No. 12-5196

IN THE
Supreme Court of the United States

STEPHEN LAW,
Petitioner,
v.
ALFRED SIEGEL, TRUSTEE
Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

REPLY BRIEF OF PETITIONER

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INTRODUCTION

In his brief in opposition, the respondent Trustee candidly concedes that the lower courts are split on the question presented by this petition: whether bankruptcy courts have the equitable power to surcharge a debtor's statutorily exempt property. BIO at 10-14. This case presents an excellent vehicle to address this important question, and the Trustee says remarkably little to the contrary. The Trustee properly does not suggest that any vehicle problem hinders this Court's consideration of the petition.[1] Nor does he deny that the issue is a significant one, which it surely is given the substantial and growing number of courts that have had occasion to address it, and the importance of the homestead exemption to individual debtors.

Instead, beyond canvassing the split itself, much of the brief in opposition is devoted simply to arguing the merits of why the Trustee believes that the Ninth Circuit has adopted the correct rule. BIO at 14-16. As discussed herein, the Trustee is incorrect that the Ninth Circuit's broad bestowal of equitable powers upon bankruptcy judges is consistent with the enumerated and limited powers the Bankruptcy Code provides. But the more important point is that the issue is one of real and important disagreement in the lower courts. Had Petitioner declared

[1] The Trustee does state that he has "been advised" that a petition for certiorari has been filed from the First Circuit's decision in *Malley v. Agin*, 693 F.3d 28 (1st Cir. 2012), which also presents the question of whether equitable surcharge is permitted. BIO at 13 n.7. The First Circuit's decision issued on August 15, 2012, and no petition for rehearing was filed. Accordingly, absent extension, any petition to this Court from that case would have been due on or before November 13, 2012. A search of this Court's electronic docket does not reveal that any such petition or extension application has been filed.

bankruptcy a few hundred miles to the east in Utah, or in any number of other jurisdictions, he would have been entitled to his homestead exemption. Instead, Petitioner's bankruptcy happened to take place in California, which permits bankruptcy judges to surcharge the exemption. Only this Court can resolve this near decade-old disparity, and it should take the opportunity that is cleanly presented by this petition to do so.[2]

REASONS WHY THE PETITION SHOULD BE GRANTED

I. There Is A Substantial And Growing Split Among The Federal Circuits And Lower Courts Over The Important Question Of The Equitable Power Of Bankruptcy Courts And The Proper Interpretation Of The Bankruptcy Code.

As the Trustee concedes, the lower federal courts are in open disagreement as to whether bankruptcy courts may invoke equitable powers to surcharge exempt assets notwithstanding specific provisions of the Bankruptcy Code. But the Trustee's presentation does not capture the full depth and breadth of that split. On one side of the split are the First and the Ninth Circuits, which have held that the language of 11 U.S.C. § 105(a) is a broad grant of equitable authority to bankruptcy courts that permits them to surcharge otherwise exempt assets. On the other side of the split are the Seventh, Tenth, and Eleventh Circuits, which have construed

[2] The Petition in this case presented an additional and independent question dealing with the preclusive effect of the Bankruptcy Appellate Panel's earlier determination that Petitioner was not subject to an equitable surcharge. Petition at 15-17. With the benefit of counsel, Petitioner respectfully withdraws that question and asks that this Court solely consider the Petitioner's remaining question of whether a bankruptcy court may equitably surcharge exempted property where the statutorily enumerated grounds permitting surcharge are not satisfied.

the bankruptcy court's equitable powers much more narrowly under 11 U.S.C. § 105(a).

The split among the circuits has been percolating for the better part of a decade now. In the decision below, the Ninth Circuit panel followed the Ninth Circuit's 2004 decision in *Latman v. Burdette*, 366 F.3d 774, 786 (9th Cir. 2004), in construing 11 U.S.C. § 105(a) to confer upon bankruptcy courts a broad equitable power to surcharge a debtor's exempt assets. In *Latman*, the Ninth Circuit held that "the bankruptcy court may equitably surcharge a debtor's statutory exemptions when reasonably necessary both to protect the integrity of the bankruptcy process and to ensure that a debtor exempts an amount no greater than what is permitted by the exemption scheme of the Bankruptcy Code." *Latman*, 366 F.3d at 786.

Since that time, several other Circuits have disagreed with this interpretation of the bankruptcy court's equitable powers. In *Scrivner v. Mashburn* (*In re Scrivner*), 535 F.3d 1258, 1265 (10th Cir. 2008), the Tenth Circuit took a much narrower view and read the Bankruptcy Code's provisions as prohibiting the court from taking any action not expressly authorized by the Code. As the *Scrivner* Court held: "[B]ecause the surcharge of exempt property is inconsistent with the Code's provisions . . . . We therefore hold that the bankruptcy court exceeded its equitable authority under § 105(a) in authorizing the surcharge of the debtor's exempt assets." *Id.* Likewise, although they have not addressed the specific question of surcharging exemptions, the Eleventh and Seventh Circuits have both broadly held that a bankruptcy court's equitable powers are limited to enforcing

affirmative provisions of the Code, a view that district courts in those Circuits have recognized forecloses a court from equitably surcharging an exemption. *See Mazon v. Tardif* (*In re Mazon*), 395 B.R. 742, 749-50 (M.D. Fla. 2008) (holding that "[l]ike *Scrivner*, the Eleventh Circuit has held that a bankruptcy court's equitable powers under § 105(a) do not allow it to override a specific provision of the Bankruptcy Code." (citing *In re Cox*, 338 F.3d 1238, 1243 (11th Cir. 2003)); *see also Grochocinski v. Campbell* (*In re Campbell*), 475 B.R. 622, 641 (Bankr. N.D. Ill. 2012) ("Because the Seventh Circuit has ruled that § 105(a) can only be used to enforce substantive rights provided elsewhere by the Bankruptcy Code, and the Trustee has not pointed to any other provision of the Code for the right to surcharge exempt property, the Court [finds that no such authority exists].") (citing *In re UAL Corp.*, 412 F.3d 775, 778 (7th Cir. 2005)); *In re Kmart Corp.*, 359 F.3d 866, 871 (7th Cir. 2004) ("[T]he fact that a [bankruptcy] proceeding is equitable does not give the judge a free-floating discretion to redistribute rights in accordance with his personal views of justice and fairness, however enlightened those views may be." (quotation marks omitted)); *see also In re Timmons*, No. 11-20513-7, 2012 WL 4435522, at *5 (Bankr. D. Kan. Sept. 24 2012); *In re Dunn*, No. 05-09708-8-JRL, 2010 WL 2721201, at *2 (Bankr. E.D.N.C. July 7, 2010) ("The court would be inclined to surcharge the exempt asset . . . but the majority construction . . . does not permit [such surcharging] under circumstances other than those provided by the Code." (citing *Scrivner*)).

Thus, while the weight of authority appeared to be trending away from the Ninth Circuit's original decision in *Latman v. Burdette*, in a very recent decision, the First Circuit held that it would "endorse the Ninth Circuit's conclusion in *Latman v. Burdette*, 366 F.3d 774 (9th Cir. 2004)." *Malley v. Agin*, 693 F.3d 28, 30 (1st Cir. 2012). In an opinion authored by Justice Souter sitting by designation, the First Circuit noted that there was a split among the circuits and that "the Supreme Court ha[d] yet to consider today's issue." *Id.* While Justice Souter looked to this Court's decision in *Marrama v. Citizens Bank of Massachusetts*, 549 U.S. 365 (2007), to support his decision, he noted that this Court in *Marrama* did not address the particular issue that arose here.

Absent guidance from this Court, this deep and intractable split over the bankruptcy courts' equitable powers to surcharge exempt property will continue to divide the lower courts. Indeed, it is not just the circuits that are divided, but also the bankruptcy courts themselves. *Compare Dunn*, 2010 WL 2721201, at *2 (adopting the Tenth Circuit's view); *In re Vaughn*, No. 08-64060-MGD, 2008 WL 7880893, at *4 (Bankr. N.D. Ga. Nov. 25, 2008) (same) *with Bierbach v. Brooks* (*In re Brooks*), 393 B.R. 80, 86 (Bankr. M.D. Pa. 2008) (adopting the Ninth Circuit's view); *In re Price*, 384 B.R. 407, 411 (Bankr. E.D. Va. 2008) (same); *Rice v. Johnson* (*In re Johnson*), 371 B.R. 380, 391 (Bankr. E.D. Ark. 2007) (same). This Court's review is therefore urgently needed as debtors will be subjected to a different rule depending simply upon the court in which they are required to file.

That is particularly true because, as this Court has observed, "[u]nlike the Commerce Clause, the Bankruptcy Clause itself contains an affirmative limitation or restriction upon Congress' power: bankruptcy laws must be uniform throughout the United States." *Railway Labor Executives' Ass'n v. Gibbons*, 455 U.S. 457, 468 (1982); *see also In re Reese*, 91 F.3d 37, 39 (7th Cir. 1996) (Posner, J.) ("[T]he uniformity clause . . . forbids . . . arbitrary regional differences in the provisions of the Bankruptcy Code."). While this Court ordinarily intervenes to ensure uniform enforcement of federal laws, *see, e.g.*, *McKesson Corp. v. Division of Alcoholic Beverages & Tobacco, Deptartment of Business Regulation of Florida*, 496 U.S. 18, 29 n.12 (1990), that responsibility is particularly heightened where the Constitution itself requires uniformity.

II. The Ninth Circuit's Decision Is On The Wrong Side Of The Split In Authority Because It Contravenes The Clear Language Of The Bankruptcy Code.

The split of authority in the lower courts is reason alone to warrant review by this Court, but review is also warranted because the decision below is incorrect and consequential. The Ninth Circuit's rule reads 11 U.S.C. § 105(a) as granting bankruptcy courts a free-floating equitable authority, untethered to the enforcement of any particular provision of the Bankruptcy Code. That interpretation upsets the carefully calibrated statute that Congress enacted and cannot be reconciled with either the text or the purpose of the statute.

Exemptions, like the homestead exemption at issue here, are specifically carved out by the Bankruptcy Code. *See* 11 U.S.C. § 522(b); Fed. R. Bankr. P. 4003. The point of those exemptions is to exclude certain assets as exempt from

administration by the bankruptcy trustee. *See Schwab v. Reilly*, 130 S. Ct. 2652, 2657 (2010); *Burlingham v. Crouse*, 228 U.S. 459, 473 (1913) ("It is the twofold purpose of the bankruptcy act to convert the estate of the bankrupt into cash and distribute it among creditors, and then to give the bankrupt a fresh start with such exemptions and rights as the statute left untouched."). At the same time, Congress has also set out a variety of circumstances in which an otherwise exempt asset may be liable for debts of the debtor. *See* 11 U.S.C. § 522(c). Such circumstances include the failure to report prepetition proceeds from the sale of a house or the failure to comply with an order to turnover such funds. *Id.*

Had Congress wanted to permit bankruptcy courts to impose a surcharge on exempt assets as a means of addressing fraudulent behavior or other bad faith conduct by debtors, Congress could easily have done so, but it did not. Yet the Ninth Circuit's rule ignores those legislative choices about the circumstances in which exemptions are allowed in favor giving courts the equitable power to create other, non-enumerated exceptions to the exemption as they see fit. That cannot be correct. As the Tenth Circuit observed in *Scrivner*, "[T]o allow the bankruptcy court, through principles of equity, to grant any more or less than what the clear language of [a statute] mandates would be tantamount to judicial legislation and is something that should be left to Congress, not the courts." *Scrivner*, 535 F.3d at 1263 (quotation marks omitted). Instead, "[b]ecause the Code contains explicit exceptions to the general rule placing exempt property beyond the reach of the estate, we may not read additional exceptions into the statute." *Id.* at 1264.

This is particularly so given that after the Ninth Circuit approved of equity surcharges in the 2004 *Latman* decision, Congress amended the Bankruptcy Code to create more *enumerated* circumstances in which an exemption could be surcharged due to bad acts by the debtor, but it did not opt to surcharge a debtor's exempt assets as a remedy for the failure to disclose assets, turn over property or obey a court order. *See* 11 U.S.C. § 522(q), *as amended by* Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, 119 Stat. 23 (allowing surcharge where, among other things, the debt in question stemmed from security fraud or an intentional tort causing death). The inference is clear: Congress has expressly articulated and has continued to adjust the circumstances in which an exemption may be surcharged. Those careful legislative choices would be superfluous if courts could make an end-run around them by invoking an equitable power to surcharge in any other circumstances they deemed appropriate.

The Trustee also relies heavily on First Circuit's reasoning in *Malley*, BIO at 13-14, but that too is unpersuasive. In *Malley*, the First Circuit highlighted the second sentence of § 105(a) in affirming the bankruptcy court's equitable authority to surcharge on exempt property. 693 F.3d at 30. In its entirety, § 105(a) provides:

> The court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title. No provision of this title 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.

11 U.S.C. § 105(a).

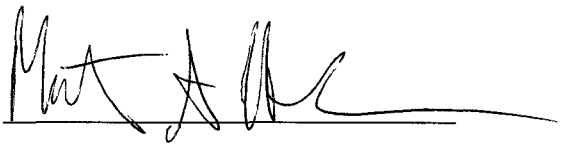
The First Circuit contended that the second sentence of this provision dealing with the Court's authority to take action *sua sponte* does more than merely clarify that a bankruptcy court need not wait for a motion by a party to take action. *Malley*, 693 F.3d at 30. Instead, the First Circuit read the provision as effectively authorizing any equitable action by the bankruptcy court that the court deemed appropriate. But that reading not only makes superfluous the enumerated bases for surcharges discussed above, it also makes superfluous the first sentence of § 105(a). There would be no point in stating that a bankruptcy court had the equitable authority to "*carry out* the provisions of this title," if in the next sentence of the provision Congress was granting the equitable authority to take action regardless whether it was inconsistent with the provisions of the title (e.g., such as ordering a surcharge on grounds not enumerated).

Finally, the Trustee contends that its interpretation is necessary to do justice. BIO at 14-15. Leaving aside the fact that Congress has expressly set out the circumstances where it believes that justice requires the imposition of a surcharge, the Trustee is too quick dismiss the panoply of tools that a bankruptcy court has its disposal to combat fraud. The threat of dismissal under 11 U.S.C. § 507 or outright denial of discharge under 11 U.S.C. § 727 provide a serious disincentive to debtors to engage in fraudulent acts. Accordingly, this Court ought to grant certiorari to confirm that the specific remedies authorized by Congress, and not those supplemented by the Ninth Circuit, are the ones available to bankruptcy courts and litigants.

CONCLUSION

The petition for certiorari should be granted.

Respectfully submitted,



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November 29, 2012

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CERTIFICATE OF SERVICE

I, Matthew S. Hellman, hereby certify that I am a member of the Bar of this Court, and that I have this 29th day of November, 2012, caused three copies of the foregoing Reply Brief of Petitioner to be served via overnight mail on:

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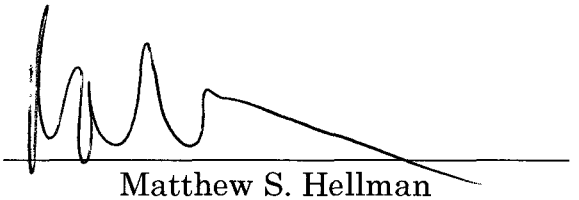

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