No. 12-5196

IN THE

Supreme Court of the United States

STEPHEN LAW,

Petitioner,

v.

ALFRED H. SIEGEL, CHAPTER 7 TRUSTEE,

Respondent.

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

BRIEF OF THE NATIONAL ASSOCIATION OF CONSUMER BANKRUPTCY ATTORNEYS AS AMICUS CURIAE IN SUPPORT OF PETITIONER

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INTEREST OF AMICUS CURIAE

The National Association of Consumer Bankruptcy Attorneys, or NACBA, is a non-profit organization of more than 3,500 consumer bankruptcy attorneys practicing throughout the country. Incorporated in 1992, NACBA is the only nationwide association of attorneys organized specifically to protect the rights of consumer bankruptcy debtors. NACBA member attorneys and their law firms represent debtors in an estimated 600,000 bankruptcy cases each year.

Among other things, NACBA works to educate the bankruptcy bar and the community at large on the uses and misuses of the consumer bankruptcy process. NACBA also advocates for consumer debtors on issues that cannot be addressed adequately by individual member attorneys. NACBA has filed amicus briefs in this Court in several cases involving the rights of consumer debtors. *See, e.g.*, *Ransom* v. *FIA Card Servs., N.A.*, 131 S. Ct. 716 (2011); *Hamilton* v. *Lanning*, 130 S. Ct. 2464 (2010).

The resolution of the question presented in this case is of substantial importance to NACBA. Many thousands of debtors represented by NACBA and its members depend on exempt property to achieve a "fresh start" after declaring bankruptcy. Furthermore, the scope of a bankruptcy court's equitable authority to implement the Bankruptcy Code is an issue that potentially affects every bankruptcy case in which NACBA or a member participates.[1]

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[1] No counsel for a party authored this brief in whole or in part, and no person or entity other than NACBA, its members, and its counsel made any monetary contribution toward the preparation or submission of this brief. Letters of consent from both parties accompany the brief.

SUMMARY OF ARGUMENT

I. One of the core purposes of a chapter 7 bankruptcy case is to provide individual debtors with a fresh start. Consistent with that longstanding principle, federal bankruptcy statutes have for centuries permitted debtors to exempt from distribution to creditors certain property viewed as necessary to a fresh start—including equity in a principal residence. And in Section 522 of the Bankruptcy Code, Congress has expressly prohibited the use of exempt property to pay unsecured pre-petition debts or administrative expenses incurred during a bankruptcy case (with certain exceptions not relevant here). Moreover, Congress specifically considered the question of when debtor misconduct can justify forfeiture of otherwise exempt property, and it set out those narrow circumstances with precision. The bankruptcy court here contravened Congress's judgment when, despite the absence of those narrow circumstances, it imposed a "surcharge" that denied petitioner the $75,000 homestead exemption to which he was entitled in order to pay legal fees incurred by the trustee.

Such a surcharge cannot be justified by invoking Section 105(a) of the Code. That section, which effectively codifies the court's inherent authority, provides that "the court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title." Section 105 does not allow a court to override the Bankruptcy Code in order to achieve what the court views as a just result in a particular case. Rather, it empowers bankruptcy courts to effectuate the Code's substantive provisions. While Section 105 may be a useful tool to that end, it is not a license to disregard, under the cloak of equity, the express judgments Congress has made.

II. Congress has also provided specific remedies for debtor misconduct in a chapter 7 case, principally the de-

nial or revocation of a discharge of indebtedness. Bankruptcy courts may also impose litigation sanctions or invoke traditional civil-contempt powers. Given that Congress expressly empowered bankruptcy courts to impose specific, and fully adequate, sanctions for debtor misconduct, Section 105(a) cannot be read to authorize the creation of a new, draconian sanction that is inconsistent with the Bankruptcy Code's express provisions.

III. Although the Code's plain language should lead this Court to hold that bankruptcy courts may not direct that exempt property be used to pay unsecured creditors, if the Court concludes otherwise then it should make clear that the power to do so is narrowly cabined. Consistent with traditional principles of equity, a court should have the power to "surcharge" the debtor's exempt property—again, if at all—only if it expressly finds that (1) the debtor has engaged in misconduct that actually injured one or more creditors by depriving them of estate assets to which they were entitled; (2) the misconduct involved an intentional effort to conceal or dissipate estate assets so as to keep them from creditors; (3) the surcharge is no greater than necessary to remedy the harm to creditors caused by the misconduct (i.e., is remedial rather than punitive); and (4) no other available remedy is adequate.

ARGUMENT

I. THE BANKRUPTCY CODE DOES NOT PERMIT SURCHARGING A DEBTOR'S EXEMPT PROPERTY TO PAY UNSECURED PRE-PETITION DEBTS OR ADMINISTRATIVE EXPENSES

NACBA certainly does not condone petitioner's lamentable conduct in this case. But that conduct should not lead the Court to embrace a rule that violates the express language of the Bankruptcy Code—and that would be prone to misuse in future cases. Contrary to the Ninth Circuit's reasoning below, a bankruptcy court may not

"surcharge" a debtor's exempt property to pay unsecured pre-petition debt or administrative expenses, such as fees incurred by the trustee or the trustee's counsel. The simple reason is that Congress has expressly forbidden it, in Section 522 of the Bankruptcy Code. A bankruptcy court's general power "to carry out" the provisions of the Code, 11 U.S.C. § 105(a), cannot be used in derogation of this explicit prohibition.[2]

A. Section 522 Prohibits Using Exempt Property To Pay Unsecured Pre-Petition Debts Or Administrative Expenses

1. This case involves petitioner's bankruptcy under chapter 7 of the Bankruptcy Code, 11 U.S.C. §§ 701 *et seq.* In a typical chapter 7 case, the debtor's assets are liquidated and used to pay creditors' claims.

If *all* of a chapter 7 debtor's property were liquidated, however, he or she would be left penniless. To avoid this, the Bankruptcy Code "allows the debtor to prevent the distribution of certain property by claiming it as exempt." *Taylor* v. *Freeland & Kronz*, 503 U.S. 638, 642 (1992).

[2] The term "surcharge" is not defined in the Code. In practice, the term commonly refers to a trustee's request, under 11 U.S.C. § 506(c), to use a secured creditor's collateral to pay administrative expenses that are incurred to preserve or dispose of the collateral. *See, e.g.*, *In re Hen House Interstate, Inc.*, 177 F.3d 719, 722 (8th Cir. 1999) (en banc) (Section 506(c) allows a trustee "to surcharge property securing the claim of an allowed secured creditor"), *aff'd sub nom. Hartford Underwriters Ins. Co.* v. *Union Planters Bank, N.A.*, 530 U.S. 1, 5 (2000) (noting that Section 506(c) is exceptional because claims for administrative expenses are otherwise subordinate to secured claims). Presumably, the term "surcharge" has come to be used in the circumstances here because the trustee similarly seeks payment of administrative expenses from property not otherwise available to pay them—except that here the trustee does so in the face of, rather than in reliance on, express statutory authority.

For instance, the Code permits an individual debtor to exempt a certain amount of equity in his or her house or vehicle, or in tools of the debtor's trade. *See* 11 U.S.C. § 522(d). With narrow exceptions, property that is properly exempted cannot be used to satisfy the debtor's unsecured pre-petition debts. *See id.* § 522(c). Nor can it be used to pay administrative claims incurred by the estate. *Id.* § 522(k).

The concept that certain property is exempt from the claims of unsecured creditors is both fundamental and venerable. It is not unique to bankruptcy; every State has laws exempting certain property from unsecured creditors' reach, so that a creditor executing a judgment cannot render a debtor wholly destitute. *See, e.g.*, Hynes et al., *The Political Economy of Property Exemption Laws*, 47 J.L. & Econ. 19, 19 (2004). And such laws have existed since well before the Founding. Traditional English law, emulated in many of the colonies, exempted real property from being sold to satisfy unsecured creditors' claims. *See* Priest, *Creating an American Property Law: Alienability and Its Limits in American History*, 120 Harv. L. Rev. 385, 401, 409 (2006). Although England adopted the Debt Recovery Act in 1732, and thereby made all colonial assets available to satisfy debts, *id.* at 423-424, at the time of the Founding many States reimposed restrictions on creditors' ability to execute on real property, *id.* at 447. And during the first half of the nineteenth century, state laws exempting both real and personal property increased in number and protectiveness. *Id.* at 455-456.

The federal bankruptcy laws have likewise provided for exemptions of certain property "for more than two centuries." *Schwab* v. *Reilly*, 130 S. Ct. 2652, 2664 (2010). *See generally Bankruptcy Exemptions: Critique and Suggestions*, 68 Yale L.J. 1459, 1465 (1959). Today, as in those days, exemptions are "designed to permit individual

debtors to … enjoy a 'fresh start' after bankruptcy." *United States* v. *Security Indus. Bank*, 459 U.S. 70, 72 n.1 (1982). Congress has "[r]ecogniz[ed] that exemptions are critical to" achieving that goal. *In re Kolich*, 328 F.3d 406, 408 (8th Cir. 2003); *accord In re Pelter*, 64 B.R. 492, 497 (Bankr. W.D. Okla. 1986) ("'Congress recognized that exemptions, whether state or federal in origin, are an essential feature of the system of financial rehabilitation afforded … in bankruptcy proceedings.'" (quoting *In re McManus*, 681 F.2d 353, 358 (5th Cir. 1982) (Dyer, J., dissenting))).

Section 522 of the Bankruptcy Code, which governs exemptions, allows debtors to select either the federal exemptions set out in the Code or the exemptions defined by applicable state law—unless the relevant State has "'opt[ed] out' of the federal list," thereby limiting the debtor to the exemptions specified under state law. *Owen* v. *Owen*, 500 U.S. 305, 308 (1991); *see also* 11 U.S.C. § 522(b)(1) (providing the choice). Both federal law and the law of most States (including California, the residence of the debtor here) provide an exemption for a certain amount of equity in the debtor's principle residence (often called the "homestead exemption"), which is the exemption at issue here. *See* 11 U.S.C. § 522(d)(1); Cal. Civ. Proc. Code § 704.710(c) (definition of homestead exemption); *id.* § 704.730 (amount of exemption).

In short, for centuries exemptions have been a major part of the overall scheme for rehabilitating individual debtors. And as the current Bankruptcy Code reflects, Congress has specifically considered and resolved a variety of issues relating to exemptions, including the nature and scope of permissible exemptions, the States' role in defining them, the procedures for claiming and objecting to exemptions, and—critically—the narrow circumstances under which exempt property may be used to pay a debtor's unsecured pre-petition or post-petition debts. The

Code contains detailed and reticulated provisions governing all of these points. Congress has thus already made "the difficult choices" regarding exemptions, balancing the "economic harm that exemptions visit on creditors" with the need to provide the debtor some means for a fresh start. *Schwab*, 130 S. Ct. at 2667.

2. There is no dispute that the debtor here was eligible, under California law, for a homestead exemption of $75,000. *See, e.g.*, Resp. to Pet. for Cert. 1, 4. He included this exemption in his initial claim of exemptions. *See* Pet. Br. Supp. App. 8a. And because neither the trustee nor any other party objected to the claimed homestead exemption, "the property claimed … [wa]s exempt." 11 U.S.C. § 522(*l*).

The debtor's $75,000 interest in his homestead, once exempted, could not be used to pay either unsecured prepetition debts or administrative expenses, except in circumstances not present here. That is the clear command of Section 522 of the Bankruptcy Code. That section provides that property exempted thereunder "*is not liable* during or after the case for any debt of the debtor that arose … before the commencement of the case," with the exception of debts validly secured by the property at issue and three other narrow categories of debt. 11 U.S.C. § 522(c) (emphasis added).[3] It likewise provides that exempt property "*is not liable* for the payment of any administrative expense," with two exceptions that are inapplicable here. *Id.* § 522(k) (emphasis added).[4]

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[3] The other three exceptions are for certain nondischargeable debts, *see* 11 U.S.C. § 522(c)(1), (3), and debts in connection with fraud relating to certain educational expenses, *see id.* § 522(c)(4).

[4] The two exceptions allow exempt property to be used to pay administrative expenses that the trustee or the debtor incurs in recovering that property from a third party. The first exception

The fees incurred here by the trustee were "administrative expenses" within the meaning of Section 522(k). They consisted entirely of the trustee's legal fees. *See In re Law*, 401 B.R. 447, 453-454 (Bankr. C.D. Cal. 2009). And the Bankruptcy Code categorizes such fees as administrative expenses: Section 503(b) defines allowable administrative expenses to include the "actual, necessary costs and expenses of preserving the estate," as well as "compensation and reimbursement awarded under section 330(a) of this title." 11 U.S.C. § 503(b)(1), (2). Section 330(a), in turn, authorizes "reasonable compensation for actual, necessary services rendered by a trustee … or attorney." *Id.* § 330(a)(1)(A). Because the trustee's fees were administrative expenses, Section 522(k) prohibits using the debtor's exempt property to pay them.

Notably, in Section 522(k), Congress considered the circumstances under which exempt property *could* be "surcharged" to pay administrative expenses, and it specified two exceptions to the general rule—both of which permit "surcharging" exempt property to recoup the costs of reclaiming that property for the debtor. *See supra* n.4 (discussing the exceptions). As this Court has explained, "[w]here Congress enumerates certain exceptions to a general prohibition, additional exceptions are not to be implied, in the absence of evidence of a contrary

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concerns exempt property that the trustee has recovered from third parties under the trustee's avoidance powers. *See* 11 U.S.C. § 522(k)(1), (g). The second exception concerns exempt property that the *debtor* has recovered from third parties under powers set out elsewhere in section 522. *See id.* § 522(k)(2). In both cases, the exempt property may be used to pay administrative expenses incurred in the process of avoiding the property's transfer and recovering it for the debtor. *See generally* 4 *Collier on Bankruptcy* ¶¶ 522.11-522.12 (Resnick & Sommer eds., 16th ed. 2013). Respondent has never asserted that either exception applies here.

legislative intent." *Andus* v. *Glover Constr. Co.*, 446 U.S. 608, 616-617 (1980); *accord United States* v. *Smith*, 499 U.S. 160, 166-167 (1991) (court of appeals erred in "inferring a third exception" after "Congress' express creation of … two"). Thus, "[b]ecause the Code contains explicit exceptions to the general rule placing exempt property beyond the reach of the estate, [courts] may not read additional exceptions into the statute." *In re Scrivner*, 535 F.3d 1258, 1264 (10th Cir. 2008).

Congress has also considered when debtor misconduct—including fraud—can be a permissible ground for using exempt property to pay debts, and it has enumerated the narrow circumstances in which such a sanction is justified. Section 522(c) provides several exceptions to the general rule that exempt property may not be used to pay unsecured pre-petition debt, including exceptions for certain specific types of fraud. For instance, exempt property may be used to pay a debt for "a tax … with respect to which the debtor made a fraudulent return or willfully attempted in any manner to evade or defeat such tax." 11 U.S.C. § 523(a)(1)(C); *see also id.* § 522(c)(1) (exception for "debt of a kind specified in paragraph (1) … of section 523(a)"). Exempt property may also be used to pay "a debt in connection with fraud in the obtaining or providing of any scholarship … at an institution of higher education." *Id.* § 522(c)(4).

Moreover, Section 522 contains two provisions specifically addressing the impact of debtor misconduct on a state-law homestead exemption, the exemption at issue here. *See* 11 U.S.C. § 522(*o*) (reducing the value of such an exemption "to the extent that such value is attributable to" the debtor's pre-petition transfer of non-exempt property "with the intent to hinder, delay, or defraud a creditor"); *id.* § 522(q)(1)(B)(ii) (allowing such an exemption to be capped at $155,675 if a debtor owes pre-petition debts attributable to, among other things, "fraud, deceit, or ma-

nipulation … in connection with the purchase or sale of any security," or misconduct causing serious physical injury or death within the preceding five years).

Congress has thus made clear precisely what sorts of fraudulent conduct justify an exception to the general rule exempting certain property from creditors' claims. The Bankruptcy Code does not permit courts to invent other exceptions that Congress did not see fit to include. Indeed, it would be anomalous, to say the least, if the Code expressly permitted a state-law homestead exemption to be capped at $155,675 when the debtor has debts attributable to a crime or intentional tort resulting in death, but implicitly allowed the same exemption to be wiped out altogether when the debtor has caused the bankruptcy trustee to incur legal fees.

B. Section 105(a) Cannot Override The Express Limitations In Section 522

1. Under Section 105 of the Code, a bankruptcy court "may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title." 11 U.S.C. § 105(a). Courts that have permitted surcharges of exempt property to pay administrative expenses (or pre-petition debts) that fall outside the specific exceptions Congress crafted have often relied on this language. *See, e.g.*, *Malley* v. *Agin*, 693 F.3d 28, 30 (1st Cir. 2012); *Latman* v. *Burdette*, 366 F.3d 774, 785 & n.8 (9th Cir. 2004). That reliance is misplaced.

By its terms, Section 105(a) confers power "to carry out" the provisions of Bankruptcy Code, not to override or contradict them. Section 105(a) "preserves the equity powers of a bankruptcy court." *In re Palmer*, 219 F.3d 580, 582 n.2 (6th Cir. 2000); *see also Celotex Corp.* v. *Edwards*, 514 U.S. 300, 303 (1995) (referring to "the Bankruptcy Court exercis[ing] its equitable powers under 11 U.S.C. § 105(a)"). But "[t]he [equity] chancellor never did,

and does not now, exercise unrestricted power to contradict statutory or common law when he feels a fairer result may be obtained by application of a different rule." *United States* v. *Noland*, 517 U.S. 535, 543 (1996) (second alteration in original) (internal quotation marks omitted). Thus, the equitable powers that Section 105(a) preserves "can only be exercised within the confines of the Bankruptcy Code." *Norwest Bank Worthington* v. *Ahlers*, 485 U.S. 197, 206 (1988); *see also SEC* v. *U.S. Realty & Improvement Co.*, 310 U.S. 434, 455 (1940) ("A bankruptcy court is … guided by equitable doctrines and principles *except in so far as they are inconsistent* with the Act." (emphasis added)); *Young* v. *Higbee Co.*, 324 U.S. 204, 214 (1945) ("Courts of bankruptcy … exercise all equitable powers unless prohibited by the Bankruptcy Act."); *cf. Magniac* v. *Thomson*, 56 U.S. 281, 299 (1853) ("Wherever the rights or the situation of parties are clearly defined and established by law, equity has no power to change or unsettle those rights[.]"). Because Section 522(k) prohibits the use of exempt property to pay administrative expenses except in specific circumstances not present here, Section 105(a) cannot authorize such a use.

This conclusion is mandated by the text of Section 105(a), which limits the authority it grants to actions necessary or appropriate "to carry out the provisions" of the Bankruptcy Code. 11 U.S.C. § 105(a). And it is reinforced by basic canons of statutory interpretation, under which when "a general permission … is contradicted by a specific prohibition …, the specific provision is construed as an exception to the general one." *RadLAX Gateway Hotel, LLC* v. *Amalgamated Bank*, 132 S. Ct. 2065, 2071 (2012). Accordingly, even if Section 105 were construed as a catch-all "general permission" to do equity, it would be circumscribed by the "specific prohibition" in Section

522(k) on using exempt property to pay administrative expenses.[5]

2. Surcharging exempt property to pay administrative expenses not only gainsays the Code's text, but also derogates the policies reflected in Section 522. The principal purpose of exemptions is to enable the debtor "to enjoy a 'fresh start' after bankruptcy." *Security Indus. Bank*, 459 U.S. at 72 n.1. That purpose is vitiated when the debtor's means for a fresh start are taken away.

Nor does the fresh-start policy become irrelevant when a debtor commits misconduct. Exemptions do not exist solely to protect the debtor, but also to protect his or her dependents, as well as society at large—a purpose reflected in Congress's decision not to permit a debtor to waive his or her exemptions. *See* 11 U.S.C. § 522(e).

In drafting Section 522, Congress had debtors' dependents firmly in mind, and it made clear that a *debtor*'s

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[5] The First Circuit has also justified a surcharge of exempt property based on what it described as the "spaciousness" of the second sentence of Section 105(a), which states that:

> No provisions 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), *cited in Malley*, 693 F.3d at 30. While this sentence is not implicated here because the bankruptcy court did not act *sua sponte*, the sentence simply makes clear that any references in the Code to the raising of an issue *by a party* should not be construed to prevent the bankruptcy court from acting on its own initiative. That sentence does not otherwise expand courts' power beyond that provided in the preceding sentence. Indeed, it would be quite odd for the second sentence to give courts the ability to do more on their own initiative than they could, under the first sentence, at the behest of a party.

failure to claim an exemption properly could not by itself take the benefit of that exemption from his or her dependents. Section 522(*l*) thus allows a dependent to submit a list of exempt property if the debtor fails to do so. Likewise, Section 522(q) provides that subsection (q)(1)'s limitations on a debtor's state-law homestead exemption—which may be imposed for certain misconduct, *see supra* pp. 9-10—"shall not apply" to any homestead amount "reasonably necessary for the support of the debtor and any dependent of the debtor." 11 U.S.C. § 522(q)(2); *see also In re Hayes*, 119 B.R. 86, 88 (Bankr. E.D. Va. 1990) (refusing to surcharge exempt property after recognizing that a state homestead exemption protects "debtors *and their families*" (emphasis added)); *Pomeroy* v. *Beach*, 49 N.E. 370, 372 (Ind. 1898) (exemptions are "based upon considerations of public policy and humanity; and it was not alone for the benefit of the debtor, but for his family also, that such laws were enacted"). Forcing a debtor's dependents to endure the hardship of losing exemptions because of the debtor's conduct in circumstances outside the narrow bounds set by the Code would contravene Congress's aim.

Exemptions also benefit the public at large, by helping a debtor avoid public assistance. *See, e.g.*, *Norwest Bank Neb., N.A.* v. *Tveten*, 848 F.2d 871, 876 (8th Cir. 1988) (homestead exemptions "reliev[e] society from the burden of supplying subsidized housing"). That purpose, too, is frustrated by construing Section 105 to grant courts a free-floating power to surcharge exemptions in situations not enumerated by Congress.

Finally, the Bankruptcy Code's exemption provisions are carefully structured to protect the States' prerogative to define and regulate exempt property. Section 522 permits debtors to choose whether to invoke the federal exemptions or the exemptions provided under the law of their State. 11 U.S.C. § 522(b)(1). But it allows States to

"opt out" of the federal exemptions by limiting debtors to the exemptions available under state law. *Id.* § 522(b)(2); *see also supra* p. 6. A majority of States, including California, have done so. *See* 4 *Collier on Bankruptcy* ¶ 522.01, at 522-14 n.2 (Resnick & Sommer eds., 16th ed. 2013). A bankruptcy court that permits creditors to claim against property that a State has seen fit to let debtors exempt defeats Congress's intent to leave the power to define exempt property—and thus ensure minimum protections for their debtor citizens—largely to the States. As this Court has previously recognized, absent a "clear and manifest" congressional intent, the Bankruptcy Code should not be construed to displace state law relating to such an essential state interest. *BFP* v. *Resolution Trust Corp.*, 511 U.S. 531, 544 (1994). There is no justification for a reading of Section 105 that would have precisely such an effect.

II. An Expansive Reading Of Section 105(a) Is Unnecessary Because Courts Possess Other Tools To Prevent And Remedy Abuses Of The Bankruptcy Process

As explained above, reading Section 105(a) to allow the surcharge here is inconsistent with the text of both Section 105 and Section 522, as well as with the purposes behind bankruptcy exemptions. Such a reading is also unnecessary, because there are ample alternative ways for a bankruptcy court to address debtor misconduct. For instance, the Bankruptcy Code contemplates that such misconduct may result in the denial or revocation of discharge, a sanction that deprives the debtor of any benefit that might otherwise accrue from a bankruptcy proceeding. Bankruptcy courts may also impose traditional litigation sanctions, including assessing attorney's fees against a debtor or invoking the civil contempt power. In light of these alternatives, there is no need for additional extra-statutory remedies, such as surcharging exempt property.

Moreover, these remedies demonstrate that—as discussed above—Congress has already considered the issue of debtor misconduct, and created the sanctions that it deemed warranted.

1. Under Section 727 of the Code, courts are authorized to deny a debtor who has engaged in misconduct any discharge of debts, or to revoke a discharge previously granted. Section 727(a) provides that a bankruptcy court should deny a discharge if, among other things, a debtor conceals assets, makes false statements or attempts to induce others to do so, or fails to obey court orders. *See* 11 U.S.C. § 727(a)(2), (4), (6). Similarly, Section 727(d) requires a court, on the request of a party in interest, to revoke a discharge that was "obtained through the fraud of the debtor, [if] the requesting party did not know of such fraud until after the granting of such discharge." *Id.* § 727(d)(1). In fact, the bankruptcy court in this very case denied the debtor a discharge under the provision of Section 727 forbidding a discharge when a debtor "knowingly and fraudulently, in or connection with the case[,] … made a false oath or account." *Id.* § 727(a)(4)(A).

Denial or revocation of discharge is a potent deterrent to debtor misconduct, because a debtor who is denied a discharge (or has it revoked later) gains none of the benefits of bankruptcy—and in particular remains fully liable for all pre-petition debt. At the same time, creditors obtain the benefit of having a trustee marshal and distribute the estate's property on account of their pre-bankruptcy claims, while at the same time retaining their state-law right to collect any deficiency from the debtor's post-petition property. In addition to being a deterrent, denial or revocation of discharge is an appropriate remedy for any abuse that does occur, as it ensures that the debtor does not profit from his or her misconduct. Moreover, debtors cannot circumvent a denial of discharge by filing a second bankruptcy petition and obtaining a discharge in

that case: Under Section 523 of the Code, debt as to which the debtor "was denied a discharge" in an earlier case is non-dischargeable in any subsequent bankruptcy case. 11 U.S.C. § 523(a)(10).

2. Bankruptcy courts can also employ traditional judicial tools to address debtor misconduct. For example, Rule 9011 of the Federal Rules of Bankruptcy Procedure authorizes sanctions for filing a pleading that is deficient in any of several enumerated respects. This rule does not, of course, cover the landscape of possible misconduct, but that does not mean that other misbehavior is immune to sanctions. While the assets of the bankruptcy estate can be disposed of only in conformance with the Code's provisions, a court may impose *in personam* liability on a debtor for litigation-related misconduct. *See Marrama* v. *Citizens Bank of Mass.*, 549 U.S. 365, 375-376 (2007) (bankruptcy courts possess "the inherent power of every federal court to sanction abusive litigation practices" (internal quotation marks omitted)). A bankruptcy court could, for instance, hold a contumacious debtor in civil contempt, and require the debtor to pay the costs associated with his or her disregard of court orders. Likewise, a court could order a debtor to pay fees incurred by a trustee in ferreting out the debtor's misconduct. Because such sanctions would be imposed post-petition, they could not be discharged, and thus any of the debtor's non-exempt post-petition assets or income could be used to satisfy them.

III. ALTERNATIVELY, ANY POWER TO SURCHARGE EXEMPT PROPERTY UNDER SECTION 105(a) MUST BE NARROWLY CIRCUMSCRIBED

For the foregoing reasons, the Court should hold that Section 105(a) does not permit surcharges of exempt property like the one imposed here. If, however, the Court concludes that such an extra-statutory surcharge *is* permissible in certain circumstances, then it is critical

that the Court establish clear limits on what those circumstances are.

More specifically, the Court should make clear—consistent with longstanding principles governing courts' resort to inherent or equitable authority to impose sanctions—that a surcharge is impermissible unless the bankruptcy court finds that: (1) the debtor has engaged in serious misconduct that actually injured one or more creditors by depriving them of value from the estate to which they were entitled; (2) the misconduct involved an intentional effort to conceal or dissipate estate assets so as to keep them from creditors; (3) the surcharge is no greater than necessary to remedy the harm caused by the misconduct (i.e., is remedial rather than punitive); and (4) no other available remedy is adequate.

Actual injury. A court should not be permitted to surcharge exempt property unless the debtor's conduct has prevented one or more creditors from receiving estate assets to which they were entitled. Absent actual injury, there is no sound basis to deny a debtor the exemptions that Congress or a State has deemed appropriate. This Court has imposed a similar limitation in other contexts, both inside and outside bankruptcy. *See Comstock* v. *Group of Institutional Investors*, 335 U.S. 211, 229 (1948) (holding in a bankruptcy case that a previously enunciated equitable rule applies only where the wrongdoer "advantage[s] itself *at the injury of the subsidiary*" (emphasis added)); *CIGNA Corp.* v. *Amara*, 131 S. Ct. 1866, 1881 (2011) ("[J]ust as a court of equity would not surcharge a trustee for a nonexistent harm, a fiduciary can be surcharged under § 502(a)(3) [of ERISA] only upon a showing of actual harm." (citation omitted)).

Misconduct concerning concealment or dissipation of estate assets. A surcharge should be permitted (again, if at all) only when a debtor has intentionally concealed or dissipated estate assets (or attempted to do so) in a

fraudulent effort to shelter them from creditors. This requirement ensures that courts would not second-guess the "difficult choices" Congress has made regarding what exemptions are appropriate, *Schwab*, 130 S. Ct. at 2667, based on conduct that is anything less than intentional fraud.

Surcharge no greater than necessary to remedy the harm to creditors. No surcharge of exempt property should exceed the amount required to undo the harm caused by the debtor's conduct, i.e., to restore to the creditors whatever value the court finds the debtor's misconduct took away. Greater surcharges would serve only to punish the debtor, which is improper because "relief in equity is remedial, not penal." *Hartford-Empire Co.* v. *United States*, 323 U.S. 386, 435 (1945), *amended by* 324 U.S. 570 (1945); *see also Tull* v. *United States*, 481 U.S. 412, 422 (1987) ("Remedies intended to punish culpable individuals, as opposed to those intended simply to extract compensation or restore the status quo, were issued by courts of law, not courts of equity."). To the extent a court deems it necessary to punish a debtor, there are other tools available, such as those discussed above.

Harm that cannot be adequately addressed with other means. Finally, a surcharge should not be permitted unless the court finds that no other available alternative would suffice to remedy the debtor's misconduct. Like the other limitations proposed above, this prerequisite helps take account of the points made in Part I regarding both the critical importance of exemptions and the (at a bare minimum) severe tension between surcharges like the one here and the language of the Code. Assuming those points do not lead the Court to prohibit such surcharges entirely—as they should—they at the very least counsel in favor of limiting this extra-statutory remedy to circumstances in which it is strictly necessary to prevent a manifest injustice.

CONCLUSION

The judgment of the court of appeals should be reversed. Alternatively, the judgment should be vacated and the case remanded for the bankruptcy court to consider the factors discussed in Part III.

Respectfully submitted.

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