United States Bankruptcy Court
Northern District of Illinois
Western Division

Transmittal Sheet for Opinions for Posting

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Bankruptcy Caption: In re William E. Kneeland

Bankruptcy No. 16-80975

Adversary Caption: N/A

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Date of Issuance: November 15, 2016

Judge: Thomas M. Lynch

Appearance of Counsel:

Attorney for Debtor: Timothy Brown, Law Office of Timothy Brown
Attorney for Creditor: Michael T. Benz

United States Bankruptcy Court, Northern District of Illinois

NAME OF ASSIGNED JUDGE	Thomas M. Lynch	**CASE NO.**	16-80975
DATE	November 15, 2016		
CASE TITLE	In re William E. Kneeland		
TITLE OF ORDER	Order		

DOCKET ENTRY TEXT

The Objection of James Perschke (ECF No. 58) to Debtor's claim of exemption is OVERRULED, and the exemption is allowed as filed.

0[For further details see text below.]

STATEMENT

Brief Procedural History

Debtor William Kneeland filed this Chapter 7 proceeding on April 20, 2016.[1] In his bankruptcy schedules, filed June 16, 2016, he listed two bank accounts at Fifth Third Bank: a checking account of $3,565.36 and a savings account of $2,600. In his Schedule C, the Debtor

[1] The petition was initially filed as a Chapter 7 without schedules on April 20, 2016. A Section 341 meeting of creditors was initially set for May 26, 2016, but before the meeting could be held the Debtor filed a motion to convert the case from Chapter 7 to Chapter 13 on May 11, 2016, which was granted on May 25, 2016. In the Chapter 13 case a Section 341 meeting was scheduled for July 12, 2016, but again not held because the Debtor filed a notice of voluntary conversion to Chapter 7 on July 11, 2016. During the short period as a Chapter 13 case, the Debtor filed Schedules A through J on June 16, 2016. Joseph Olsen was appointed interim Chapter 7 trustee of the re-converted Chapter 7 case and the Section 341 meeting was finally held on August 18, 2016.

asserted as exempt under 735 ILCS 5/12-1001(b): $400 in cash, the full $3,565.36 checking account and $34.64 of the $2,600 savings account. The Section 341 meeting of creditors was held and concluded on August 18, 2016. Creditor James Perschke timely filed an objection to claim of exemptions on September 16, 2016.

Trustee Olsen filed a "no-asset report" on August 18, 2016. On September 20, 2016, Mr. Perschke filed a motion to compel abandonment of the non-exempt portion of the Fifth Third savings account, as well as a $2,300 security deposit that Mr. Perschke alleges the Debtor testified to at the Section 341 meeting but failed to schedule. On September 28, 2016, the court entered an agreed order abandoning the estate interest in "(a) funds held by the Debtor as a security deposit in the amount of $2300, and (b) funds in the Debtor's Fifth Third Bank savings account in the amount of $2565.36, which amount exceeds the maximum available exemption under 735 ILCS 5/12-1001(b)." The order further provided that such "assets abandoned hereby are no longer property of the estate, and no longer subject to the automatic stay of Section 362 of the Bankruptcy Code."

Discussion

In his objection to the Debtor's claim of exemption of a portion of the two Fifth Third Bank accounts, Mr. Perschke states that the "Fifth Third Funds are not exempt because they are subject to liens in favor of Perschke by virtue of a Citation to Discover Assets served upon Kneeland on March 1, 2014 and a Citation to Discover Assets served upon Fifth Third Bank on April 11, 2016." At oral argument held on November 9, 2016, counsel for Mr. Perschke clarified that he did not object to the claim of exemption on any basis other than the alleged existence of a lien in his favor. During the hearing the court asked counsel if he could identify any specific case law that supported the proposition that the mere existence of a lien on property prevents a bankruptcy debtor from asserting an exemption in the debtor's interest in such property as against the bankruptcy estate. Counsel could not.

The Debtor contends that there is no authority for such proposition and also disputes as a matter of fact the validity of Mr. Perschke's alleged lien. He argues either that the lien never attached because the March 1, 2014 citation was not properly served on him or that it was subsequently terminated when the third party citation to discover assets against Fifth Third Bank was dismissed by order entered by the state court on May 5, 2016. However, at oral argument, counsel for the Debtor clarified that he raised the factual issue solely as a defense to Mr. Perschke's objection to the claim of exemption and that the Debtor does not currently seek to avoid a lien or seek an independent determination as to the validity of Mr. Perschke's purported lien.

To "help the debtor obtain a fresh start," the Bankruptcy Code allows debtors "to exempt from the estate limited interests in certain kinds of property." *Clark v. Rameker*, 134 S. Ct. 2242, 2244 (2014). A debtor "need not invoke an exemption to which the statute entitles him; but if he

does, the court may not refuse to honor the exemption absent a valid statutory basis for doing so." *Law v. Siegel*, 134 S.Ct. 1188, 1196 (2014). Indeed, unless the trustee, a creditor or other party objects within the time set by Bankruptcy Rule 4003, all property claimed by a debtor in his or her bankruptcy schedules "is exempt," regardless of whether the debtor "had a colorable statutory basis for claiming it." *Taylor v. Freeland & Kronz*, 503 U.S. 638, 643 (1992) (citing 11 U.S.C. §522(l), Fed. R. Bankr. P. 4003).

The "Bankruptcy Code specifies the types of property debtors may exempt." *Schwab v. Reilly*, 560 U.S. 770, 774 (2010). However, it does so in part by reference to state law. Although the Bankruptcy Code sets forth a series of federal exemptions to be applied in bankruptcy cases in Section 522(d), the Bankruptcy Code permits bankruptcy debtors to elect to instead apply their domiciliary state's exemptions as their bankruptcy exemptions. 11 U.C.S. § 522(b).[2] The Debtor here has elected to apply exemptions based on Illinois law for purposes of Section 522(b)(3)(A), which election the objector has not disputed. Therefore, the Debtor is entitled to exempt from the bankruptcy estate, among other things, "any property that is exempt under [Illinois] law that is applicable on the date of the filing of the petition" to Illinois. 11 U.S.C. §522(a)(3)(A).

Congress, in deferring by reference to state exemption law, gave the states "great latitude in formulating their own exemptions and in establishing eligibility requirements for these exemptions." *In re Geise*, 992 F.2d 651, 655-56 (7th Cir. 1993). The bankruptcy court's role "is to discern the will of the state legislature: what was the exemption scheme that the legislature wished to make available to the state's residents as an alternative to the federal exemptions set forth in the Bankruptcy Code?" 992 F.2d at 658. Illinois courts "have consistently held that personal property exemption statutes should be liberally construed in order to carry out the legislature's purpose in enacting them—to protect debtors." *In re Barker*, 768 F.2d 191, 196 (7th Cir. 1985).

The exemption statute in question here, 735 ILCS 5/12-1001, provides exemptions "from judgment, attachment, or distress for rent" for personal property owned by the debtor of the types listed in ten separate sub-sections. The Debtor asserts an exemption under sub-section (b). This sub-section is sometimes referred to as the "wildcard" exemption because, unlike the other exemptions in 735 ILCS 5/12-1001, it is not limited to a particular category of personal property. Instead, it permits the debtor to exempt the "debtor's equity interest, not to exceed $4,000 in value, in any other property." 735 ILSC 5/12-1001(b). The statute establishes certain limitations to the wildcard exemption. For example, the property to be exempted must be "personal property," not real property. *See, e.g., In re Woodworth*, 152 B.R. 258 (Bankr. C.D. Ill. 1993). The statute also

[2] For states, such as Illinois, bankruptcy debtors *must* choose to apply state exemptions and cannot assert the list of exemptions in Section 522(d). *See, e.g., Owen v. Owen*, 500 U.S. 305, 308 (1991) ("If a State opts out, then its debtors are limited to the exemptions provided by state law."). The Bankruptcy Code permits states to deny debtors the right to assert the exemptions listed in Section 522(d), and Illinois has made such election. 11 U.S.C. §522(b)(2); 735 ILCS 5/12-1201.

provides that its exemptions "shall apply only to individuals and only to personal property that is used for personal rather than business purposes." 735 ILCS 5/12-1001. The statute further provides that a debtor may not exempt property purchased "with the intent of converting nonexempt property into exempt property or in fraud of his or her creditors." *Id.* Mr. Perschke's counsel acknowledged during oral argument that he does not allege that the Debtor is not an individual, that the accounts are not used for personal purposes, or that they were obtained fraudulently. Nor does he contend that the Debtor has attempted to assert an exemption in excess of the $4,000 in value permitted under 735 ILCS 5/12-1001(b).

Whether or not Mr. Perschke has a lien in the bank accounts is not relevant to the Debtor's claim of exemption because he does not seek to impact any lien that Perschke may have in the property.[3] The Debtor seeks neither to terminate nor avoid any lien or other property interest that Mr. Perschke may have through the claim of exemption. Instead the Debtor seeks to exempt the interest that the Debtor has in the property from being included *within the bankruptcy estate*. A claim of an exemption in bankruptcy will generally not affect otherwise valid liens or security interests. Exemptions "immunize property which would otherwise belong to the estate from 'seizure or attachment for satisfaction of debts incurred prior to the bankruptcy proceeding.'" *In re Vance*, 165 F.3d 34 (7th Cir. Nov. 2, 1998) (quoting *In re Scarpino*, 113 F.3d 338, 340 (2d Cir. 1997)). However, such 'immunization' does not apply to collateral securing a "debt secured by a lien that is … not avoided under" Section 522(f) or (g) or Sections 544, 545, 547, 548, 549 or 724(a) of the Bankruptcy Code or void under Section 506(d). 11 U.S.C. §522(c)(2)(A). Thus, while no pre-petition unsecured creditor can assert any right to payment from properly exempt funds, unless avoided in the bankruptcy a "creditor's right to foreclose on [a lien] survives or passes through the bankruptcy." *In re Schoonover*, 331 F.3d 575, 578 (7th Cir. 2003).

The objector here relied on one case at oral argument, *In re Porayko*, 705 F.3d 703 (7th Cir. 2013), in support of his objection. But that case did not involve an objection to claim of exemption. Rather, *Porayko* involved a creditor who sought to lift the automatic stay to enforce a pre-petition citation lien against a checking account. The Chapter 7 trustee objected, contending that there could be no effective lien when the citation was served only on the debtor and not on the account bank. The court of appeals affirmed the bankruptcy court's order lifting the stay, holding that a checking account is "personal property" within the depositor's "control" and thus to the extent non-exempt was subject to a lien in favor of the judgment creditor upon service of the citation on the

[3] The existence of a lien could be relevant if there is a dispute whether the value of the wild card exemption asserted exceeds the monetary limit for the exemption. Only the monetary value of the judgment debtor's interest in property above the value of liens or other encumbrances against such property apply against the monetary cap set by the statute. It is in this sense that the statute uses the term "the debtor's equity interest" to provide that the exemption shall not "exceed $4,000 in value." 735 ILSC 5/12-1001(b). But that is not the case here. Although the two accounts together are worth more than the $4,000 limit, the Debtor has not sought an exemption in either in excess of that limit. And neither the Debtor nor Mr. Perschke allege that the bank accounts are encumbered by any third party liens or security interests.

judgment debtor. 705 F.3d at 704-05 (citing 735 ILCS 5/2-1402(m)). But here the Chapter 7 trustee does not dispute Mr. Perschke's lien on non-exempt property. Indeed, the trustee has agreed to abandon the estate's interest in such non-exempt property. While the Debtor questions as a factual matter whether Mr. Perschke's service of the citation was effective to create a lien, at oral argument his attorney made it clear that the Debtor does not seek to challenge or avoid such lien in or through the pending matter. There is no dispute here that by asserting the bankruptcy exemption the Debtor is not attempting to affect or modify Mr. Perschke's lien in non-exempt property under state law.

Nor does Mr. Perschke assert that the Debtor should be collaterally estopped from asserting a bankruptcy exemption. The effect of a judgment in subsequent litigation is determined by the law of the jurisdiction that rendered the judgment. *In re Catt*, 368 F.3d 789, 791 (7th Cir. 2004) (citing 28 U.S.C. § 1738). Under Illinois law, collateral estoppel requires that "(1) the issues decided in the prior adjudication are identical to issues presented for adjudication in the current proceeding; (2) there be a final judgment on the merits; and (3) the party against whom estoppel is asserted was a party or in privity with a party in the prior action." *Gambino v. Koonce*, 757 F.3d 604, 608 (7th Cir. 2014) (quoting *Am. Family Mut. Ins. Co. v. Savickas*, 739 N.E.2d 445, 451 (Ill. 2000). In addition, "the party sought to be bound must actually have litigated the issue in the first suit and a decision on the issue must have been necessary to the judgment in the first litigation." *Id.* Generally, a default judgment cannot form the basis for collateral estoppel under Illinois law. *In re Juma*, 530 B.R. 682, 688 (Bankr. N.D. Ill. 2015).

Here, Mr. Perschke has not identified any prior judgment, established any such judgment to be final and actually litigated between him and the Debtor, or established that an issue adjudicated is identical to that presented here. Indeed, at oral argument his counsel admitted that the state court had not entered any turnover order or otherwise adjudicated either citation prior to the filing of the bankruptcy petition. Although service of the first citation, if proper, may have been sufficient without further order to create a lien in non-exempt property, *Porayko*, 705 F.3d at 704-05, there has been no adjudication as to the scope of such lien. Further, even if there had been, it is not clear that collateral estoppel would apply, since the assertion of an exemption in a citation proceeding and in a bankruptcy proceeding are ultimately distinct as they are based on different law and the debtor's assets as existing at different points in time. For this reason, a number of bankruptcy courts have held that a pre-petition waiver of exemption "has no bearing on whether [the debtor] waived his exemption in this bankruptcy proceeding" and has no preclusive effect on the issue. *In re Quade*, 482 B.R. 217, 235 (Bankr. N.D. Ill. 2012) (citing *Crowell v. Porayko (In re Porayko)*, 443 B.R. 419, 426 (Bankr. N.D. Ill. 2010); *In re Watkins*, 298 B.R. 342, 351 (Bankr. N.D. Ill. 2003)).

Because the mere existence of a judicial lien is not a valid objection to a claim of an exemption in bankruptcy on the basis of 735 ILCS 5/12-1001(b), the court concludes that Mr.

Perschke's objection must be overruled without need to rule on the validity of the alleged citation lien.

November 15, 2016 ENTER:

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Thomas M. Lynch
United States Bankruptcy Judge