No. 12-5196

IN THE

Supreme Court of the United States

STEPHEN LAW,

Petitioner,

v.

ALFRED SIEGEL, TRUSTEE,

Respondent.

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

REPLY BRIEF OF PETITIONER

CATHERINE L. STEEGE
JENNER & BLOCK LLP
353 N. Clark Street
Chicago, IL 60654

CARL N. WEDOFF
JENNER & BLOCK LLP
919 Third Ave.
New York, NY 10022

MATTHEW S. HELLMAN
Counsel of Record
JESSICA RING AMUNSON
ADAM G. UNIKOWSKY
MATTHEW S. MCKENZIE
CAROLINE M. DECELL
JENNER & BLOCK LLP
1099 New York Ave., N.W.
Washington, DC 20001
(202) 639-6000
mhellman@jenner.com

Counsel for Petitioner

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INTRODUCTION

The Trustee devotes the bulk of his brief to contending that bankruptcy courts have the power to sanction litigants for misconduct. But this case is not about *whether* a court has authority to sanction a litigant who engages in misconduct (it surely does), but rather *what kind* of sanction is permitted. Here, Congress has expressly barred bankruptcy courts from imposing the very sanction the court imposed below: taking a debtor's exempt property to satisfy his estate's administrative expenses.

Deep into his brief, the Trustee concedes – as he must, and as this Court has repeatedly held – that an Article I bankruptcy court does not have equitable authority to act contrary to a statutory provision. Instead, "whatever equitable powers remain in the bankruptcy courts must and can only be exercised within the confines of the Bankruptcy Code." *Norwest Bank Worthington v. Ahlers*, 485 U.S. 197, 206 (1988).

That proposition is fatal to the Trustee's argument because Section 522 of the Code plainly forbids taking a debtor's exempt property to pay administrative expenses. Not only does the Code expressly say just that, but it also contains a bevy of exceptions to that general prohibition, none of which applies here. These provisions reflect Congress's long-standing judgment that even an unscrupulous debtor, in most cases, should be able to exit bankruptcy with some property so that he and his family are not rendered destitute and dependent on the state.

The Trustee has no persuasive answer to the text, structure, and purpose of Section 522. Indeed, the

Trustee's main textual arguments are so implausible that the United States has declined to make them. Equally unpersuasive is the Trustee's invocation of Section 105 case law. The Trustee and United States place great weight on this Court's decision in *Marrama v. Citizens Bank of Massachusetts*, 549 U.S. 365 (2007), which they collectively invoke nearly two dozen times. But *Marrama* stands only for proposition that Section 105 may permit a court to do "prompt[ly]" what it could *otherwise* do in a "delayed" fashion. *Id.* at 375–76. *Marrama* does not permit courts to do by equity what Congress has otherwise forbidden by statute. And contrary to the Trustee's repeated contention, a bankruptcy court cannot impose a sanction forbidden by the Code in the name of punishing "an abuse of process," 11 U.S.C. § 105(a), any more than it can override the Code for any other reason.

In the end, the Trustee's argument amounts to a naked plea to equity divorced from the Code, and one that would work a sweeping expansion of the power of bankruptcy courts. But as the United States previously acknowledged, Section 105 neither "authorize[s] the bankruptcy courts to create substantive rights that are otherwise unavailable" nor "constitute[s] a roving commission to do equity." U.S. Br. 30, *United States v. Energy Resources*, 495 U.S. 545 (1990) (No. 89-255). Petitioner has already incurred substantial punishment for his actions. He was denied his discharge. After all his creditors were fully paid, he lost hundreds of thousands of dollars of non-exempt equity in his home to pay the administrative expenses of the Trustee. As to whether the Trustee should now be able to take the last dollar of Petitioner's equity in

his home to pay Trustee's counsel, Congress has made the judgment that it is more important that debtors – even dishonest ones – emerge from bankruptcy with some resources to make a fresh start. This Court should respect Congress's determination and reverse the decision below.

ARGUMENT

I. Section 522 Forbids Taking Exempt Property To Satisfy Administrative Expenses.

The Trustee claims that Section 522 creates a discretionary regime that permits a court, as it deems appropriate, to surcharge[1] otherwise exempt property to pay the estate's administrative expenses. Those arguments twist the text, structure, and purpose of Section 522 beyond recognition, and they should be rejected.

A. The Express Terms Of Section 522 Bar The Trustee's Argument.

The bankruptcy court in this case did what Section 522 expressly forbids: it took Petitioner's concededly exempt property to pay his estate's administrative expenses. The plain language of Section 522 categorically forbids that sanction. Congress provided

[1] The Trustee fashions a new term, "equitable forfeiture," in lieu of the surcharge terminology that bankruptcy courts use. This is an apparent attempt to make the bankruptcy court's actions sound akin to the doctrine of "equitable disallowance" of claims. The Trustee's neologism is misleading. As discussed *infra* at 17-18, equitable disallowance is a doctrine where Congress has *expressly authorized* bankruptcy courts to make equitable judgments.

that a debtor "may exempt" specified property, that absent timely objection such property "is exempt," and that exempt property "is not liable for payment of any administrative expense." 11 U.S.C. § 522(b), (*l*), (k). The Trustee takes this straightforward language and wrongly argues that it permits a bankruptcy court to do precisely the opposite of what the Code mandates.

1. The Trustee begins by contending that it is significant that Section 522 states that a debtor "may exempt" property. Resp. Br. 35 (quoting 11 U.S.C. § 522(b)). According to the Trustee, that phrasing indicates that "the privilege of exempting property … is conditional," because Congress would have stated that a debtor "*shall* be allowed" to exempt had Congress meant to forbid surcharging. *Id.* at 36 (emphasis in original); *see id.* at 14.

There is, however, no meaningful difference between "may exempt" and "shall be allowed" to exempt. They mean the same thing. *E.g.*, *The American Heritage Dictionary of the English Language* 1083 (4th ed. 2000) (defining "may" as "[t]o be allowed or permitted"). Moreover, although "may" connotes discretion, it is equally clear that Section 522(b) gives that discretion to the *debtor*, who "may" choose among the various exemptions provided by State and Federal law, 11 U.S.C. § 522(b)(2), (3); *see* H.R. Rep. No. 95-595, at 360 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6316 ("[Section 522(b)] is a significant departure from present law. It permits an individual debtor … *a choice* between exemption systems. The debtor *may choose* the federal

exemptions to which he is entitled under other federal law and [state law]." (emphasis added)).

Had Section 522 placed that discretion in the court by providing that "the *court* may allow a debtor to exempt property," then the Trustee's interpretation would be plausible. *Cf.* 11 U.S.C. § 110(h)(4) ("The debtor … may file a motion for an order …."). But because Section 522 bestows that discretion on the debtor, the phrase "may exempt" indicates that exemptions are the debtor's prerogative, consistent with this Court's description of the exemption regime. *See, e.g.*, *Rousey v. Jacoway*, 544 U.S. 320, 325 (2005) ("[T]he Bankruptcy Code *permits* [the debtor] to withdraw from the estate certain interests in property." (emphasis added)).

2. The Trustee next contends that bankruptcy courts are free to disallow exemptions because the Code does not contain language requiring the court to "allow" a debtor's exemptions, Resp. Br. 35. But under Section 522(*l*), once a debtor declares property to be exempt, absent timely objection, that property "is exempt." 11 U.S.C. § 522(*l*). No court ratification is required. *See Taylor v. Freeland & Kronz*, 503 U.S. 638, 643 (1992) (absent an objection within thirty days, "Section 522(*l*) … ma[kes] the property exempt").[2]

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[2] The Trustee's focus on the objection process is particularly misplaced because there is no basis to object to Petitioner's homestead exemption in any case. It is undisputed that Petitioner had $75,000 in equity in his homestead, and that California law allows the exemption. This is not a case where Petitioner "did not have a right to exempt … these proceeds … under state law."

3. The Trustee then argues that Section 522(k)'s express prohibition on using exempt property to pay administrative expenses does not apply here. According to the Trustee, this is because "administrative expenses" are defined as the "actual, necessary costs and expenses of preserving the estate" and the Trustee's expenses here were "unnecessary" because they resulted from inequitable conduct. Resp. Br. 41 & n.10 (quoting 11 U.S.C. § 503(b)(1)(A)). But if the Trustee's expenses were "unnecessary," then they would not be "administrative expenses" at all, and the Trustee could not claim them. *See, e.g.*, *In re Taxman Clothing Co.*, 49 F.3d 310, 316 (7th Cir. 1995). In any event, the Trustee already certified that his expenses were necessary, *see* J.A. 25a (Docket entry No. 247), and if expenses are "administrative expenses" for compensation purposes under Section 503(b)(1)(A), they must be "administrative expenses" for purposes of protecting the debtor's exempt property under Section 522(k). *See Cohen v. de la Cruz*, 523 U.S. 213, 220 (1998) (In Code, "equivalent words have equivalent meaning").

4. Section 522's categorical language is unsurprising given that the provision was intended to

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Taylor, 503 U.S. at 642. Nor did the bankruptcy court surcharge the exemption because it "objected" to it. On the contrary, the bankruptcy court recognized that Petitioner was "otherwise entitled" to the exemption, but surcharged it to compensate the Trustee for his expenditures investigating the Lin lien. J.A. 97a; *see also* J.A. 150a ("[I]t is apparent that the debtor was not abusing his exemptions." (2006 BAP opinion)).

ensure that dishonest debtors would not become wards of the state. The Trustee points to no countering indicia suggesting that Congress intended exemptions to be subject to the unfettered discretion of bankruptcy courts. As the Commission on the Bankruptcy Laws explained in addressing the provision that ultimately became Section 522 of the Code:

> The right to the exemption is unqualified; it does not depend on *whether the debtor receives a discharge* and is *not forfeited by "bad conduct"* of the debtor.[3]

Report of the Commission on the Bankruptcy Laws of the United States, H.R. Doc. No. 93-137, pt. II, at 128 (1973) (proposed § 4-503 note 2) (emphasis added). Section 522 thus means what it says, and not the opposite, as the Trustee would have it: property that "is exempt" under Section 522 "is not liable for payment of any administrative expense." 11 U.S.C. § 522(k), (*l*).[4]

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[3] The Trustee urges the Court to ignore this passage because the original proposed Section 522 stated that a "debtor … shall be allowed to exempt." Resp. Br. 36–37. As explained above, that phrasing is not materially different from Section 522 as enacted and simply reflects that the current section allows debtors to choose between federal and state exemptions, which the Commission's proposal did not. Report of the Commission on the Bankruptcy Laws of the United States, H.R. Doc. No. 93-137, pt. II, at 125 (1973) (proposed § 4-503).

[4] The Trustee contends that the "overwhelming majority of lower courts" permit equitable surcharging. Resp. Br. 22 n.4. But the leading bankruptcy treatise reports that "*most courts* have held that section 105 *cannot* be used as a basis for any implied good faith exception" to the provisions governing exemptions. 2 *Collier*

B. Section 522 Impliedly Forbids Using Exempt Property.

The Trustee also cannot reconcile his interpretation of Section 522 with that provision's numerous enumerated exceptions and limitations on a debtor's right to exempt property – all of which are uncontestedly inapplicable here.

Getting statutory interpretation exactly backwards, the Trustee asks this Court to ignore these many exceptions because they "were enacted at different times by different Congresses." Resp. Br. 50. But as this Court has repeatedly recognized, Congress's decision to enumerate specific exceptions to the exemption regime means that "additional exceptions are not to be implied." *Hillman v. Maretta*, 133 S. Ct. 1943, 1953 (2013) (quotation marks omitted). And "[t]hat is particularly true where," as here, "'Congress has enacted a comprehensive scheme and has deliberately targeted specific problems with specific solutions.'" *RadLAX Gateway Hotel, LLC v. Amalgamated Bank*, 132 S. Ct. 2065, 2071 (2012) (quoting *Varity Corp. v. Howe*, 516 U.S. 489, 519 (1996) (Thomas, J., dissenting)).

1. Faced with explaining why courts should be free to graft additional exceptions onto Congress's "comprehensive scheme," the Trustee repeatedly reprises his flawed argument that Section 522 does not actually prohibit using exempt property to satisfy administrative expenses. *E.g.*, Resp. Br. 43 ("[T]here

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on Bankruptcy ¶ 105.02[5][a], at 105-30 (Alan N. Resnick & Henry J. Sommer eds., 16th ed. 2013) (emphasis added).

are no 'specific' statutory terms to 'compl[y] with' in this case."); *id.* at 47 ("circular" to assume that exceptions to "general bar" are exhaustive because the question is whether there "is in fact a bar").

But there *are* specific statutory terms to comply with in this case, namely, Section 522(k)'s flat command that exempt property "is not liable for payment of any administrative expense." *See supra.* And when Congress created numerous exceptions to that general prohibition *without* creating an exception for inequitable conduct, the inference that Congress intended no such exception is proper, not "circular."[5]

2. The Trustee then argues that even if Section 522 does contain a categorical bar (and it does), no inference should be drawn from Section 522's numerous exceptions because supposedly none of those exceptions deals with inequitable conduct. Resp. Br. 44–45; *see also* U.S. Br. 27. Again, that blinks the statutory reality. The fact that Congress did not also create a generalized exception for inequitable conduct is precisely why a bankruptcy court ought not fashion the exception itself. *See Hillman*, 133. S. Ct. at 1953. And in any case, the Trustee is simply wrong to contend that Section 522 is not concerned with inequitable conduct. To the contrary, that is one of the Section's primary concerns.

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[5] The statutes in *Barnhart v. Peabody Coal Co.*, 537 U.S. 149, 154–55 (2002), and *Varity Corp. v. Howe*, 516 U.S. 489, 507–08 (1996) (cited in Resp. Br. 47), contained nothing like Section 522(k)'s express prohibition on taking exempt property.

a. In the first place, the Trustee fails to come to terms with Section 522(q), which was enacted with other amendments in the 2005 Bankruptcy Abuse Prevention and Consumer Protection Act ("BAPCPA"), Pub. L. No. 109-8, 119 Stat. 23. As Petitioner explained, Pet'r Br. 30, Section 522(q) provides that even when a debtor engages in *criminal* bankruptcy fraud resulting in an "abuse of the [Code]," the court may only cap, and cannot eliminate, the debtor's homestead exemption. 11 U.S.C. § 522(q)(1). By surcharging all of Law's exempt property here, therefore, the court imposed a sanction that Congress has spared even bankruptcy felons.

The Trustee's principal response is that Section 522(q) and other BAPCPA limitations on exemptions are irrelevant here because Congress provided that the BAPCPA amendments would not apply to pre-2005 petitions such as Law's. Resp. Br. 48. But Section 522(q)'s relevance is obvious and substantial. Were the Trustee correct that courts already had equitable authority to surcharge the exemptions of dishonest debtors, amendment would have been unnecessary. And the fact that Congress chose to take the debtor-friendly step of making the amendment *inapplicable* to existing petitions like Law's shows that Congress understood that the amendment *curtailed* a debtor's right to exempt. Given that the pre-BAPCPA Code did not allow a bankruptcy court even to cap exemptions for felonies demonstrating an "abuse of the [Code]," 11 U.S.C. § 522(q)(1), it surely did not allow a court to eliminate a debtor's exemption altogether for such conduct, let alone the non-criminal conduct at issue here.

The Trustee half-heartedly contends that Section 522(q)'s cap on exemptions was not intended to apply "outside the context of generous state homestead provisions." Resp. Br. 49. But the plain language of the provision and common sense show otherwise. Congress's chosen penalty for criminal conduct was not to eliminate the wrongdoer's exemption, but merely to cap it. That decision embodies Congress's judgment that even felons are entitled to retain *some* portion of the homestead exemption their state provides. Yet the bankruptcy court here eliminated Petitioner's entire homestead exemption for conduct that, according to Congress, does not even warrant a cap.

b. The Trustee also has no answer for the fact that Congress specified the particular kinds of debts for which exempt property is liable, including debts where the debtor engaged in misconduct. *E.g.*, 11 U.S.C. § 522(c)(4) (debts from fraudulent student loans). And particularly relevant is Congress's decision not to premise a debtor's right to exemptions on obtaining a discharge. Pet'r Br. 33.

The Trustee's sole treatment of denial of discharge is buried in a footnote urging that, "[a]lthough a debtor may be able to exempt property even if he is denied a discharge, nothing in the Code mandates that he must always be able to do so." Resp. Br. 53 n.13. But when Congress expressly declined to make exemptions liable for all non-dischargeable debts, the reasonable inference is that Congress did not intend a debtor to lose his exemptions in *other* circumstances warranting non-dischargeability, as the legislative history confirms. *See supra*.

c. Likewise, the Trustee has no answer to the fact that Section 522(k) itself contains two finely tuned exceptions yet has no exception for administrative expenses arising out litigation misconduct. 11 U.S.C. § 522(k)(1), (2). Congress could have enacted "Section 522(k)(3)," but it chose not to. *Cf.* 11 U.S.C. § 362(k)(1) (authorizing "attorneys' fees" for persons injured by violations of automatic stay).

4. Finally, the Trustee misses the point when he emphasizes that the Code does not limit a state's power to reduce or eliminate its exemptions. Resp. Br. 49–50. Congress had good reason to permit states to determine what property may be exempted. If a state sets exemptions too low, the state itself will bear the burden of supporting its destitute debtors. Thus, states are best equipped to make policy judgments about the kind of minimum property their debtors need – such as their homes, tools of trade, or pensions – to avoid becoming wards of the state. *See* H.R. Rep. No. 95-595, at 126, *reprinted in* 1978 U.S.C.C.A.N. at 6087. In sum, Congress let states set the exemptions they believe best balance the interests of creditors, debtors, their dependents, and the public. And that is exactly why bankruptcy courts are not free to strike a different balance.

II. Neither Section 105 Nor A Bankruptcy Court's "Inherent" Powers Allow The Court To Do What Section 522 Forbids.

A. This Court's Section 105 Case Law Contradicts The Trustee's Position.

1. Because Section 522 forecloses using exempt property to pay administrative expenses, the

bankruptcy court has no equitable authority to order otherwise. The Trustee nonetheless suggests at times that the provision *does* allow a bankruptcy court to take action prohibited by other sections of the Code. For example, he places great weight on the fact that Section 105 states that the court may take "any" action "necessary *or appropriate*" to carry out the Code. Resp. Br. 19. And he emphasizes that, when this Court held in *Norwest* that "whatever equitable powers remain in the bankruptcy courts must and can only be exercised within the confines of the Bankruptcy Code," the Court did not mention Section 105 in its discussion, as if Section 105 provided greater powers than those at issue in *Norwest*. *Id.* 23–24 (quoting *Norwest*, 485 U.S. at 206).

These are red herrings. It is well-settled that bankruptcy courts are Article I tribunals that have no power to act inconsistently with the Code.[6] *See, e.g.*, *Raleigh v. Ill. Dep't of Revenue*, 530 U.S. 15, 24–25 (2000); *United States v. Noland*, 517 U.S. 535, 543 (1996); *Young v. Higbee Co.*, 324 U.S. 204, 214 (1945); *SEC v. U.S. Realty & Improvement Co.*, 310 U.S. 434, 455 (1940); *D. Ginsberg & Sons, Inc. v. Popkin*, 285 U.S. 204, 207–08 (1932). *Cf. Stern v. Marshall*, 131 S. Ct. 2594, 2603–04 (2011) (discussing limited powers of bankruptcy courts).

[6] Contrary to the Trustee's contention, Resp. Br. 22, this is not an argument that bankruptcy courts may use Section 105 to do only what the Code authorizes, but rather that they may not use it to do what the Code forbids.

2. The Court's decision in *Ginsberg* squarely demonstrates that Section 105 cannot justify the surcharge ordered here. In *Ginsberg*, the Court held that a bankruptcy court had no equitable power to order the arrest of an officer of a bankrupt corporation who was fleeing with "a large amount of cash belonging to the corporation." *Ginsberg*, 285 U.S. at 205. The creditor argued that the court needed the power to arrest the fleeing officer to prevent an abuse of judicial process. *See* Pet'r Br. 10–11, *D. Ginsberg & Sons, Inc. v. Popkin*, 285 U.S. 204 (1932) (No. 429). This Court, however, held that the bankruptcy court's equitable authority could not support the arrest given that the specific Act provision dealing with arrests reached only bankrupts and not officers of bankrupt corporations. Pet'r Br. 25–26.

The Trustee argues that *Ginsberg* is distinguishable because the Act specifically addressed detention, whereas here the Code does not specifically address the surcharge of homestead exemptions by debtors who engage in misconduct. Resp. Br. 44–45; *see also* U.S. Br. 28–29. This distinction does not withstand scrutiny. Most obviously, Section 522(k) categorically prohibits using exempt property to pay administrative expenses, and many provisions in Section 522 *do* address debtor misconduct. *Supra*, at 9-12.

In addition, one might just as easily have said in *Ginsberg* that the Act did not specifically address the arrest of officers of bankrupt corporations. But that is the approach this Court properly rejected. *Ginsberg* instead recognized that the Act identified the circumstances in which bankruptcy courts could impose

a particular *remedy* – arrest – and the Court held that bankruptcy judges could not invoke general equitable powers to order arrests under different circumstances. So too here. "However inclusive" Section 105 may be, it "will not be held to apply to a matter specifically dealt with in another part of the same enactment."[7] *Fourco Glass Co. v. Transmirra Prods. Corp.*, 353 U.S. 222, 228 (1957). Rather, "[t]he terms of the specific authorization must be complied with." *RadLAX*, 132 S. Ct. at 2071.

3. Unable to distinguish *Ginsberg*, the Trustee and the United States place enormous weight on *Marrama*, which they repeatedly invoke. But *Marrama* is plainly distinguishable, and in fact supports Petitioner's position.

In *Marrama*, a debtor sought to convert a bankruptcy petition under Chapter 7 to a petition under Chapter 13. The debtor invoked Section 706 of the Code, which provides that a debtor "may convert a case under [chapter 7] to a case under chapter … 13." 549 U.S. at 371. The bankruptcy court denied the

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[7] The Trustee tries to distinguish *Ginsberg* on the ground that Section 105's predecessor permitted only "necessary" orders and not "appropriate" orders, and did not include the sentence about a bankruptcy court's *sua sponte* authority. Resp. Br. 45 n.12. But *Ginsberg*'s reasoning did not turn on whether the arrest could be justified as "necessary." Indeed the arrest probably was "necessary," as the corporate officer had attempted to flee the jurisdiction with "a large amount of cash belonging to the corporation." 285 U.S. at 205. Nor did the bankruptcy court act *sua sponte* – it acted on the creditor's application for the officer's arrest. *Id.*

debtor's conversion petition because he had engaged in "bad faith" conduct. *Id.* at 369–70.

In affirming that denial, this Court's primary holding had nothing to with Section 105. Although Section 706 gave debtors the right to convert their case to Chapter 13, it also contained an express provision stating that a debtor was entitled to convert only if the "debtor may be a debtor under such chapter." 11 U.S.C. § 706(a), (d). The debtor's inequitable conduct made him ineligible to be a debtor under Chapter 13. *See Marrama*, 549 U.S. at 373. This Court thus held that "[Section] 706(d) … provides adequate authority for the denial of his motion to convert." *Id.* at 374.

The Court went on to discuss Section 105 as an alternative basis for its holding, but that discussion demonstrates the error of the Trustee's argument. In explaining that Section 105 could also provide a basis to justify the bankruptcy court's action, the Court emphasized that the Code expressly permitted the bankruptcy court to convert a debtor back to Chapter 7 upon a showing of inequitable conduct. 549 U.S. at 372–74. Recognizing that the Code would permit the conversion, the Court simply held that Section 105 could "authorize an *immediate* denial of a motion to convert filed under § 706 in lieu of a conversion order *that merely postpones the allowance of equivalent relief*." *Id.* at 375 (emphasis added). The Court repeated the same point a little later: a bankruptcy court's equitable powers "might well provide an adequate justification for *a prompt*, *rather than a delayed*, ruling on an unmeritorious attempt to qualify

as a debtor under Chapter 13." *Id.* at 376 (emphasis added).

This case is *Marrama*'s polar opposite. The bankruptcy court here did not do "prompt[ly]" what it could otherwise do on a "delayed" basis. *Id.* It did what the Code *forbids*. *Marrama* thus stands only for the proposition that Section 105 gives bankruptcy courts discretion in how they carry out the powers the Code gives them. It does not hold that Section 105 permits what other provisions of the Code forbid.

3. The Trustee also places great weight on the First Circuit's decision in *Malley v. Agin*, 693 F.3d 28 (1st Cir. 2012), *e.g.*, Resp. Br. 39, but that case cannot be squared with this Court's teachings and Section 522's plain language.

In *Malley*, the court reasoned that a surcharge order would "carry out," not contravene, the Code because it "vindicate[s] … § 522, regulating the determination of legitimate exemptions for the debtor's benefit." *Malley*, 693 F.3d at 30. But Congress has defined what is a "legitimate exemption[]" in Section 522, and determined that not every bad act by a debtor warrants a loss of exemptions. The Trustee also embraces *Malley*'s contention that surcharging "vindicates § 521, requiring honest disclosure of non-exempt assets." *Id.* But it is a non-sequitur to say that because the Code requires honest disclosure of assets, it "vindicates" the Code to impose a punishment that the Code forbids.

4. Finally, the Trustee also invokes "long" historical practice. Resp. Br. 30. The Trustee's primary argument on this score has nothing to with

exemptions, but rather bankruptcy courts exercising equitable powers to "disallow a claim." *Id.* at 30–31. The Trustee fails to mention that equitable disallowance is, and has always been, expressly permitted by statute. Section 57(k) of the Bankruptcy Act of 1898 originally provided that "[c]laims which have been allowed may be reconsidered for cause and reallowed or rejected in whole or in part, *according to the equities of the case*." ch. 541, § 57(k), 30 Stat. 544, 561 (emphasis added) (repealed 1978); *Pepper v. Litton*, 308 U.S. 295, 305 & n.12 (1939) (citing Section 57(k) as support for the disallowance claims). And today, the Code provides in Section 502(j) that a bankruptcy court may "reconsider" a claim and "disallow[]" that claim "according to the equities of the case." 11 U.S.C. § 502(j). Such language is conspicuously absent from Section 522.[8]

When the Trustee does finally turn to historical claims about surcharging, his argument also fails. As the Trustee acknowledges, the cases he cites are ones where the debtor has concealed *exempt* property from the trustee (*i.e.*, initially failed to turn over property that debtor later tried to claim as exempt). Resp. Br. 32. Leaving aside the fact that Petitioner claimed and disclosed his homestead exemption when he filed his petition, the historical practice claimed by Petitioner is in fact highly mixed. There was no consistent practice because under the Act, unlike the Code, exemptions

[8] The United States is similarly wrong to rely on *United States v. Noland*, 517 U.S. 535 (1996). That case concerned the "equitable subordination," which is also expressly authorized by the Code. 11 U.S.C. § 510(c)(1) (allowing "equitable subordination").

were largely the product of state law. *See, e.g.*, I Harold Remington, *A Treatise on the Bankruptcy Law of the United States* § 1094 (2d ed. 1915) (question is "variously decided"); *see also In re Thompson*, 140 F. 257, 261 (E.D. Wash. 1905) ("weight of authority" supports allowing exemption). Accordingly, there is no conceivable historical basis to depart from Section 522's plain language.

B. The Second Sentence Of Section 105 Cannot Justify The Surcharge Order.

Apparently recognizing the weakness of his argument under the first sentence of Section 105, the Trustee relies heavily on the second sentence, which provides: "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).

Through the frequent use of well-placed ellipses and quotation marks, the Trustee repeatedly attempts to recast this sentence as an independent grant of power to bankruptcy judges to do whatever they wish in order to prevent an abuse of process. *E.g.*, Resp. Br. 3, 13. In effect, the Trustee treats the provision as if it said: "Notwithstanding *any other provision of law*, a bankruptcy court may take any action necessary or appropriate to prevent an abuse of process." But that is not what Section 105 says, and that construction would radically depart from existing Section 105 law, which has always recognized that a bankruptcy court's

equitable powers do not trump the Code. Instead, this sentence provides only that a bankruptcy court may take action *sua sponte* in certain instances even if a party authorized to raise an issue fails to do so. Here, no party is authorized by the Code to move for a surcharge, and thus the sentence is irrelevant.[9]

Citing the First Circuit's decision in *Malley*, the Trustee responds that "[i]f Congress had intended the second sentence of Section 105(a) to clarify only that courts are not barred from acting *sua sponte* where the Code authorizes a party to raise an issue, Pet'r Br. 38, it presumably would have drafted the second sentence to match the first." Resp. Br. 25 (citation omitted). But there is an obvious reason that the second sentence of Section 105 does not match the first sentence. Congress did not want bankruptcy judges to act *sua sponte* whenever the Code provided for the raising of an issue by a party in interest; that would be contrary to the adversarial process. *Cf. NASA v. Nelson*, 131 S. Ct. 746, 756 n.10 (2011). Rather, Congress wanted bankruptcy courts to respect the adversarial process and grant relief only upon a party's request, *except* "to enforce or implement court orders or rules, or to prevent an abuse of process," in which case the court could act *sua sponte*. 11 U.S.C. § 105(a).

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[9] Contrary to the Trustee's suggestion, Resp. Br. 26 & n.6, this 1986 amendment overruled *In re Gusam Restaurant Corp.*, 737 F.2d 274, 276 (2d Cir. 1984), which *had* held that a court could not act *sua sponte* where the Code allowed a party to raise the issue. Pet'r Br. 37–38. A wealth of authority has concluded that the amendment was intended to overrule *Gusam*. *E.g.*, *In re Tennant*, 318 B.R. 860, 869 (B.A.P. 9th Cir. 2004) (citing authority).

C. "Inherent Authority" Cannot Justify The Surcharge Order.

Finally, both the Trustee and the United States argue that the bankruptcy court was entitled to issue the surcharge order under an "inherent authority" apparently *broader* than Section 105. Resp. Br. 27–30; U.S. Br. 17–22. They rely on *Chambers v. NASCO, Inc.*, 501 U.S. 32 (1991), which held that a district court had the inherent power to impose attorney's fees. This argument was never presented below, and is waived. *Cf. Taylor*, 503 U.S. at 645–46. It is also meritless.

Even assuming bankruptcy courts have some inherent authority,[10] that authority would not allow them to override contrary provisions of the Code. *Chambers*, 501 U.S. at 47; U.S. Br. 22 (conceding the point). When *Chambers* held that an Article III court was authorized to award attorneys fees in situations *in addition* to those enumerated in the Federal Rules, it emphasized that the court would have no such power had the rules otherwise prohibited fee awards. 501 U.S. at 47. Here, Section 522(k) does prohibit surcharging.[11]

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[10] *Marrama* acknowledged only that a bankruptcy court might have possessed an "inherent power" "*if § 105 had not been enacted.*" 549 U.S. at 375–76 (emphasis added).

[11] The United States also argues that a federal court's inherent authority "supersedes contrary provisions of state law, including provisions that declare particular property to be exempt from execution of a money judgment." U.S. Br. 26. This case does not raise any federal preemption question, however, because Petitioner relies on federal law: 11 U.S.C. § 522. The fact that Section 522 incorporates state law exemptions does not alter its

III. The Punishments That Congress Has Authorized Are Sufficient To Deter Improper Conduct.

The Trustee concedes that the Bankruptcy Code's existing punitive provisions, such as criminal sanctions and denial of discharge, deter litigation misconduct. Resp. Br. 53. But without any supporting argument, he asserts that these remedies "add nothing to the pot for listed creditors." *Id.* (quotation marks omitted). That is false; denial of discharge ensures that listed creditors can collect debts from the debtor's post-petition earning, and criminal prosecution can result in a restitution judgment. Similarly, the Trustee asserts that he should not be required to "pay out of pocket for fulfilling his duty to expose and prevent fraud." *Id.* But the bankruptcy court has an existing remedy to prevent that outcome: it may impose a sanction on the debtor, which would be payable from the debtor's post-petition assets. What it may *not* do is order that the sanction be paid from the debtor's homestead exemption.

The Trustee suggests a surcharge is permissible because a sanctions order would allow the Trustee to

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character as federal law. *See Arkansas v. Oklahoma*, 503 U.S. 91, 110 (1992). And tellingly, neither of the two cases cited by the United States concerned Section 522 (indeed, the first was not even a bankruptcy case, and the second turned on state set-off law). Neither provides a basis for this Court to depart from Congress's determination that exempt property "is not liable for payment" of administrative expenses. 11 U.S.C. § 522(k). And that is true regardless of whether a court calls its order a "surcharge" or a "set-off."

obtain equivalent relief. Resp. Br. 54. But tellingly, the "equivalent" relief the Trustee posits is not equivalent. The Trustee carefully states that a sanctions order could be "used to attach a lien to … a *dwelling* purchased with the exemption." *Id.* (emphasis added). But the Trustee properly does not contend that he would be entitled to the *exempt* portion of Petitioner's homestead. No matter how a sanctions order is denominated, a bankruptcy court may not deprive a debtor of exemptions that Section 522 allows.

Thus, the Trustee's primary argument is that collecting a debtor's non-exempt property may be "cumbersome" or may not result in full compensation if the debtor is judgment-proof. Resp. Br. 53–54. But a court may not ignore the Bankruptcy Code in order to make judgment collection more convenient for the Trustee. Indeed, the Court has rejected a similar argument before. In *Grupo Mexicano de Desarrollo, SA v. Alliance Bond Fund, Inc.*, a creditor argued for a preliminary injunction preventing a debtor from transferring assets. 527 U.S. 308, 312 (1999). The United States supported the creditor, arguing the remedy would "preserv[e] … the court's ability to render a judgment that will prove enforceable" and "preven[t] inequitable conduct on the part of defendants." *Id.* at 330 (quoting United States' *amicus* brief). This Court rejected that contention, declining to "add[], through judicial fiat, a new and powerful weapon to the creditor's arsenal [which] could radically alter the balance between debtor's and creditor's rights." *Id.* at 331. So too here: Congress has chosen to protect exemptions, and a bankruptcy court may not

"radically alter th[at] balance between debtor's and creditor's rights."

CONCLUSION

The judgment of the Ninth Circuit should be reversed and the case remanded for further proceedings.

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Respectfully submitted,

CATHERINE L. STEEGE
JENNER & BLOCK LLP
353 N. Clark Street
Chicago, IL 60654

CARL N. WEDOFF
JENNER & BLOCK LLP
919 Third Ave.
New York, NY 10022

MATTHEW S. HELLMAN
Counsel of Record
JESSICA RING AMUNSON
ADAM G. UNIKOWSKY
MATTHEW S. MCKENZIE
CAROLINE M. DECELL
JENNER & BLOCK LLP
1099 New York Ave., N.W.
Washington, DC 20001
(202) 639-6000
mhellman@jenner.com

Counsel for Petitioner