

UNITED STATES BANKRUPTCY COURT
DISTRICT OF SOUTH DAKOTA
Southern Division

In re:) Bankr. No. 02-41376
) Chapter 7
DOROTHY DAVIS)
Soc. Sec. No. 503-22-3509) INTERIM DECISION RE: DEBTOR'S
) CLAIMED HOMESTEAD EXEMPTION
Debtor.)

The matter before the Court is Trustee John S. Lovald's objection to Debtor's claimed homestead exemption and the response thereto filed by Debtor. This is a core proceeding under 28 U.S.C. § 157(b)(2). This Interim Decision and accompanying Order shall constitute the Court's interim findings and conclusions under Fed.Rs.Bankr.P. 7052 and 9014. As set forth below, the Court concludes that Trustee Lovald, using his § 544 powers, may not access any equity in Debtor's home in excess of \$30,000 at this time or in the future. Regarding Trustee Lovald's constitutional challenge to S.D.C.L. § 43-45-3, the Attorney General of South Dakota will be given notice and a briefing schedule on a preliminary issue will be set.

I.

Dorothy Davis filed a Chapter 7 petition on November 29, 2002. On the date of the petition, she was 75 years of age. She declared a \$93,331 exemption in her home, which she valued at \$95,000. (The difference reflected real estate taxes due of \$1,669.00). Debtor claimed her homestead exemption under three state statutes. The first, S.D.C.L. § 43-31-1, provides in part that the homestead held by a person age 70 or over is exempt from sale for taxes as long as it continues "to possess the character of a homestead." The

second, S.D.C.L. § 43-31-2, sets forth *inter alia* the general qualification that the homestead "must embrace the house used as a home by the owner." The third, S.D.C.L. § 43-45-3, provides that if a homestead is sold voluntarily or under Chapter 21-19 of the state code, then proceeds of the sale to the extent of \$30,000 are exempt. Section 43-45-3 also contains an exception to the \$30,000 limit on which Debtor relied. The exception in S.D.C.L. § 43-45-3(2) provides, "Such exemption shall not be limited to thirty thousand dollars for a homestead of a person seventy years of age or older or the unremarried surviving spouse of such person so long as it continues to possess the character of a homestead."

John S. Lovald, the case trustee, objected to this claimed exemption. He argued that the bankruptcy estate should remain open (or be closed subject to reopening) so that the bankruptcy creditors could realize Debtor's equity in the home once it ceases being her homestead. Debtor responded that her status on the petition date should control her exemption and that any potential change in circumstances post-petition is not relevant.

A hearing was held March 11, 2003. Since no facts were in dispute, the parties presented their arguments by brief.

In his brief, Trustee Lovald first argued that 11 U.S.C. § 544 imposes a lien on Debtor's equity in her home and that this lien can be realized when the house is no longer used as her home. Trustee Lovald's second argument was that, if Debtor could have an

unlimited homestead under S.D.C.L. § 43-45-3, then that state statute violates Article VI, § 18, and Article XXI, § 4, of the South Dakota Constitution.

In her brief, Debtor argued that her homestead exemption must be fixed on the petition date and not contingent on a possible future event. She cited several cases, relying most on *Armstrong v. Peterson (In re Peterson)*, 897 F.2d 935, 937-38 (8th Cir. 1990). Debtor also responded to Trustee Lovald's two arguments that § 43-45-3's provision for persons age 70 and over is unconstitutional. Finally, Debtor argued that as a matter of public policy Debtor's homestead exemption should be upheld and not subject to later divestiture.

II.

TRUSTEE LOVALD'S § 544 ARGUMENTS.

Section § 43-45-3 of the South Dakota Code provides in full:

A homestead:

- (1) As defined and limited in chapter 43-31, is absolutely exempt; or
- (2) In the event such homestead is sold under the provisions of chapter 21-19, or is sold by the owner voluntarily, the proceeds of such sale, not exceeding the sum of thirty thousand dollars, is absolutely exempt for a period of one year after the receipt of such proceeds by the owner. Such exemption shall not be limited to thirty thousand dollars for a homestead of a person seventy years of age or older or the unremarried surviving spouse of such person as long as it continues to possess the character of a homestead.

The last sentence of the statute is at the heart of this decision. It contains an apparent internal inconsistency that makes it

difficult to decipher.

The subject sentence is codified in subsection (2), which addresses what is deemed exempt if the homestead owner voluntarily sells his or her home or if the homestead is sold under ch. 21-19 of the South Dakota code (ch. 21-19 governs the process of levying on a homestead or personal property in excess of the allowed exemption). The first half of the subject sentence can easily be read to fit within that context. "Such exemption" would mean the available exemption discussed earlier in subsection (2) if the homestead is sold voluntarily or under ch. 21-19, and "shall not be limited to thirty thousand dollars for a homestead of a person seventy years of age or older ..." would mean that a home owner who is seventy or more years old could keep as exempt all the proceeds from the sale of his homestead for a period of one year. However, the last clause of the subject sentence, "so long as it continues to possess the character of a homestead," creates confusion because "Such exemption" now seems to refer to the actual homestead and not the proceeds from a sale of the homestead.

In *In re Ned Maryott*, Bankr. No. 01-10052, slip op. (Bankr. D.S.D. Sept. 24, 2001), the Court delved briefly into the history of subsection (2) of § 43-45-3.

Except for the last sentence of subsection (2), § 43-45-3 has been a part of South Dakota's homestead laws since at least 1939 with only the value limitation changing over the years. See S.D.C. § 51.1802(7)(1939). The last sentence in subsection (2) was added in 1980. S.L. 1980, ch. 296, § 3. The phrase "so long as it continues to

possess the character of a homestead," which is a part of the last sentence in subsection (2), has been a part of § 43-31-1 and that statute's earlier versions since at least 1874-75. See S.L. 1874-75, ch. 37, § 1 (Dak. Terr.).

Maryott, slip op. at 12 n.6. In *Maryott*, the Court also expressed concern about some of the conclusions reached in *Beck v. Lapsley*, 593 N.W.2d 410 (S.D. 1999), where the court limited the 70 or older person's exemption to only \$30,000 in proceeds if the homestead is voluntarily sold.

In *Beck*, the South Dakota Supreme Court, with limited discussion, concluded that upon a voluntary sale of a homestead, the property no longer possesses the character of a homestead, as required by § 43-45-3(2). *Beck*, 593 N.W.2d at 413. The state Supreme Court thus has interpreted § 43-45-3(2) to provide that a debtor, age 70 or over, may protect a homestead of any value from an execution sale, but that he may protect only \$30,000 in proceeds for one year if he voluntarily sells his home. *Id.* at 412-13.

The conclusion in *Beck* appears to be inconsistent with S.D.C.L. § 43-31-9, which states an owner may change his homestead entirely, and S.D.C.L. § 43-31-11, which provides that "[t]he new homestead shall in all cases be exempt to the same extent and in the same manner as the old or former homestead was exempt."⁷ [Footnote 7.: The provisions of S.D.C.L. §§ 43-31-9 and 43-31-11 have been a part of South Dakota's homestead laws since 1875. See S.L. 1874-75, ch. 37, §§ 12 and 13 (Dak. Terr.).] The conclusion in *Beck* also appears to be inconsistent with earlier case law. See *Christiansen v. United National Bank of Vermillion*, 176 N.W.2d 65, 67 (S.D. 1970) (upon a voluntary sale, every protection originally given to the homestead right adheres to the proceeds for one year after receipt); *Smith v. Midland National Life Insurance Co.*, 234 N.W. 20, 21 (S.D. 1930) ("An attempt to sell the property is not in and of itself any evidence of an abandonment."); *Smith v. Hart*, 207 N.W. 657, 658-59 (S.D. 1926) (in order to give full effect to the state's statute that allows an owner to change his homestead, the proceeds from a voluntary sale of a homestead, which the owner intends to

reinvest in a new homestead, must be protected from creditors)⁸ [Footnote 8: As discussed in *Christiansen*, 176 N.W.2d at 67, *Smith v. Hart* prompted a change in South Dakota's homestead exemption statutes to clarify that a voluntary sale did not constitute an abandonment of the homestead.]; see also *Keleher v. Technicolor Government Services, Inc.*, 829 F.2d 691, 693 (8th Cir. 1987) (a debtor cannot be presumed to willingly imperil his homestead or homestead proceeds unless necessity so requires or he expressly does so) (cites therein); *Botsford Lumber Co. v. Clouse (In re Clouse's Estate)*, 257 N.W. 106, 108 (S.D. 1934) (the homestead privilege ceases when there is no longer any reason for the homestead).

Maryott, slip op. at 13-14. This Court then went on to discuss its holding in *In re Hughes*, 244 B.R. 805 (Bankr. D.S.D. 1999), and to reach a conclusion on the multifaceted homestead issue presented in *Maryott*.

In *Hughes*, this Court applied S.D.C.L. § 43-45-3(2) in a case where the debtor was under age 70. The Court concluded that equity in a homestead in excess of \$30,000 was property of the bankruptcy estate available to pay creditor's claims. *Hughes*, 244 B.R. at 810-12. The Court noted in *Hughes* that the same conclusion would be reached regardless of whether the debtor's bankruptcy petition was deemed a voluntary sale of the property, see *Karcher v. Gans*, 83 N.W. 431, 432 (S.D. 1900) (cited in *Hughes*, 244 B.R. at 813 and 813 n.6), or whether the case trustee accessed the equity by standing in the shoes of a judgment lien creditor. *Hughes*, 244 B.R. at 812-13.

In light of the South Dakota Supreme Court's recent ruling in *Beck*, it appears that a different result would be reached in this case, where Debtor is age 70 or older, depending on which theory was applied. If we considered Debtor's bankruptcy petition as putting the trustee in the shoes of a judgment lien creditor, Debtor's entire homestead would be protected, regardless of value, because the Trustee could not force an execution sale. However, if we considered Debtor's bankruptcy as a voluntary transfer of his property, including his homestead, then under *Beck* Debtor could only protect \$30,000 in equity. The Court will not force that loss of exemption upon Debtor by deeming his Chapter 7 petition

to be a voluntary transfer of his and his wife's homestead property. First, to do so would be inconsistent with S.D.C.L. §§ 43-31-9 and 11, which allow a debtor to change his homestead without peril to his exemption. Second, exemption laws are to be construed liberally in the debtor's favor. *Wallerstedt v. Sosne (In re Wallerstedt)*, 930 F.2d 630, 631 (8th Cir. 1991) (cited in *Andersen v. Ries (In re Andersen)*, 259 B.R. 687, 690 (B.A.P. 8th Cir. 2001)). Third, the application of exemption laws should not be altered by the filing of a bankruptcy petition. See *Hughes*, 244 B.R. at 812. Finally, this result is consistent with the Court's decision on a related judgment discharge issue in *Langford State Bank v. West (In re West)*, Bankr. No. 99-10322, Adv. No. 00-1013, slip op. at 3-4 (Bankr. D.S.D. Dec. 26, 2000). Accordingly, Debtor may declare the entire 160 acres exempt as his homestead, regardless of value. Trustee Pfeiffer, as a hypothetical judgment lien creditor, or other actual judgment lien creditors may not access any equity in this homestead that may exceed \$30,000.

Maryott, slip op. at 14-16.

The twist that Trustee Lovald has added in this case, that distinguishes it from *Maryott*, is his specific request that Debtor's case be held open so that he can recoup the equity in Debtor's home should the home lose its homestead character sometime in the future. This argument does not survive scrutiny.

A debtor's entitlement to an exemption is determined on the day he files his bankruptcy petition. 11 U.S.C. § 522(b)(2)(A); *Peterson*, 897 F.2d at 937-39; and *Mueller v. Buckley (In re Mueller)*, 215 B.R. 1018, 1022 (8th Cir. B.A.P. 1998) (cites therein). Further, as noted earlier, exemptions are construed liberally in favor of the debtor. *Wallerstedt v. Sosne (In re Wallerstedt)*, 930 F.2d 630, 631 (8th Cir. 1991). In light of these

basic tenets and this Court's earlier holding in *Maryott*, the Court concludes that Trustee Lovald may not hold open Debtor's case until her home is no longer her homestead and then recover, on some future date, her equity in it. His ability to access any equity in the property was fixed on the petition date. On that date, Debtor occupied her house as her homestead; there is no evidence she held a present intent to the contrary. Further, her homestead exemption on that date, based on the South Dakota Supreme Court's holding in *Beck*, was unlimited. Thus, there was no equity to which a lien for Trustee Lovald could attach under § 544(a) since his powers under that statute are fixed on the petition date.

III.

TRUSTEE LOVALD'S CONSTITUTIONAL ARGUMENTS.

Trustee Lovald has asked that two constitutional challenges regarding S.D.C.L. § 43-45-3 be addressed if he were unsuccessful on his § 544 argument.¹ Before that can happen, the Attorney General for the State of South Dakota needs to be advised of this proceeding and be given an opportunity to participate in the debate. S.D.C.L. § 15-6-24(c). Notice will be given by the Court in the form of a cover letter and a copy of this decision.

Further, before the actual constitutional challenges are addressed by this Court, the Court wants interested parties to file *short* briefs on whether they believe there is sufficient guidance

¹ This Court previously addressed constitutional challenges on homestead related issues in *Hughes*, 244 B.R. at 814-16.

in South Dakota's Constitution, South Dakota's statutes, and existing case law to guide this Court or whether these particular constitutional challenges should be referred (through the United States District Court) to the South Dakota Supreme Court pursuant to S.D.C.L. ch. 15-24A. *Arizonans for Official English v. Arizona*, 520 U.S. 43, 79 (1997) (novel, unsettled questions of state law are necessary before a federal court may avail itself of a state's certification process). A briefing schedule will be set on that issue.

Dated this 29 day of May, 2003.

BY THE COURT:



Irvin N. Hoyt
Bankruptcy Judge

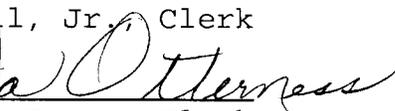
NOTICE OF ENTRY
Under F.R. Bankr.P. 9022(a)
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MAY 29 2003

Charles L. Nail, Jr., Clerk
U.S. Bankruptcy Court
District of South Dakota



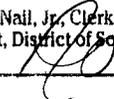
Charles L. Nail, Jr., Clerk


Deputy Clerk

(SEAL)

I hereby certify that a copy of this document was electronically transmitted, mailed, hand delivered or faxed this date to the parties on the attached service list.

MAY 29 2003

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