No. 12-5196

In the Supreme Court of the United States

STEPHEN LAW, PETITIONER

v.

ALFRED H. SIEGEL, CHAPTER 7 TRUSTEE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE UNITED STATES AS AMICUS CURIAE

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QUESTION PRESENTED

Whether, pursuant either to its authority under 11 U.S.C. 105(a) or to its inherent power to sanction misconduct, a bankruptcy court may impose an equitable surcharge on a debtor's otherwise-exempt property in order to compensate the estate for litigation costs that it incurred as a result of the debtor's bad-faith litigation conduct.

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This brief is submitted in response to this Court's order inviting the Solicitor General to express the views of the United States. In the view of the United States, the petition for a writ of certiorari should be denied.

STATEMENT

1. a. A debtor commences a voluntary bankruptcy case by filing a petition in bankruptcy court. 11 U.S.C. 301. Individual debtors typically file for relief under Chapter 7 or Chapter 13 of the Bankruptcy Code. The present case arises under Chapter 7, which provides for a liquidation of a debtor's non-exempt pre-petition assets in exchange for a discharge of debts. 11 U.S.C. 701 *et seq.* After filing a voluntary bankruptcy petition, a debtor must file a schedule of assets and liabilities, a schedule of current income and current expenditures, and a statement of the debtor's financial affairs. 11 U.S.C. 521(a)(1); Fed. R. Bankr. P. 1007(c); Fed. R.

Bankr. P. Official Forms 6 (Schedules) and 7 (Statement of Financial Affairs)). A debtor must file those documents under penalty of perjury. See Fed. R. Bankr. P. 1008.

Commencement of a Chapter 7 case creates an "estate" that includes all of the debtor's "legal or equitable interests * * * in property as of the commencement of the case." 11 U.S.C. 541(a). The debtor must surrender all non-exempt estate property to the Chapter 7 trustee, who takes custody of such property, liquidates it, and disburses the proceeds to creditors in accordance with their rights and priorities under the Code. 11 U.S.C. 507, 521(a)(3) and (4), 704(a)(1), 726. The Bankruptcy Code accords a high priority to paying administrative expenses incurred by the estate. 11 U.S.C. 507(a)(2); see 11 U.S.C. 503(b) (administrative expenses include "the actual, necessary costs and expenses of preserving the estate").

The Bankruptcy Code "give[s] the bankrupt a fresh start with such exemptions and rights as the [bankruptcy] statute left untouched." *Burlingham* v. *Crouse*, 228 U.S. 459, 473 (1913). A debtor is entitled to claim various statutory exemptions to prevent the liquidation or distribution of specific categories of property. 11 U.S.C. 522. Generally speaking, "property exempted" from the estate "is not liable during or after the case for any debt of the debtor that arose * * * before the commencement of the case." 11 U.S.C. 522(c).

Exemptions may be defined by state or federal law. See 11 U.S.C. 522(b)(1) and (2), (d). The State of California (where this bankruptcy was filed) requires debtors in California to use the exemptions defined by state law. See Cal. Civ. Proc. Code §§ 703.130, 703.140 (West Supp. 2013). As relevant here, California currently

provides for a "homestead" exemption of between $75,000 and $175,000 (depending on the debtor's household circumstances) for a debtor's interest in his principal dwelling. See *id.* §§ 704.710(c), 704.730. When a debtor claims eligible property as exempt and no "party in interest" objects, the federal Bankruptcy Code ordinarily excludes such property from the bankruptcy estate. See 11 U.S.C. 522(*l*).

b. Section 105 of the Bankruptcy Code, 11 U.S.C. 105, sets forth the powers of courts adjudicating bankruptcy cases. As relevant here, Section 105(a) provides that the "court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of" Title 11 of the United States Code. 11 U.S.C. 105(a). Section 105(a) further provides that "[n]o provision" of Title 11 "providing for the raising of an issue by a party in interest shall be construed to preclude the court from, sua sponte, taking any action or making any determination necessary or appropriate to enforce or implement court orders or rules, or to prevent an abuse of process." *Ibid.*

2. In January 2004, petitioner filed a voluntary Chapter 7 bankruptcy petition. Pet. App. 5. Respondent was appointed to serve as Chapter 7 Trustee. *Ibid.*

a. Petitioner's bankruptcy schedules listed petitioner's home as the sole asset of the bankruptcy estate. Pet. App. 5. The schedules represented that the home was worth $363,348 and that it was encumbered by two liens totaling $304,085.56. *Id.* at 6. Petitioner listed a first priority mortgage lien for $147,156.52, held by Washington Mutual Bank, and a second priority lien for $156,929.04, held by "Lin's Mortgage and Associates." *Ibid.* Petitioner also claimed a homestead exemption of $75,000 pursuant to Cal. Civ. Proc. Code § 704.730(a)(2).

Pet. App. 6. Petitioner's schedules thus represented that the total amount of the claimed homestead exemption plus the two listed liens exceeded the value of the house. The practical implication of those figures was that the home was not a source of value that the bankruptcy estate could use to satisfy petitioner's other creditors.

Petitioner's homestead exemption became final without opposition from respondent. Pet. App. 9. Years of litigation ensued, however, concerning the validity of the second lien and associated deed of trust. See 401 B.R. 449-455. Petitioner offered unpersuasive and contradictory evidence in support of his claim that in 1998 he had received a loan of $168,000 from a woman named Lili Lin. *Id.* at 449-450. He could not produce evidence to establish the form in which he had received the money, and he offered shifting accounts of how and to whom those funds were paid. *Ibid.* Petitioner contended that in June 1999 (a year after he had allegedly received the loan) he had executed and obtained notarization of two separate promissory notes in favor of a person named Lili Lin to document the alleged loan. *Id.* at 450. The two notes were inconsistent with each other, however, and petitioner could not explain why. *Ibid.* Petitioner recorded a deed of trust in favor of Lili Lin on June 28, 1999—after an action had been commenced against petitioner in Los Angeles Superior Court, and four months before that action resulted in a judgment of $131,821.74 against petitioner. *Ibid.*

Petitioner was acquainted with a woman named Lili Lin, who lived in Artesia, California. 401 B.R. 450. Although she had never loaned any money to petitioner, petitioner delivered to her the deed of trust and promissory note in June 1999. *Ibid.* Petitioner later asked Lin

to accept a check from him for $168,000 in satisfaction of the loan, and then to return the money to him. *Id.* at 450-451. Lin refused. *Id.* at 451. In early 2000, County Records Research received a letter purporting to be from Lin and seeking to institute foreclosure proceedings on petitioner's home. *Ibid.* Lin stated that she had not sent that letter. *Ibid.* Around the same time, Lin received a packet of documents that, had she signed them, would have transferred any interest she had in the disputed second lien to petitioner's ex-wife. *Ibid.* Lin declined to sign the documents and later entered into a stipulated judgment with respondent, in which Lin stated that she had never loaned money to petitioner and that petitioner had attempted to involve her in a sham foreclosure of the disputed deed of trust. *Id.* at 451-452.

When petitioner filed his bankruptcy petition four years later, he listed "Lin's Mortgage & Associates," purportedly located in Guangzhou, China, as the holder of the second lien on his residence. 401 B.R. 451. Respondent filed an adversary proceeding asserting fraud against Lili Lin. *Ibid.* In his opposition, petitioner alleged that he had received the second-lien loan from a *different* woman named Lili Lin who resided in China. *Ibid.* Although Lin of China purportedly never traveled to the United States during the pendency of the bankruptcy, did not speak English, and was often unrepresented by counsel, numerous pleadings in the bankruptcy court advocating for petitioner's position were filed in her name. *Id.* at 452-453. The bankruptcy court ultimately concluded that no person named Lili Lin—either from Artesia or from China—had ever loaned money to petitioner in exchange for the disputed deed of trust. *Id.* at 453.

Respondent's investigation into the validity of the scheduled second lien—and petitioner's resistance to the investigation—spawned years of litigation, including discovery disputes, more than a dozen appeals to the Bankruptcy Appellate Panel (BAP), and several appeals to the Ninth Circuit. Pet. App. 5 n.4. With permission from the bankruptcy court, respondent ultimately sold petitioner's residence. *Id.* at 6 & n.5. After paying all costs of the sale and satisfying the (undisputed) first lien, the bankruptcy estate was left with $208,777.91. *Id.* at 6 n.5. That amount would have been sufficient to pay petitioner's creditors, to pay respondent's costs, and to pay petitioner the $75,000 value of his homestead exemption if petitioner had not invented the false second lien. *Id.* at 13. As a result of the litigation surrounding that fictitious lien, however, respondent and the estate had incurred more than $450,000 in legal fees. *Ibid.*

In 2005 (during the dispute about the validity of the second lien), the bankruptcy court entered a default judgment against petitioner denying discharge of his debts in bankruptcy. No. CC-05-1352, 2006 WL 6810957, at *2. Petitioner appealed the denial of discharge, and the BAP affirmed. *Id.* at *3-*4.

b. When respondent moved to sell petitioner's house in 2006, he also filed a motion to "surcharge" petitioner's $75,000 homestead exemption in order to recoup some of the expenses the estate had incurred in resisting petitioner's attempt to shield equity in his home with the fraudulent second lien. Pet. App. 6. The bankruptcy court authorized the surcharge, explaining that petitioner's conduct was "the direct cause of the expenses that have been incurred by [respondent]," and that respondent was likely to incur additional related expenses. *Id.* at 7.

Petitioner appealed, and the BAP reversed. See Pet. App. 7. The BAP acknowledged that petitioner had exhibited "misconduct, obstinance, blatant ignorance of court orders and directives, animosity towards the court and the trustee, and efforts to thwart administration of the [bankruptcy] case." No. CC-06-1180, at 17. The BAP reversed, however, because the surcharge was based on the disputed validity of the second lien, which at that point had not yet been determined. *Ibid.*

c. In April 2008, respondent filed a second motion to surcharge petitioner's homestead exemption. Respondent therein alleged that petitioner had used the fictitious second lien to attempt to defraud his creditors; that petitioner had twice perjured himself, first by listing the fraudulent lien in his schedules and then by attaching a fraudulent promissory note to his motion to reconsider the order approving the sale of his residence; and that petitioner had invented Lili Lin of China in order to frustrate respondent's administration of the estate and to exhaust the estate's assets. See Pet. App. 9-10. The bankruptcy court conducted an evidentiary hearing on the motion and memorialized its findings in a written memorandum decision. See *id.* at 11.

The bankruptcy court found that petitioner had attempted to perpetrate a fraud on the court by claiming the second lien on his residence. See Pet. App. 11-13. The court concluded that "[t]he preponderance of the evidence clearly shows that the loan was a fiction, meant to preserve [petitioner's] equity in his residence beyond what he was entitled to exempt as a homeowner, and a fraud on his creditors and the court." *Id.* at 12; see generally 401 B.R. 453. The bankruptcy court further found that, "had [petitioner] not invented the second deed of trust and persisted in his misrepresentations to

the court, ample funds would have been available in the bankruptcy case to pay [petitioner's] creditors and [respondent's] costs, pay [petitioner] his full homestead exemption, and to return surplus funds to [petitioner]." Pet. App. 13. During the extensive litigation over the fraudulent second lien, however, the bankruptcy estate had incurred more than $450,000 in expenses as a "direct result of [petitioner's] active misrepresentations to [respondent] and to the court." *Ibid.* Recognizing that "the actual costs" of petitioner's misconduct "to the estate far exceed $75,000 (the exemption to which [petitioner] would otherwise be entitled)," the bankruptcy court granted respondent's motion to surcharge petitioner's homestead exemption in its entirety. *Ibid.* The practical effect of the surcharge was to deny petitioner the $75,000 portion of the residence-sale proceeds to which he would otherwise have been entitled under the California homestead exemption.

d. Petitioner appealed to the BAP, which affirmed in an unpublished decision. Pet. App. 4-26. The BAP observed that, although "[t]he Bankruptcy Code does not expressly authorize surcharges against a debtor's exemptions," the Ninth Circuit had previously "held that a bankruptcy court may equitably surcharge a debtor's statutory exemptions when reasonably necessary to protect the integrity of the bankruptcy process and to ensure that a debtor receives as exempt property an amount no more than what is permitted by the Bankruptcy Code." *Id.* at 15 (citing *Latman* v. *Burdette*, 366 F.3d 774, 786 (9th Cir. 2004)). The BAP also relied on a previous BAP decision upholding a bankruptcy court's surcharge of a debtor's homestead exemption to reimburse the estate for expenses incurred as a result of the debtor's misconduct. *Id.* at 16-17 (citing *In re Onubah*,

375 B.R. 549, 553-558 (B.A.P. 9th Cir. 2007)). The BAP had held in that decision that such a surcharge is permitted when a debtor has "abused the processes of the bankruptcy court" or when a debtor's "efforts at obstruction were not litigation tactics undertaken in good faith." *Id.* at 17 (quoting *In re Onubah*, 375 B.R. at 554).

While recognizing "that a surcharge of a debtor's exemptions is appropriate only in 'exceptional circumstances,'" the BAP concluded that such circumstances "exist when a debtor engages in inequitable or fraudulent conduct that, when left unchallenged, denies creditors access to property in excess of that which is properly exempted under the Bankruptcy Code." Pet. App. 17-18 (quoting *Latman*, 366 F.3d at 786). The BAP held that the surcharge against petitioner's homestead exemption was not an abuse of discretion because the "second trust deed loan was a fiction" and a fraud on the court. *Id.* at 21. The surcharge was justified, the BAP explained, to "protect the integrity of the bankruptcy system, and to prevent [petitioner] from reaping a benefit from his actions to the prejudice of his creditors." *Id.* at 18-21.

e. The court of appeals affirmed in an unpublished decision. Pet. App. 1-3. The court explained that "[t]he BAP properly affirmed the bankruptcy court's order granting [respondent's] surcharge motion because the surcharge was calculated to compensate the estate for the actual monetary costs imposed by [petitioner's] misconduct, and was warranted to protect the integrity of the bankruptcy process." *Id.* at 2 (citing *Latman* and *Onubah*).

DISCUSSION

Petitioner asks this Court to resolve a division among three courts of appeals concerning a bankruptcy court's

authority to impose an "equitable surcharge" on a debtor's exempt property. In the prior cases that created the circuit conflict, the surcharge was used to make available for distribution to creditors other property that the debtor should have turned over to the estate but did not. The question whether an equitable surcharge may be used for that purpose might warrant this Court's review in an appropriate case. That issue, however, is not presented here.

Rather, this case presents the distinct question whether the bankruptcy court could properly withhold from the debtor the amount ($75,000) of his state-law homestead exemption as a sanction for the debtor's vexatious and bad-faith litigation conduct, which constituted a fraud on the court and caused the estate to incur substantial litigation expenses it would not otherwise have borne. Petitioner does not identify any circuit split on that question, and bankruptcy courts (like other courts) have inherent authority to impose monetary sanctions on persons who engage in fraudulent or abusive litigation conduct. The petition for a writ of certiorari should be denied.

A. Review Is Not Warranted Because This Case Does Not Present The Question On Which Courts Of Appeals Are Divided

1. The equitable powers of bankruptcy courts are codified in 11 U.S.C. 105(a), which provides:

> The court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of [Title 11 of the United States Code]. No provision of [Title 11] providing for the raising of an issue by a party in interest shall be construed to preclude the court from, sua sponte, taking any action or

> making any determination necessary or appropriate to enforce or implement court orders or rules, or to prevent an abuse of process.

See *Malley* v. *Agin*, 693 F.3d 28, 29 (1st Cir. 2012) (Souter, J.); *In re Scrivner*, 535 F.3d 1258, 1262-1263 (10th Cir. 2008), cert. denied, 556 U.S. 1126 (2009). Section 105(a) thus makes clear that a bankruptcy court may exercise its equitable authority either "to carry out the provisions of" the Bankruptcy Code or to vindicate the court's own authority, including by "prevent[ing] an abuse of process." 11 U.S.C. 105(a). Although Section 105(a) does not authorize bankruptcy courts to take action that contravenes other provisions of the Bankruptcy Code, see *SEC* v. *United States Realty & Improvement Co.*, 310 U.S. 434, 455 (1940), it is a "spacious[]" grant of authority intended to safeguard the bankruptcy system, *Malley*, 693 F.3d at 30.

Three courts of appeals have considered whether a bankruptcy court may equitably surcharge—*i.e.*, treat as non-exempt—a debtor's otherwise-exempt property when the debtor wrongfully withholds non-exempt property from the estate. As used in that context, an equitable surcharge provides additional funds for distribution to creditors, thus compensating the creditors for the loss they would otherwise incur from the debtor's wrongful withholding of non-exempt property, and prevents the debtor from retaining more property than is authorized by the Code. Two of the three courts of appeals to consider the question have held that an equitable surcharge may permissibly be used for that purpose.

Most recently, the First Circuit held in *Malley* (per Justice Souter, sitting by designation) that Section 105(a) authorizes such a surcharge. 693 F.3d at 29-31. The court in *Malley* reasoned that, in enacting Section

105(a), "Congress intended bankruptcy courts to be able to enforce the 'provisions' requiring honest disclosure on the part of the debtor, *see* [11 U.S.C.] 521, and placing limits on exemption claims, *see* [11 U.S.C.] 522." *Id.* at 29. The court further explained that, when a debtor has wrongfully concealed or withheld non-exempt property that can no longer be turned over to the estate (because, for example, the debtor has sold the property and/or spent the money), "surcharge is an appropriate and necessary way to vindicate § 521, requiring honest disclosure of non-exempt assets, and § 522, regulating the determination of legitimate exemptions for the debtor's benefit." *Id.* at 30. The First Circuit concluded that imposing "an offsetting surcharge against otherwise exempt property interests" in such a case "is reasonably necessary 'both to protect the integrity of the bankruptcy process and to ensure that a debtor exempts an amount no greater than . . . the Bankruptcy Code [permits].'" *Ibid.* (quoting *Latman* v. *Burdette*, 366 F.3d 774, 786 (9th Cir. 2004)) (brackets in original). The *Malley* court also noted that such a surcharge implements the bankruptcy court's Section 105(a) authority to "prevent an abuse of process" because it "mitigate[es] the effect of fraud in retaining non-exempt assets and thus enhancing the set-aside for a fresh start beyond the amount Congress provided for the honest debtor." *Ibid.* (quoting 11 U.S.C. 105(a)).

The Ninth Circuit has likewise held that a bankruptcy court may impose an equitable surcharge on otherwise-exempt property of debtors who have attempted to "pocket[] funds that belonged to creditors, by sheltering more assets than permitted by the exemption scheme of the Bankruptcy Code." *Latman*, 366 F.3d at 783, 785-786. Although the court in *Latman* did not cite Section

105(a), it held that "the equitable powers of the bankruptcy court" authorized it to surcharge otherwise-exempt property in order to "prevent[] what would otherwise have been a fraud on the bankruptcy court and the [debtors'] creditors caused by the [debtors'] nondisclosure of monies that should have been listed on the bankruptcy schedules and available for the [debtors'] creditors." *Id.* at 784-785. Such a surcharge, the court reasoned, served to enforce the limitations set forth in 11 U.S.C. 522 on the amount of property a debtor is entitled to shelter during the bankruptcy process. *Id.* at 785.

The Tenth Circuit has reached a different result, holding in *Scrivner*, *supra*, that Section 105(a) does not authorize a bankruptcy court to surcharge debtors' exempt property as a remedy for the debtors' withholding of non-exempt property from the estate. 535 F.3d at 1263-1265. The court in *Scrivner* recognized that Section 105(a) codifies a bankruptcy court's equitable powers, including "the power to 'sanction conduct abusive of the judicial process.'" *Id.* at 1263 (quoting *In re Courtesy Inns, Ltd.*, 40 F.3d 1084, 1089 (10th Cir. 1994)). The court held, however, that those equitable powers did not authorize the equitable surcharge imposed by the bankruptcy court in that case. *Id.* at 1264-1265. The court explained that the Bankruptcy Code includes specific provisions establishing penalties for debtor misconduct and identifying circumstances in which normally exempt property should be treated as non-exempt. *Id.* at 1264. The court concluded that, where those specific provisions are inapplicable, Section 105(a) does not authorize courts to address debtor misconduct by denying exemp-

tions to which the debtor would otherwise be entitled. *Id.* at 1265.[1]

2. In the view of the United States, the courts of appeals in *Malley* and *Latman* correctly held that a bankruptcy court may impose an equitable surcharge on a debtor's otherwise-exempt property as a remedy for the debtor's wrongful withholding of non-exempt property from the estate. Section 105(a) authorizes a bankruptcy court to "issue any order, process, or judgment that is necessary or appropriate to carry out the provisions" of the Bankruptcy Code. 11 U.S.C. 105(a). In *Malley*, *Latman*, and *Scrivner*, the bankruptcy courts issued surcharge orders because recovering the debtors' otherwise-exempt property was necessary to effectuate the provisions of the Code that require debtors to honestly disclose and turn over non-exempt property. See 11 U.S.C. 521, 522. As the court in *Malley* explained, "[i]f § 105(a) was not meant to empower a court to issue" such an order, "it is hard to see what use Congress had in mind for it." 693 F.3d at 30.

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[1] Petitioner suggests that the division among the courts of appeals is more extensive than it is by relying on decisions from a district court in the Eleventh Circuit and a bankruptcy court in the Seventh Circuit. Pet. Reply Br. 3-4 (quoting *In re Mazon*, 395 B.R. 742, 749-750 (M.D. Fla. 2008); *In re Campbell*, 475 B.R. 622, 641 (Bankr. N.D. Ill. 2012)). As those decisions suggest, the Seventh Circuit has described Section 105(a) as a "means to enforce the Code rather than an independent source of substantive authority," *In re UAL Corp.*, 412 F.3d 775, 778 (2005), and the Eleventh Circuit has noted that "[t]he bankruptcy court's equitable powers * * * do not allow it to override the specific statutory language found in" another provision of the Code, *In re Cox*, 338 F.3d 1238, 1243 (2003), cert. denied, 541 U.S. 991 (2004). Neither the Seventh nor the Eleventh Circuit, however, has considered whether or in what circumstances Section 105(a) authorizes a bankruptcy court to impose a surcharge on otherwise-exempt property.

The Tenth Circuit concluded in *Scrivner* that, at least when some provision of the Code addresses the conduct at issue, Section 105(a) does not empower a bankruptcy court to take any action not specifically authorized by the Code. 535 F.3d at 1265. That reading, however, would render largely superfluous Section 105(a)'s general authorization to issue orders "necessary or appropriate to carry out the provisions of the" Code. 11 U.S.C. 105(a). When a debtor's breach of Code requirements would otherwise leave him with a larger amount of property than the Code authorizes him to retain, thereby leaving his creditors with a correspondingly smaller share of the debtor's assets, a bankruptcy court may appropriately take steps to recover otherwise-exempt property in order to ensure that both the debtor and the creditors ultimately receive the amounts to which they are entitled under the applicable Code provisions. In such a case, the surcharged property should not be "recognized as 'exempted under [Section 522]' when its exemption would consummate a fraud on creditors by giving the debtor a greater exemption in fact than the code entitles him to claim in law." *Malley*, 693 F.3d at 29.[2]

The First and Ninth Circuits' understanding of bankruptcy courts' remedial authority under Section 105(a) is consistent with this Court's decision in *Marrama* v.

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[2] Such steps are equally justified by Section 105(a)'s authorization of bankruptcy courts to "tak[e] any action or mak[e] any determination necessary or appropriate to enforce or implement court orders or rules, or to prevent an abuse of process." 11 U.S.C. 105(a). As the First Circuit explained: "There could not be a clearer example of foiling abuse of process than a surcharge order mitigating the effect of fraud in retaining non-exempt assets and thus enhancing the set-aside for a fresh start beyond the amount Congress provided for the honest debtor." *Malley*, 693 F.3d at 30.

Citizens Bank, 549 U.S. 365 (2007). In *Marrama*, the bankruptcy court denied a Chapter 7 debtor's motion to convert his case to a Chapter 13 bankruptcy even though 11 U.S.C. 706(a) provides that a Chapter 7 "debtor may convert a case under [Chapter 7] to a case under chapter 11, 12, or 13 [of Title 11] at any time." See *Marrama*, 549 U.S. at 368-371. This Court upheld the bankruptcy court's action, reasoning that "the broad authority granted to bankruptcy judges to take any action that is necessary or appropriate 'to prevent an abuse of process' described in § 105(a) of the Code, is surely adequate to authorize an immediate denial of a motion to convert filed under § 706." *Id.* at 375. The reasoning of *Marrama* strongly suggests that *Malley* and *Latman*, rather than *Scrivner*, reflect the better understanding of bankruptcy courts' authority under Section 105(a) to surcharge a debtor's otherwise-exempt property in order to return wrongfully withheld assets to the bankruptcy estate for distribution to creditors.

3. Although the circuit conflict described above is relatively shallow, the Court may wish to resolve that division in an appropriate case. This is not an appropriate case in which to do so, however, because the surcharge at issue here was premised on a different form of debtor misconduct, and served a different purpose, than the surcharges ordered in *Malley*, *Scrivner*, and *Latman*. In this case, petitioner's creditors were paid in full from the concededly non-exempt portion of the proceeds that the sale of his residence produced. See Pet. App. 6 n.5 (secured first lien on residence satisfied); 2:04-bk-10052-TD, Docket entry No. 354 (ordering respondent to disburse estate funds to satisfy petitioner's other major creditor). Unlike in the prior cases discussed above, petitioner did not squander or ultimately

withhold non-exempt assets from the estate, and the bankruptcy court's surcharge of petitioner's homestead exemption was not intended to restore to the estate property that petitioner should have handed over as part of the bankruptcy process. To be sure, petitioner *attempted* through the fictitious lien to retain more assets than the Code (and the applicable state-law homestead exemption) would allow. But when that fraud was discovered and respondent sold petitioner's residence (with permission from the bankruptcy court), he obtained for the estate all of the property that the Code required petitioner to turn over as an initial matter.

Here, the bankruptcy court surcharged petitioner's homestead exemption, not as a substitute for non-exempt property that petitioner had concealed or dissipated, but to partially compensate the estate for its enormous expenditures in exposing and avoiding petitioner's fraud on the court. As the bankruptcy court found, "based upon an ample record," petitioner "engaged in inequitable conduct, bad faith, and fraud on a truly egregious scale." Pet. App. 18. In order to counteract petitioner's fraudulent attempt to withhold non-exempt property from the estate, respondent incurred significant expenses. By surcharging petitioner's homestead exemption, the bankruptcy court "protect[ed] the integrity of the bankruptcy system" *id.* at 21, and "prevent[ed] an abuse of process," 11 U.S.C. 105(a).

The Ninth Circuit's brief, unpublished opinion in this case is the first court of appeals decision to address the question whether Section 105(a) authorizes a bankruptcy court to surcharge otherwise-exempt property in order to compensate the estate for administrative expenses caused by a debtor's abusive litigation conduct.

See Pet. App. 2 ("[T]he surcharge was calculated to compensate the estate for the actual monetary costs imposed by the debtor's misconduct, and was warranted to protect the integrity of the bankruptcy process."). Although the Ninth Circuit's Bankruptcy Appellate Panel has upheld a surcharge under similar circumstances, see *In re Onubah*, 375 B.R. 549, 556 (2007), the relevant law is undeveloped and there is no circuit conflict. The question presented in this case does overlap with the question on which the courts of appeals are divided, since both questions involve the scope of a bankruptcy court's equitable powers to address and remedy debtor misconduct. But the questions are sufficiently distinct that a decision by this Court upholding or invalidating the surcharge here would not necessarily resolve the issue presented in *Malley*, *Scrivner*, and *Latman*. The Court should therefore deny the petition for a writ of certiorari.

B. The Equitable Surcharge At Issue In This Case Was Independently Supported By The Bankruptcy Court's Inherent Authority To Sanction Fraudulent And Abusive Litigation Conduct

As applied to the circumstances of this case, Section 105(a) simply confirms the bankruptcy court's power to impose appropriate sanctions for fraudulent and abusive litigation conduct. This Court has long held that judicial bodies possess inherent authority to sanction misconduct, authority that is "governed not by rule or statute but by the control necessarily vested in courts to manage their own affairs so as to achieve the orderly and expeditious disposition of cases." *Chambers* v. *NASCO, Inc.*, 501 U.S. 32, 43 (1991) (quoting *Link* v. *Wabash R.R.*, 370 U.S. 626, 630-631 (1962)). A court's imposition of sanctions for litigation misconduct "transcends [the]

court's equitable power concerning relations between the parties and reaches a court's inherent power to police itself." *Id.* at 46. It encompasses the authority to order an abusive litigant to compensate his opponent for litigation expenses incurred in response to abuses of the judicial process, including by assessing attorney's fees against a party who has "acted in bad faith, vexatiously, wantonly, or for oppressive reasons." *Id.* at 45-46 (quoting *Alyeska Pipeline Serv. Co.* v. *Wilderness Soc'y*, 421 U.S. 240, 258-259 (1975)). A court may exercise such power even when alternative sanctions are authorized by statute or rule. See *id.* at 49 ("the inherent power of a court can be invoked even if procedural rules exist which sanction the same conduct").

Article I bankruptcy courts, like Article III tribunals, have inherent power to sanction litigation misconduct. This Court noted in *Marrama* that, "even if [11 U.S.C.] 105(a) had not been enacted, the inherent power of every court to sanction 'abusive litigation practices' * * * might well provide an adequate justification" for a bankruptcy court to take action to remedy misconduct by a debtor. 549 U.S. at 375-376 (quoting *Roadway Express, Inc.* v. *Piper*, 447 U.S. 752 (1980)). Here, the bankruptcy court found that petitioner had engaged in systemic abuse of the bankruptcy process, including through misrepresentations to respondent and the court. See 401 B.R. 452-453. The court further found that respondent's "reasonable costs of coping with [petitioner's] deception far exceed $75,000, the exemption to which [petitioner] otherwise would be entitled." *Id.* at 453 (emphasis omitted). Those findings would have fully justified the imposition of a $75,000 sanction as an exercise of the bankruptcy court's inherent authority to

penalize petitioner's litigation misconduct and vindicate the integrity of the court's own processes.

The bankruptcy court's use of an equitable surcharge was likewise an appropriate means of achieving the same objectives. Even if petitioner had not engaged in any misconduct, he would have had no valid objection to the sale of his residence and the distribution to creditors of most of the sale proceeds. Rather, petitioner's state-law homestead exemption would simply have entitled him to a $75,000 share of the sale proceeds. In implementing its inherent authority to sanction petitioner's abusive litigation conduct, the bankruptcy court appropriately authorized respondent to retain the $75,000, rather than ordering that the money be paid over to petitioner and simultaneously directing petitioner to pay the same sum to respondent.

"The right of setoff (also called 'offset') allows entities that owe each other money to apply their mutual debts against each other, thereby avoiding 'the absurdity of making A pay B when B owes A.'" *Citizens Bank* v. *Strumpf*, 516 U.S. 16, 18 (1995) (quoting *Studley* v. *Boylston Nat'l Bank*, 229 U.S. 523, 528 (1913)). A federal court's ability to implement sanctions imposed in furtherance of its inherent authority supersedes contrary provisions of state law, including provisions that declare particular property to be exempt from execution of a money judgment. See, *e.g.*, *FTC* v. *Neiswonger*, 580 F.3d 769, 777 (8th Cir. 2009) (district court may implement civil-contempt monetary sanction by collecting otherwise-exempt property); see also *In re Ward*, 210 B.R. 531, 538 (Bankr. E.D. Va. 1997) (allowing trustee to retain amount of homestead exemption when debtors owed more money to the estate than the exemption was worth, and explaining that the homestead exemption

was "not being in any sense denied but [was] simply being applied by way of setoff to a mutual obligation arising post-petition"); cf. *Steffen* v. *Gray, Harris & Robinson, P.A.*, 283 F. Supp. 2d 1272, 1282 (M.D. Fla. 2003) (holding that district court's ability to enforce disgorgement order is not limited by state law governing exempt property), aff'd, 138 Fed. Appx. 297 (11th Cir. 2005) (Table); *SEC* v. *Musella*, 818 F. Supp. 600, 602 (S.D.N.Y. 1993) (same)

The bankruptcy court's inherent authority to sanction a litigant's egregious misbehavior, combined with background principles governing setoff, therefore provides an independent basis for affirming the surcharge in this case. Further review is not warranted.

CONCLUSION

The petition for certiorari should be denied.

Respectfully submitted.

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