, 313, 322.

116. *Id.* § 522(b); KAN. STAT. ANN. § 60-2301 (1994).

117. See 11 U.S.C. § 522 (2000), as amended by Pub. L. No. 109-8, 119 Stat. 23, 307.

118. *Id.* § 522(b)(3)(A). If the debtor does not meet the residency requirement, he is limited to the exemptions provided by his previous state of residence. *Id.*

119. Pub. L. No. 109-8, 119 Stat. 23, 322 (to be codified at 11 U.S.C. § 522(p)(2)(B)).

120. Pub. L. No. 109-8, 119 Stat. 23, 322 (to be codified at 11 U.S.C. § 522(q)).

121. 11 U.S.C. § 522(b) (2000), as amended by Pub. L. No. 109-8, 119 Stat. 23, 307.

not impose dollar limits on homestead exemptions will be limited in the dollar amount they can claim as exempt.¹²² Another significant change post-BAPCPA is that the value of the homestead exemption may be reduced to the extent that the value of the debtor's homestead has been increased by the debtor's expenditure of nonexempt assets within ten years before the filing date.¹²³ Because the property listed by a debtor is presumptively exempt, however, the creditor still maintains the heavy burden of proving that the intent of the debtor is to "hinder, delay, or defraud" the creditor in order to invalidate the exemption.¹²⁴

IV. COURT'S DECISION

A. Parties' Arguments

1. Lawrence Jenkins and Roger Hood

In *Hodes*, the United States Court of Appeals for the Tenth Circuit analyzed whether a cash deposit given to a home builder constitutes a valid homestead exemption in an involuntary bankruptcy proceeding.¹²⁵ On appeal to the Tenth Circuit, Jenkins and Hood argued that the lower courts erroneously interpreted the plain meaning of the Kansas homestead exemption to unduly reach the personal property of wealthy debtors.¹²⁶ Jenkins and Hood claimed instead that interpretation of the homestead exemption by the Kansas Supreme Court had consistently remained true to the purpose of the statute: to protect the destitute.¹²⁷ Jenkins and Hood repeatedly asserted that the Hodeses were far from destitute, and regardless of whether the debtors were allowed to retain the \$225,000 exemption, they would emerge from bankruptcy with \$1,000,000 of exempt property.¹²⁸ Essentially, Jenkins and Hood's first major contention was that the plain meaning of the Kansas homestead exemption extends only to real estate, not cash gained from the liquidation of nonexempt property.¹²⁹

Jenkins and Hood further argued that the district court erred by relying on the "homestead proceeds rule," which allows a debtor to

122. *Id.* § 522(b); Pub. L. No. 109-8, 119 Stat. 23, 322 (to be codified at 11 U.S.C. § 522(p)(q)).

123. Pub. L. No. 109-8, 119 Stat. 23, 308 (to be codified at 11 U.S.C. § 522(o)).

124. *See id.*

125. *Jenkins v. Hodes (In re Hodes)*, 402 F.3d 1005, 1008 (10th Cir. 2005).

126. Appellants' Brief at 17-19, *Jenkins v. Hodes (In re Hodes)*, 402 F.3d 1005 (10th Cir. 2005) (No. 03-3309).

127. *Id.* at 17-18 (citing *Mahone v. Mahone*, 517 P.2d 131 (Kan. 1973)) (noting that in some circumstances, even when the exemption provision is clear on its face, certain exemptions are inapplicable such as child support).

128. *Id.* at 18-19.

129. *Id.* at 20.

exempt cash proceeds received from the sale or mortgage of a homestead as long as the evidence shows that those funds are intended for the addition to or construction of a new homestead.¹³⁰ Pointing to the language of the statute, Jenkins and Hood reasoned that the homestead exemption only applies to real estate and cannot extend to a cash deposit.¹³¹ They argued that a cash deposit is personal property rather than real estate and is not exempt.¹³² Moreover, Jenkins and Hood contended that the cases the district court cited as representative of the homestead proceeds rule were distinguishable from the Hodeses' situation.¹³³ Those cases involved cash intended to be used for the acquisition of a new homestead.¹³⁴ Further, when courts have exempted cash intended to be used for improvements to homesteads, the cash was generated from the sale of an already exempt homestead and was intended for investment in a substitute homestead.¹³⁵ In the Hodeses' case, however, the lower courts incorrectly extended the homestead proceeds rule to cover cash that did not originate from the sale of a homestead but rather was generated from the liquidation of nonexempt personal property.¹³⁶ Jenkins and Hood maintained that the lower courts' decision to exempt cash from the liquidation of non-exempt assets was inconsistent with the intent of the Kansas homestead law.¹³⁷

In *Kessler v. Frost*, a case that the bankruptcy court relied upon to support its decision, the Kansas Supreme Court held that proceeds obtained by mortgaging an exempt homestead, intended to finance improvements on that homestead, remain exempt.¹³⁸ Jenkins and Hood distinguished *Kessler* by arguing that the sources funding the property in *Kessler* were initially exempt, so the creditors remained unharmed because they never would have been able to recover the exempt property.¹³⁹ In the Hodeses' situation, however, Jenkins and Hood contended that creditors were harmed because the cash in question constituted proceeds not from exempt assets, but rather from

130. *Id.* at 21-22 (citing *Int'l Harvester Credit Corp. v. Ross*, 538 P.2d 655 (Kan. 1975) (prohibiting exemption for proceeds of homestead because debtor lacked intent to reinvest in homestead); *First Nat'l Bank v. Dempsey*, 11 P.2d 735 (Kan. 1932) (allowing exemption for proceeds from exchange of farm for house); *Kessler v. Frost*, 175 P. 967 (Kan. 1918) (allowing exemption for proceeds from mortgage of exempt homestead intended for improvements on homestead)).

131. *Id.* at 20 (citing *Commercial Nat'l Bank v. Carnahan*, 276 P. 57, 58 (1929)).

132. *Id.* at 21 (citing *In re Thexton*, 39 B.R. 367, 370-72 (Bankr. D. Kan. 1984)) (deciding that unsevered oil and gas beneath a homestead constituted real estate and was subject to exemption under the homestead provision and noting that if it had been severed prior to the bankruptcy petition date it would have been nonexempt personal property).

133. *Id.* at 23.

134. *Id.*

135. *Id.*

136. *Id.*

137. *Id.*

138. *Id.* (citing *Kessler v. Frost*, 175 P. 967, 968 (Kan. 1918)).

139. *Id.*

nonexempt assets that otherwise would have been available to satisfy creditors' claims.¹⁴⁰

Jenkins and Hood argued that the Kansas legislature was compelled to extend the homestead exemption to mobile homes in 1979 because the homestead exemption at that time did not apply to personal property.¹⁴¹ The legislature wanted to ensure that a mobile home, although personal property, would be exempt as a homestead when used as a residence.¹⁴² Jenkins and Hood reasoned that a mobile home is more similar to a homestead than cash, and if the Hodeses wanted to claim the cash as exempt, they should have relied on the statute dealing with personal property rather than the homestead exemption statute.¹⁴³

Jenkins and Hood also objected to the lower courts' refusal to use the bankruptcy filing date to determine the Hodeses' exemptions instead of the order date.¹⁴⁴ They observed that the district court upheld the exemption in part because "the right to convert non-exempt into exempt assets is well settled in Kansas."¹⁴⁵ Jenkins and Hood criticized this reasoning, arguing that the main point should be "whether the right to convert assets from nonexempt to exempt status remains available to a bankrupt debtor *after* either the involuntary bankruptcy petition is filed or the order for relief in the ensuing bankruptcy is entered."¹⁴⁶ Jenkins and Hood insisted that "[i]t is error to conclude that the conversion right remains after the bankruptcy filing simply because the right existed prior to the filing."¹⁴⁷ In sum, Jenkins and Hood argued that the plain language of the homestead exemption statute cannot be construed to sustain the Hodeses' position that personal property in the form of cash qualifies as real estate under the homestead exemption.¹⁴⁸

The next major point made by Jenkins and Hood was that the lower courts "committed error when they relied upon changes in the

140. *Id.* at 25.

141. *Id.* at 21.

142. *Id.*

143. *Id.* The Kansas legislature chose to enact separate statutes to deal with personal and real property. Compare KAN. STAT. ANN. § 60-2301 (1994), with § 60-2304. Debtors may exempt household goods, fuel, food, and clothing that are in the debtor's possession and are reasonably necessary for use at the debtor's principal residence for one year. See § 60-2304. If cash or other items found within the home were to be considered exempt as part of the homestead, then a separate personal property exemption statute would not have been needed. See *id.* The legislature's enactment of such a statute suggests that the homestead exemptions should be limited to real estate.

144. Appellants' Brief, *supra* note 126, at 25. The order date is the date the court entered the relief agreement for the debtor under 11 U.S.C. § 303(h).

145. Appellants' Brief, *supra* note 126, at 26 (quoting *In re Hodes (Hodes II)*, 287 B.R. 561, 568 (D. Kan. 2002)).

146. *Id.* at 27.

147. *Id.*

148. *Id.* at 24-25.

use or form of property which occurred after the [d]etermination [d]ate to support the homestead exemption claim.”¹⁴⁹ They maintained that the court should not have allowed any changes to the property of the bankruptcy estate after the determination date, which in this case was the transfer of liquidated assets to a contractor for the purpose of increasing the value of the already exempt homestead.¹⁵⁰ Section 522(b) of the Bankruptcy Code prevents the conversion of property after the determination date, and thus Jenkins and Hood contended that the district court erred in interpreting that section.¹⁵¹ They argued that the plain language of the statute means that a “debtor’s right to an exemption is determined as of the date the bankruptcy petition is filed.”¹⁵² Even if the more liberal Kansas laws would have permitted exemption of the cash based on the debtor’s future intentions, federal law would not uphold the exemption because the nonexempt cash was not in the form of exempt “real estate on the [d]etermination [d]ate.”¹⁵³

Finally, Jenkins and Hood professed that by deceptively entering into the post-judgment settlement, the Hodeses persuaded them to stop pursuing their 11 U.S.C. § 303(f) motion.¹⁵⁴ They argued that the Hodeses should be estopped from claiming the homestead exemption because they continued with the construction and exhausted the cash deposit, while leading Jenkins and Hood to believe that they would pay the settlement as agreed.¹⁵⁵ In sum, Jenkins and Hood were certain that the judgments of both the bankruptcy and district courts should be reversed and that the Tenth Circuit should hold that the cash deposited with the builder was not exempt.¹⁵⁶

2. Philip and Barbara Hodes

The Hodeses first contended that the decisions of the lower courts comported with Kansas public policy.¹⁵⁷ The debtors argued that the homestead provision was intended to protect more than just the destitute and should extend to the overall protection of the home.¹⁵⁸ They claimed that Jenkins and Hood incorrectly asserted

149. *Id.* at 30.

150. *Id.* After the filing of a bankruptcy petition, a bankruptcy estate is created and almost all the debtors’ property becomes property of the bankruptcy estate, subject to exemptions. *Id.*

151. *Id.* 11 U.S.C. § 522(b) outlines the types of property that a debtor may claim as exempt.

152. Appellants’ Brief, *supra* note 126, at 33 (quoting *Mansell v. Carroll*, 379 F.2d 682, 684 (10th Cir. 1967); *In re Ginther*, 282 B.R. 16, 19 (Bankr. D. Kan. 2002)).

153. *Id.* at 30.

154. *Id.* at 48.

155. *Id.*

156. *Id.* at 55.

157. Brief of Appellees at 19, *Jenkins v. Hodes (In re Hodes)*, 402 F.3d 1005 (10th Cir. 2005) (No. 03-3309).

158. *Id.* at 21-22. The appellees relied heavily on *Mahone v. Mahone*, 517 P.2d 131 (Kan. 1973), to support the argument that Kansas courts construe exemption provisions in light of

that only real estate could be claimed under the homestead exemption and that the lower courts correctly interpreted the Kansas homestead provisions.¹⁵⁹

The Hodeses insisted that the lower courts correctly interpreted §§ 303 and 522 of the Bankruptcy Code by upholding their homestead exemption.¹⁶⁰ They maintained that the lower courts correctly held that the controlling date for determining when property is exempt was the date the order for relief was issued, not the date Jenkins and Hood filed the involuntary petition.¹⁶¹ The Hodeses used legislative history to bolster their claims by maintaining that legislative intent is clear: debtors may legitimately convert nonexempt property into exempt property.¹⁶²

Finally, the Hodeses argued that the district court correctly concluded that estoppel did not apply.¹⁶³ The Hodeses indicated that Jenkins and Hood first raised this particular argument on appeal.¹⁶⁴ The district court held that Jenkins and Hood did not prove that the Hodeses had induced them to abandon their § 303(f) claim with promises of settlement, and thus the creditors' estoppel claim was fu-

public policy, sometimes reaching a conclusion that is contrary to the plain language of the statute. Brief of Appellees, *supra* note 157, at 21-23.

159. *Id.* at 25-26 (citing *Int'l Harvester Credit Corp. v. Ross*, 538 P.2d 655 (Kan. 1975), which held that "where a debtor intends to invest money received from the sale of his homestead in another homestead," the money shall be exempt). The Hodeses also cited *Kessler v. Frost*, 175 P. 967 (Kan. 1918), for the proposition that "if there is an intent to use cash for purchase or improvements to a homestead, such sums will be exempt." Brief of Appellees, *supra* note 157, at 27.

160. *Id.* at 28.

161. *Id.* at 29. The debtors cited *Wilson v. Davis (In re Wilson)*, 62 B.R. 43 (E.D. Tenn. 1985), as background for §§ 303(f), 522(b)(2), and 541 of the pre-BAPCPA Bankruptcy Code. *Id.* According to *Wilson*,

Section 541(a) of the Code provides that *the commencement of a case under § 301, 302, or 303 (involuntary petitions) creates an estate*. Section 522 of the Bankruptcy Code provides that the debtor may exempt from property of the estate any property that is exempt under federal law or under local law that is applicable *on the date of the filing of the petition* at the place in which the debtor's domicile has been located for the 180 days [W]hile Section 522(b)(2)(A) does provide that the debtor may exempt from property of the estate any property that is exempt under federal law or state law that is applicable on the date of the filing of the petition, this section can be read to fix the law controlling the exemptions, not to fix the property subject to these exemptions at the time of the filing of the petition.

Id. at 30 (quoting *In re Wilson*, 62 B.R. at 45). Thus, the debtors argued the date on which the order for relief is filed is the correct date for determining which property will be exempt in involuntary cases. *Id.* at 29.

162. *Id.* at 32-33.

As under current law, the debtor will be permitted to convert nonexempted property into exempt property before filing a bankruptcy petition. The practice is not fraudulent as to creditors, and permits the debtor to make full use of the exemptions to which he is entitled under the law.

Id. at 33 (citation omitted) (quoting H.R. REP. NO. 95-595, at 360-61 (1977)).

163. *Id.* at 40.

164. *Id.* at 41.

tile.¹⁶⁵ The Hodeses insisted that the court should affirm the lower courts and allow the homestead exemption.¹⁶⁶

B. *Majority Opinion*

In a unanimous decision, the United States Court of Appeals for the Tenth Circuit used the doctrine of equitable conversion to hold that the Hodeses' cash deposit may be treated as exempt under the Kansas homestead provision.¹⁶⁷ The Tenth Circuit reasoned that the moment the Hodeses gave the deposit to the contractor, the cash was equitably converted into the homestead, and all the cash actually used to complete the addition to the existing homestead was exempt.¹⁶⁸ The court used the doctrine of equitable conversion to affirm the lower courts' holdings, even though the issue was never previously raised; the court explained that it was free to affirm on any relevant ground.¹⁶⁹

The court explained equitable conversion and noted that the doctrine is not normally invoked under facts similar to those present in this case.¹⁷⁰ Equitable conversion "involves a change in the character of property so that realty is considered personalty and personalty is considered realty."¹⁷¹ Although this case did not involve the sale of land, the court noted that under Kansas law, real estate includes "buildings, fixtures, and improvements, and rights and privileges appurtenant thereto."¹⁷²

Applying the doctrine, the court held that "the Hodeses' homestead exemption is proper to the extent the deposit is actually spent on improvements to the homestead."¹⁷³ The court also stated that "[a]t the moment [the Hodeses] entered into that enforceable contract, the deposit was equitably converted into the addition, and the builder's consideration—the construction itself—was equitably converted into the \$225,000."¹⁷⁴ Although construction had not yet commenced when the bankruptcy petition was filed, the Tenth Circuit held that equitable conversion was still applicable because the doctrine is "forward-looking."¹⁷⁵

165. *Id.*

166. *Id.* at 47.

167. *Jenkins v. Hodes (In re Hodes)*, 402 F.3d 1005, 1013 (10th Cir. 2005).

168. *Id.*

169. *Id.* at 1011 (citing *Lambertsen v. Utah Dep't of Corr.*, 79 F.3d 1024, 1029 (10th Cir. 1996)).

170. *Id.* The court observed that equitable conversion is most commonly used in contract or risk of loss cases. *Id.* The Hodeses situation was different, however, because it involved using the doctrine to permit an exemption, rather than assigning liability. *Id.*

171. *Id.* at 1012 (citing *In re Estate of Hills*, 564 P.2d 462, 468-69 (Kan. 1977)).

172. *Id.* (quoting *Wyandotte County Gas Co. v. Spaeth*, 109 P. 785, 786 (Kan. 1910)).

173. *Id.*

174. *Id.*

175. *Id.*

The lower courts and the parties spent a significant amount of time disputing whether the petition or order date controls for determining exemptions.¹⁷⁶ Because the equitable conversion occurred the moment the parties entered into the contract, a month prior to the involuntary bankruptcy filing, the Tenth Circuit believed the issue to be moot.¹⁷⁷ The court held that only the money actually spent on the addition was exempt.¹⁷⁸

The court relied on the “strong public policy in Kansas of protecting the homestead, as well as improvements to the homestead, whether construction is completed or in progress” to justify applying the doctrine of equitable conversion to allow the homestead exemption to extend to the cash deposit paid to a builder pre-petition for additions to an exempt homestead post-petition.¹⁷⁹ Recognizing the possible abuse inherent in its expansion of the homestead provision, the court attempted to narrowly tailor its holding by stating that “[e]quitable conversion only has meaning if the contract between the debtor and the builder is valid in the first place,” thereby discouraging attempts by debtors to deceptively transfer cash to third parties to avoid creditors.¹⁸⁰ The Tenth Circuit stated that if the holding seems to reinforce inequities between Kansas debtors and debtors in other states, it is only a result of Kansas’s unlimited homestead exemption, which could be changed by legislators.¹⁸¹ Until then, “Kansas will continue to be a ‘debtors’ paradise.’”¹⁸²

V. COMMENTARY

Bankruptcy is designed for the honest but unfortunate debtor.¹⁸³ Specific provisions within the Bankruptcy Code allow debtors to either obtain a fresh start or reorganize their debts to regain financial stability.¹⁸⁴ Unfortunately, some debtors who are capable of fulfilling their financial obligations manipulate the code to avoid those commitments.¹⁸⁵ The exploitation of Kansas’s liberal exemptions is an example of the abuse that Congress chose to correct with BAPCPA.¹⁸⁶ It is

176. See *supra* Part IV.A.

177. *In re Hodes*, 402 F.3d at 1013.

178. *Id.*

179. *Id.* at 1014.

180. *Id.*

181. *Id.*

182. *Id.* (citing H.R. REP. No. 108-40, pt. 1 at 596 (2003)).

183. See *Vilt v. Moore (In re Vilt)*, 56 B.R. 723, 725 (Bankr. N.D. Ill. 1986) (citing H.R. REP. No. 95-595, at 117-18, 125 (1978), reprinted in 1978 U.S.C.C.A.N. 5787).

184. See generally 11 U.S.C. § 524 (2000) (allowing debtors to emerge from bankruptcy debt free under Chapter 7); §§ 1141(d), 1328 (requiring debtors to establish a reduced repayment plan for their debt under Chapters 11 and 13).

185. See, e.g., *In re Hodes*, 402 F.3d at 1008; *supra* note 94.

186. See, e.g., Pub. L. No. 109-8, 119 Stat. 23, 308 (to be codified at 11 U.S.C. § 522(o)) (limiting the use of otherwise nonexempt assets to procure additions to homesteads).

important to analyze what the results would have been if Jenkins and Hood had filed this case after BAPCPA's effective date.¹⁸⁷ Although BAPCPA addresses a variety of problems in the Bankruptcy Code, it is possible that the Tenth Circuit's use of equitable conversion circumvented that reform, creating additional ways for debtors to escape their obligations. The application of equitable conversion to bankruptcy creates opportunities for courts to apply the concept to further expand the already liberal exemptions available to debtors.

A. *Possible Effects of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 on the Kansas Homestead Exemption*

Several provisions in the old Bankruptcy Code permitted certain debtors to avoid their financial responsibilities.¹⁸⁸ Debtors often artfully shift their assets to gain the full exemptions allowable under the law.¹⁸⁹ While legal, these actions may result in debtors spending thousands of otherwise nonexempt dollars on the eve of bankruptcy, rather than fulfilling the debts they owe.¹⁹⁰ For example, notwithstanding a \$4 million judgment owed to creditors, the Hodeses claimed as exempt, among other things, a \$225,000 cash deposit paid to a builder for an addition to their home.¹⁹¹ Congress enacted BAPCPA to curb exploitation of the Bankruptcy Code.¹⁹² BAPCPA was passed after the *Hodes* decision, and the question remains whether Congress adequately closed the loopholes in the Bankruptcy Code, and specifically, whether the same result would have been reached in *Hodes* had BAPCPA been in effect.¹⁹³

1. BAPCPA Section 522(o) and Its Applicability to Homestead Exemptions

Congress implemented a major overhaul of the exemptions permitted in bankruptcy, paying particular attention to homestead exemptions.¹⁹⁴ Enacting 11 U.S.C. § 522(o), Congress directly ad-

187. While several of BAPCPA's provisions became effective immediately, many provisions did not take effect until October 17, 2005. See BAPCPA, *supra* note 9.

188. See generally 11 U.S.C. § 522 (2000) (allowing various exemptions that debtors sometimes used to circumvent their obligation to pay debts).

189. See, e.g., *In re Hodes*, 402 F.3d at 1008 (noting that the Hodeses liquidated approximately \$514,000 in nonexempt assets and used that money to procure exempt assets shortly after a \$4 million judgment was entered against them).

190. See *supra* notes 14, 94.

191. *In re Hodes*, 402 F.3d at 1008.

192. See, e.g., Daniel Morman, *Judgment Liens, Homestead Exemptions and Involuntary Bankruptcies: Who Gets What After BAPCPA*, ABI JOURNAL, July-Aug. 2005, at 20.

193. See BAPCPA, *supra* note 9. In other words, would the Hodeses have been allowed to claim as exempt a cash deposit, procured from the liquidation of otherwise nonexempt assets, given to a homebuilder?

194. See Pub. L. No. 109-8, 119 Stat. 23, 308 (to be codified at 11 U.S.C. § 522(o)). For example, sections of BAPCPA are aimed at preventing debtors in states with conservative home-

dressed additions to homes during the ten years prior to bankruptcy.¹⁹⁵ This new subsection might have altered the outcome in *Hodes* because it restricts the value of the homestead exemption: (1) that is attributable to any of debtors' property disposed of within the ten years prior to the filing of the bankruptcy petition; (2) that is done "with the intent to hinder, delay, or defraud a creditor"; and (3) that could not otherwise be claimed as exempt by the debtor.¹⁹⁶

Because the Hodeses spent \$225,000 of otherwise nonexempt cash on the addition to their homestead, it is possible that § 522(o) would have been applicable to their deposit, entitling Jenkins and Hood to receive partial payment as judgment creditors.¹⁹⁷ This result, however, could only occur if it were established that the Hodeses acted with the intent to hinder, delay, or defraud the judgment creditors.¹⁹⁸ Defining the meaning of this intent element is integral to successfully arguing in favor of or against an exemption.

a. *The Meaning of the Phrase "Intent to Hinder, Delay, or Defraud"*

It is difficult to discern with particularity congressional intent regarding the phrase "hinder, delay, or defraud."¹⁹⁹ The legislative record is deplete and lacks support for deciphering what Congress meant by the phrase.²⁰⁰ Further, Congress failed to address any particular cases or situations that it desired to remedy with the amendment.²⁰¹

stead laws from moving to states with more liberal homestead laws. See 11 U.S.C. § 522(b)(3)(A). New residents of states with unlimited homestead exemptions are now restricted from using the liberal exemptions available to long-time residents of those states. See *id.* Note, however, that the Hodeses were not new residents of Kansas, so the extended residency requirements of BAPCPA would not prevent their manipulation of the Bankruptcy Code. See *id.* (requiring that a debtor's domicile be located in a state for a 730-day period before being allowed to use that state's homestead exemption laws); *In re Hodes*, 402 F.3d at 1009 (explaining that the Hodeses purchased their home in 1989).

195. See Pub. L. No. 109-8, 119 Stat. 23, 308 (to be codified at 11 U.S.C. § 522(o)).

196. *Id.* The pertinent part of that section states as follows:

[T]he value of an interest in . . . (4) real or personal property that the debtor or a dependent of the debtor claims as a homestead: shall be reduced to the extent that such value is attributable to any portion of any property that the debtor disposed of in the 10-year period ending on the date of the filing of the petition with the *intent to hinder, delay, or defraud* a creditor and that the debtor could not exempt, or that portion that the debtor could not exempt, under subsection (b), if on such date the debtor had held the property so disposed of.

Id. (emphasis added). To put it another way, the value is reduced if: (1) it is attributable to a portion of property that the debtor *did* dispose of before filing and that the debtor could not exempt; or (2) it is attributable to a portion of property that the debtor *did* dispose of before filing but that the debtor *would not* have been able to exempt under subsection (b) *if* the debtor had instead held onto the property.

197. See *id.*; *In re Hodes*, 402 F.3d at 1008.

198. Pub. L. No. 109-8, 119 Stat. 23, 308 (to be codified at 11 U.S.C. § 522(o)(4)).

199. See *In re McNabb*, 326 B.R. 785, 789 (Bankr. D. Ariz. 2005).

200. *Id.*

201. *Id.*

Proving that the debtor disposed of the property with the intent to hinder, delay, or defraud is a difficult task.²⁰² Generally, courts interpret the phrase liberally, often holding that creditors must establish a debtor's actual intent to defraud by providing extrinsic evidence, which may include circumstantial evidence or evidence drawn inferentially from the debtor's course of conduct.²⁰³ The inferences are drawn from fact-specific situations, including the conversion of nonexempt assets immediately prior to filing for bankruptcy,²⁰⁴ as well as the conversion of nonexempt assets that "occurred after entry of a large judgment against the debtor."²⁰⁵

The law is well established that it is not per se fraudulent for debtors to convert nonexempt property into exempt property before bankruptcy.²⁰⁶ Instead, the conversion of nonexempt property into exempt property prior to filing for bankruptcy simply represents the debtor's "use of the exemptions to which he is entitled under the law."²⁰⁷

Because bankruptcy law allows the conversion of nonexempt assets into exempt assets prior to filing for bankruptcy, subject to the restriction that the conversion must be free of intent to hinder, delay, or defraud creditors, the courts are forced to strike a delicate balance in determining when pre-bankruptcy planning ends and fraudulent behavior begins.²⁰⁸ Regardless of Congress's unknown intent regarding the phrase, it did not change its overall goal regarding bankruptcy: to provide a fresh start for honest debtors.²⁰⁹ Before BAPCPA, judges maintained wide discretion to determine if a debtor was honest.²¹⁰ Under BAPCPA, however, Congress has restricted judicial discretion by more narrowly defining what constitutes a valid homestead exemp-

202. Proving intent is a difficult task because it requires one to make subjective assumptions regarding another's thoughts.

203. *Marine Midland Bus. Loans v. Carey (In re Carey)*, 938 F.2d 1073, 1077 (10th Cir. 1991) (citing *In re Bowyer*, 916 F.2d 1056, 1059 (5th Cir. 1990); *In re Smiley*, 864 F.2d 562, 566 (7th Cir. 1989); *In re Johnson*, 880 F.2d 78, 81 (8th Cir. 1989); *Farmers Coop. Ass'n v. Strunk*, 671 F.2d 391, 395 (10th Cir. 1982)). The phrase "hinder, delay, or defraud" was previously used in the Bankruptcy Code and therefore courts have had the opportunity to interpret it. See, e.g., *Rutter v. Gen. Motors Acceptance Corp.*, 70 F.2d 479, 481 (10th Cir. 1934); *Thomas McKinnon Sec., Inc. v. Hiegel (In re Hiegel)*, 117 B.R. 655, 657-58 (Bankr. D. Kan. 1990).

204. *In re Carey*, 938 F.2d at 1077 (citing *In re Mueller*, 867 F.2d 568, 569-70 (10th Cir. 1989); *First Tex. Sav. Ass'n v. Reed (In re Reed)*, 700 F.2d 986, 989 (5th Cir. 1983)).

205. *Id.* at 1077 n.4 (citing COLLIER, *supra* note 87, ¶ 727.02[3], at 20).

206. *Id.* at 1076.

207. *Id.* (quoting H.R. REP. NO. 95-595, at 361 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6317; S. REP. NO. 95-989, at 76 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5787, 5762).

208. This is an important question to consider because the law permits pre-bankruptcy planning to some extent. Several exemptions are allowed, and debtors are free to use those exemptions to maximize their success after the bankruptcy proceeding. There is a line between using the exemptions available under the law and engaging in fraudulent behavior. Just exactly where that line exists is an interesting question that the courts generally decide on a case-by-case basis.

209. See *Vilt v. Moore (In re Vilt)*, 56 B.R. 723, 725 (Bankr. N.D. Ill. 1986) (citing H.R. REP. NO. 95-595, at 117-18, 125 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5787).

210. See *supra* notes 206-07 and accompanying text.

tion.²¹¹ Kansas case law enumerates various “badges of fraud,” but the delicate balance is ultimately decided by a bankruptcy judge who must weigh various factors to determine the debtor’s intent.²¹²

b. *Applying BAPCPA to Hodes: A Different Result?*

The hypothetical application of 11 U.S.C. § 522(o) to the Hodeses’ situation requires consideration of whether the creditors could have proved that the Hodeses intended to hinder, delay, or defraud them.²¹³ Because the Hodeses invested \$225,000 of otherwise nonexempt cash assets in the construction contract, the fair market value of the improved homestead would have to be reduced by the value “attributable” to the infusion of cash in building the addition.²¹⁴ However, this incremental value would only be reduced if the creditors could prove fraudulent intent by the transfer of nonexempt assets, a presumably heavy burden of proof.²¹⁵ The Hodeses claimed that they had a legitimate reason for the addition to their home—the need for additional space to care for their twin grandchildren.²¹⁶ To prove that the Hodeses acted with the intent to hinder, delay, or defraud the creditors, Jenkins and Hood would have been required to show badges of fraud to the court, as exemplified by direct and circumstantial evidence.²¹⁷ Although BAPCPA has the potential to tighten loopholes in homestead exemptions, its effects will not be known until the federal courts interpret and apply 11 U.S.C. § 522(o).

It was undisputed that the Hodeses converted nonexempt assets to fund the addition to their homestead.²¹⁸ Under the new statute, creditors seeking to avoid an exemption must still prove that the debtors converted those assets with the intent to hinder, delay, or defraud.²¹⁹ Notwithstanding this burden, revisions to the Bankruptcy Code may be beneficial to creditors because they will have a better argument against such actions if they can prove the debtor’s intent to hinder, delay, or defraud. The factual inquiry into the intent of the debtors will at least allow creditors to survive summary judgment and will give them an argument against debtor’s pre-bankruptcy actions.

211. See Pub. L. No. 109-8, 119 Stat. 23, 308 (to be codified at 11 U.S.C. § 522(o)(4)).

212. See KAN. STAT. ANN. § 33-204 (1994) (codifying Kansas’s “badges of fraud” for determining fraudulent intent). The bankruptcy court’s determination that a debtor acted with the intent to hinder, delay, or defraud is a factual determination subject to the clearly erroneous standard of review, giving the bankruptcy judge’s determination of a debtor’s fraudulent behavior great weight on appeal. *In re Carey*, 938 F.2d at 1077.

213. See Pub. L. No. 109-8, 119 Stat. 23, 308 (to be codified at 11 U.S.C. § 522(o)(4)).

214. See *id.*

215. See *id.*

216. *Jenkins v. Hodes (In re Hodes)*, 402 F.3d 1005, 1008 (10th Cir. 2005).

217. *Douglas County Bank v. Fine (In re Fine)*, 89 B.R. 167, 174 (Bankr. D. Kan. 1988).

218. *In re Hodes*, 402 F.3d at 1008.

219. Pub. L. No. 109-8, 119 Stat. 23, 308 (to be codified at 11 U.S.C. § 522(o)(4)).

Upon surviving summary judgment, however, creditors still sustain a heavy burden to receive payment from debtors.

c. *In re McNabb: Interpreting BAPCPA to Have Limited Applicability*

*In re McNabb*²²⁰ is one of the few cases decided since the enactment of BAPCPA that has interpreted the new Bankruptcy Code.²²¹ The bankruptcy court in Arizona noted that the phrase “hinder, delay, or defraud” could be a term of art, but the court was unprepared to define its meaning.²²² The court interpreted the homestead exemption of § 522(o) narrowly, holding that the \$125,000 cap on homestead exemptions is applicable only “as a result of electing” a state’s homestead exemption over the federal government’s exemption scheme.²²³ Because most states do not give bankruptcy debtors a choice between the state or federal exemption schemes, the court held that Congress’s language made the amendment applicable to only the few states that allow citizens to elect either the state or federal exemptions.²²⁴ The court reasoned that, based on the plain meaning of the statute, provisions of BAPCPA have extremely limited applicability.²²⁵ Important because it is one of the few cases interpreting the new Bankruptcy Code, *McNabb* illustrates the problems left unresolved by BAPCPA and new problems that it might have inadvertently created.²²⁶

2. Equitable Conversion Creates Fair but Inequitable Results in Bankruptcy

The court’s decision in *Hodes* protected the contractor from becoming involved in the litigation.²²⁷ The Tenth Circuit, however, erred when it applied the doctrine of equitable conversion to hold that a cash deposit given to a builder for additions to a debtor’s home was exempt from creditors under the Kansas homestead laws.²²⁸ Al-

220. 326 B.R. 785 (Bankr. D. Ariz. 2005).

221. *See id.* at 786.

222. *Id.* at 788 n.5.

223. *Id.* at 791.

224. *Id.* Kansans, for example, are required to use the Kansas exemptions and are not allowed to “elect” the federal exemptions. KAN. STAT. ANN. § 60-2312 (1994) (prohibiting Kansans from electing federal bankruptcy exemptions, subject to the those specifically listed in 11 U.S.C. § 522(d)(10)).

225. *In re McNabb*, 326 B.R. at 791.

226. *See id.*

227. Because the builder already had possession of the cash deposit and had expended it by the time the case reached the Tenth Circuit, perhaps the court reached a result that avoided the logistical problems inherent in ruling that the \$225,000 should not have been exempt. Even if the court had ruled that the cash was not exempt, it would not have ordered the addition to be torn down because no proceeds would have been generated by that action. An alternative result may seem more reasonable had the debtors used the cash to buy a tangible product, and that product was sold and the value returned to the judgment creditors.

228. *See Jenkins v. Hodes (In re Hodes)*, 402 F.3d 1005, 1013 (10th Cir. 2005).

though this was the first time a court used equitable conversion in the bankruptcy context to address an addition to an existing homestead, the court's application of the doctrine will inevitably provide courts in future cases with the authority to reach "equitable," but arguably unfair results in bankruptcy and other areas of the law.²²⁹

a. *The Nature of Equitable Conversion Prevents Its Use in Bankruptcy*

Equitable conversion in the context of bankruptcy mischaracterizes the usual manner in which the doctrine is used and requires an inconsistent justification. Equitable conversion was traditionally used in cases dealing with risk of loss, with the purpose of assigning liability to the appropriate party.²³⁰ Rather than focusing on the risk of loss of a tangible homestead, the court's application of equitable conversion to a cash deposit for an addition to a homestead allows the exemption of intangible property.²³¹ In the case of a contract for the sale of wheat, for example, the wheat is a tangible product that exists at the time of contract.²³² The addition to the Hodeses' home, in contrast, was not in existence when the bankruptcy petition was filed.²³³ Because the cash was given to the builder as payment for a promise to build an addition,²³⁴ the Tenth Circuit permitted nonexempt cash to be equitably converted into a promise—and that promise was allowed to constitute an exempt homestead.

This reasoning is nonsensical because the court allowed the Hodeses to claim the homestead exemption based on a mere promise to improve their home.²³⁵ The court held that the equitable conversion occurred at the moment the cash was given to the builder, even though nothing was actually built at that time. Such a promise should not be subject to equitable conversion. Simply put, the application of equitable conversion to intangible property is illogical because there is no risk of the intangible becoming nonexistent, so the risk of loss normally required for the assessment of liability does not shift.²³⁶

229. The Tenth Circuit noted that this case was the first time equitable conversion had been applied to a deposit with a homebuilder in bankruptcy, yet it felt comfortable doing so because the essential elements of equitable conversion were present. *Id.* at 1012. With this precedent, courts can apply equitable conversion to new areas of the law. *See, e.g., In re Stroble*, No. 03-24926, 2005 Bankr. LEXIS 1720, at *7-8 (Bankr. D. Kan. Sept. 7, 2005).

230. *See supra* Part III.B.

231. *See In re Hodes*, 402 F.3d at 1013.

232. *See supra* Part III.B.

233. *In re Hodes*, 402 F.3d at 1013.

234. *Id.* at 1008-09.

235. *See id.*

236. The application does not recognize the importance of assigning liability to make the market run more smoothly. With tangible property, it is necessary to assign liability so that each party to the contract understands the risks involved if the goods are destroyed. *In Hodes*, however, there was no addition to destroy because nothing existed during the initial dispute.

The Tenth Circuit's use of equitable conversion is also flawed because of the paradoxical nature of its analysis. Equitable conversion requires a forward-looking analysis, but determining its validity requires a backward-looking inquiry. The court initially stated that the nature of equitable conversion is forward-looking; therefore, it was irrelevant that a single nail had not been hammered when the bankruptcy petition was filed.²³⁷

In *Hodes*, both the judgment creditors and the debtors agreed that the cash deposit was given to the builder prior to both the date the involuntary petition was filed and the date the order for relief was entered.²³⁸ The court avoided deciding which date controls for the purpose of determining exemptions.²³⁹ Instead, the court reasoned that because equitable conversion is forward-looking, the cash deposit was exempt the moment the Hodeses gave it to the builder.²⁴⁰

In the same breath it proclaimed that the nature of equitable conversion is forward-looking, the court pronounced that the doctrine of equitable conversion would apply only if the contract was validly performed, a standard that requires a backward-looking analysis.²⁴¹ While the Tenth Circuit had the benefit of hindsight to affirm that the contract was performed,²⁴² courts in future cases will not have that luxury because the contracts are likely to be in the executory stage when examined. Using the precedent set forth by the Tenth Circuit, cash is equitably converted at the moment a contract is created. The contract will not have been fully performed, however, forcing the lower courts to rely on the word of the contracting parties rather than the inescapable truth of completed performance. This approach will open the door for abuse by the "fraudulent-minded debtor."²⁴³

The Tenth Circuit held that the applicability of equitable conversion in bankruptcy requires both forward-looking and backward-looking analysis. This inconsistency in the court's reasoning, coupled with the inappropriate application of the doctrine to an intangible contract with a home builder, illustrates the inherent problems in applying equitable conversion to bankruptcy under the facts of *Hodes*.

237. *In re Hodes*, 402 F.3d at 1012.

That the builder had not yet hammered a nail or installed a sheet of drywall is irrelevant, because the essential principle of equitable conversion is forward-looking: "[t]he equitable conversion doctrine . . . is anticipatory; it gets a jump on reality by imagining the conversion . . . in advance."

Id. (quoting 1 DAN B. DOBBS, *LAW OF REMEDIES: DAMAGES, EQUITY, RESTITUTION* § 4.3(8) (2d ed. 1993)).

238. *Id.* at 1013.

239. *Id.*

240. *Id.*

241. *Id.* at 1012-14.

242. *Id.* at 1014. By the time the court made its decision, the builder had completed the addition, and the entire \$225,000 was spent. *Id.*

243. *Id.* at 1013.

b. *The Result of Applying Equitable Conversion:
A Dangerous Precedent*

In *Hodes*, the debtors liquidated nonexempt property, using the proceeds to procure exempt assets.²⁴⁴ The Hodeses purchased two luxury cars, additional life insurance coverage, and an enormous addition to an already expensive home, each with nonexempt cash that could have otherwise gone to creditors.²⁴⁵ This extensive, last minute spending spree on the eve of bankruptcy left the Hodeses with a mere \$300 in cash at the time the bankruptcy schedules were filed, but they retained the capacity to continue a luxurious lifestyle.²⁴⁶

In the face of this aggressive pre-bankruptcy planning, the Tenth Circuit allowed the Hodeses, with a monthly disposable income of \$9,800, to escape paying creditors while retaining a home worth more than \$750,000.²⁴⁷ Applying the doctrine of equitable conversion to these facts, the court inadvertently opened the door for wide-ranging abuse.

Aside from the drastic results evidenced by *Hodes*, applying equitable conversion to homestead exemptions in the context of bankruptcy creates dangerous precedent and unintended consequences. The principles of equitable conversion may be used in a variety of circumstances to extend an already expansive law.²⁴⁸ The decision in *Hodes* marks the first time equitable conversion has been applied in the context of a deposit given to a homebuilder in bankruptcy,²⁴⁹ providing courts in future cases with the opportunity to apply the doctrine to a multitude of other circumstances.

In a recent case, *In re Stroble*,²⁵⁰ a bankruptcy court in Kansas relied on *Hodes* to allow the exemption of a settlement fee obtained by debtors.²⁵¹ Debtors Richard and Mary Stroble filed for Chapter 7 relief.²⁵² A few months later, the Strobles claimed as exempt a settle-

244. *Id.* at 1008. The court did not address which date controls for the purpose of exemptions in an involuntary bankruptcy proceeding. Instead, it used a new theory on which to decide the case. Using equitable conversion, the Tenth Circuit made the lower courts' decisions regarding the controlling date non-precedential. *Id.* at 1013. In an involuntary proceeding, the question of whether the petition date or the order date controls remains unanswered in the Tenth Circuit. The court narrowly tailored its holding to the particular facts in *Hodes*. *Id.* If the court had answered the question regarding the controlling date, the decision would have established clear and reliable precedent.

245. Debtors' Schedules, *In re Hodes*, 98-20039-7-JAR, 98-20040-7-JAR (1998); see *supra* note 94.

246. Debtors' Schedules, *In re Hodes*, 98-20039-7-JAR, 98-20040-7-JAR (1998). Every item the Hodeses purchased was later claimed as exempt under the appropriate Kansas statute. *Id.*

247. *Id.*

248. See, e.g., *In re Stroble*, No. 03-24926, 2005 Bankr. LEXIS 1720, at *7-8 (Bankr. D. Kan. Sept. 7, 2005).

249. *In re Hodes*, 402 F.3d at 1012.

250. No. 03-24926, 2005 Bankr. LEXIS 1720 (Bankr. D. Kan. Sept. 7, 2005).

251. *Id.* at *7-8.

252. *Id.* at *1.

ment that was received as a result of unfair mortgage practices by a lender.²⁵³ The Trustee objected and argued that the Kansas homestead exemption did not extend to money received from such a settlement regarding a homestead.²⁵⁴ Conversely, the Stroble asserted that the settlement money derived from the homestead should be protected under this exemption.²⁵⁵ In this case of first impression, the court used the precedent set in *Hodes* to hold that “the equitable considerations warranting the protection of homestead proceeds and the application of the equitable conversion doctrine are present.”²⁵⁶ Relying on the decision in *Hodes* and using equitable conversion, the court upheld the exemption.²⁵⁷

Stroble represents an extension of the doctrine of equitable conversion from cash deposits for homestead additions to settlements received from lender disputes. Even though the Tenth Circuit attempted to narrowly tailor its holding to an extremely specific set of facts,²⁵⁸ the court’s use of the doctrine of equitable conversion provides courts in future cases the opportunity to expand the doctrine in new ways.

VI. CONCLUSION

The Tenth Circuit incorrectly held that the doctrine of equitable conversion permits a debtor to convert nonexempt assets into exempt assets by allowing a cash deposit paid to a contractor to constitute part of the homestead, even if no construction had yet occurred when the bankruptcy petition was filed. The court had ample opportunity to hold the Hodeses accountable for their actions, but it instead chose to use equitable conversion to leave the judgment creditors with an inequitable result.

The judgment creditors did nothing wrong by pursuing payment, yet they were left without recovery of their \$4 million judgment. The Tenth Circuit’s ruling leaves creditors with few options; the Kansas bankruptcy bar with unanswered questions; federal courts with precedent allowing use of an old concept in expansive new ways; and the Hodeses with an expensive home, a new addition, and a court-approved escape from responsibility to their judgment creditors. As a result, the Tenth Circuit has used equitable conversion to create an inequitable result for the judgment creditors, while leaving the Hodeses to bask in “debtor’s paradise.”

253. *Id.*

254. *Id.* at *2.

255. *Id.* at *4-5.

256. *Id.* at *7.

257. *Id.*

258. *Jenkins v. Hodes (In re Hodes)*, 402 F.3d 1005, 1013 (10th Cir. 2005).

