BANKRUPTCY IN THE SUPREME COURT

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The Supreme Court granted certiorari in four bankruptcy cases during the present Term. To date, three have been resolved, and one awaits decision, doubtless by the end of the month.

1. *Milavetz, Gallop & Milavetz, P.A v. United States*, 559 U.S. ___, 130 S.Ct. 1324 (2010).

a. Facts: The petitioners filed a pre-enforcement suit in federal district court in Minnesota seeking declaratory relief with respect to BAPCPA's debt-relief-agency provisions, 11 U.S.C. §§ 526(a)(4), 528(a)(3-4), and 526(b)(2)[2]. The petitioners asked the court to hold that attorneys and law firms are not bound by these provisions and, thus, may freely advise clients to incur additional debt and need not identify themselves as debt relief agencies in advertisements. The district court held that the statute was not intended to apply to attorneys and that, as applied to them, both § 526 and § 528 violated the First Amendment. The Eighth Circuit held that the statute does apply to attorneys, that the disclosures mandated by § 528 do not violate the First Amendment, but that the limitations in § 526 (as construed by that court) on the advice that lawyers could give clients did violate the First Amendment.

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[2] § 526(a)(4) states in relevant part that a debt relief agency shall not "advise an assisted person…to incur more debt in contemplation of such person filing a case under this title."

§ 528(a)(3) requires debt relief agencies to "clearly and conspicuously disclose in any advertisement of bankruptcy assistance services or of the benefits of bankruptcy directed at the general public…that the services or benefits are with respect to bankruptcy relief under this title."

§ 528(a)(4) requires that debt relief agencies also include in their advertisements a statement substantially similar to "We are a debt relief agency. We help people file for bankruptcy relief under the Bankruptcy Code."

§ 528(b)(2) compels similar disclosures in advertising "indicating that the debt relief agency provides assistance with respect to credit defaults, mortgage foreclosures, eviction proceedings, excessive debt, debt collection pressure, or inability to pay any consumer debt." Subsection A requires that such agencies must also disclose "that the assistance may involve bankruptcy relief."

b. Ruling: The Supreme Court reversed,[3] holding that (1) attorneys who provide bankruptcy assistance to assisted persons are debt relief agencies under the BAPCPA; (2) § 526(a)(4) applies to attorneys, but only prevents debt relief agencies from advising a debtor to incur more debt when the impelling reason for such advice is the prospect of bankruptcy, rather than a valid purpose; and (3) the disclosure provisions of § 528 are valid as applied to the petitioner lawyers.

i. Under § 101(12A), the term "debt relief agency" includes attorneys. In reaching this holding, the Court looked to the fact that the term "bankruptcy assistance," contained in the definition of a "debt relief agency," includes several services commonly, and sometimes exclusively, performed by attorneys. Though § 101(12A) does not expressly include attorneys in the definition of "debt relief agency," the Court concluded that Congress has given no indication that it intended to exclude attorneys. Furthermore, the Court points out, if § 101(12A) included only persons expressly mentioned in the definition, then only bankruptcy petition preparers would fall under the definition. This would lead to an absurd result, for the statute defines "debt relief agency" as "any person who provides bankruptcy assistance…*or* who is a bankruptcy petition preparer" (emphasis in Court's opinion).

ii. § 526(a)(4) only prohibits a debt relief agency from advising a debtor to incur more debt because the debtor is filing for bankruptcy, rather than for a valid purpose. The controlling question is whether the impelling reason for advising an assisted person to incur more debt is the prospect of filing for bankruptcy. Stating that "[i]t would make scant sense to prevent attorneys and other debt relief agencies from advising individuals thinking of filing for bankruptcy about options that would be beneficial to both those individuals and their creditors," the Court found the narrow interpretation of the provision sounder and more natural than the broader view. Finally, the Court rejected the petitioners' contention that § 526(a)(4) as construed narrowly is impermissibly vague.

iii. The disclosure requirements of § 528 are valid as applied to the petitioner lawyers. Because the provisions are directed at misleading commercial speech and because they impose a disclosure requirement rather than an

[3] The Court's decision, written by Justice Sotomayor, was unanimous. Two of the justices concurred in part and in the judgment. Justice Scalia's concurrence objected only to footnote 3 of the opinion, in which the Court used a congressional committee report and some evidence from a legislative hearing to support its reading of the statute. Justice Scalia, whose opposition to the use of legislative history is well-known, referred to these citations as superfluous.

Justice Thomas's concurrence was entirely on First Amendment grounds. He disagreed with the reasoning, but not the outcome, of the majority's analysis of the constitutionality of the disclosure requirement in § 528. In this, Justice Thomas followed his own well-established approach to the level of scrutiny appropriate to mandatory speech but, because of the parties' concession that there is at least one conceivable manner in which § 528 can be enforced consistent with the First Amendment, he agreed that the challenge to § 528 fails in this case.

affirmative limitation on speech, the Court used the relatively lax scrutiny standard of *Zauderer v. Office of Disciplinary Counsel of Supreme Court of Ohio*, 471 U.S. 626 (1985), rather than a standard that would require the government to show that the restriction on speech directly advances a substantial interest. Under the *Zauderer* standard, "an advertiser's rights are adequately protected as long as disclosure requirements are reasonably related to the State's interest in preventing deception of consumers." *Id*. Considering the possibility for deception in debt relief advertisements self-evident, the Court rejected the argument that there was no evidence that the petitioners' advertisements are misleading. Thus, § 528's requirements that a law firm identify itself as a debt relief agency and include certain information about its bankruptcy assistance services are reasonably related to the Government's interest in preventing deception, it is constitutional.

2. *United Student Aid Funds, Inc. v. Espinosa*, 559 U.S. ___, 2010 WL 1027825.

a. Facts: Espinosa filed a Chapter 13 plan with the bankruptcy court in Arizona that proposed to pay the principal on his student loan over the life of the plan, upon the completion of which his student loan interest would be discharged. No part of such a debt may be discharged under the Code unless the debtor shows that failure to discharge the debt would impose an "undue hardship" on the debtor and his dependents. 11 U.S.C. §§ 523(a)(8), 1328. Despite this requirement, the debtor failed to initiate an adversary proceeding to determine whether such an undue hardship existed, as required by Rule 7001(6). The creditor received notice of the plan but did not object to it and failed to file an appeal from the order confirming the plan. After the debtor had completed payment of the principal due on the loan, the bankruptcy court entered an order, consistent with the plan, discharging the obligation to pay interest. Sometime later, the creditor filed a motion under Federal Rule of Civil Procedure 60(b)(4) asking the bankruptcy court to vacate its order confirming the plan on the ground that it was void, because it was issued in violation of the substantive provisions of the Code and the procedural provisions of the rule. The bankruptcy court denied the motion. The district court reversed, holding that failure to serve the creditor with an adversary summons and complaint denied it due process. The Ninth Circuit, consistent with its own precedent requiring bankruptcy courts to approve discharge of student loan debts without a finding of undue hardship, unless the creditor objects, reversed the district court, reinstating the confirmation order.

b. Ruling: In a unanimous decision, written by Justice Thomas, the Supreme Court held that the bankruptcy court's confirmation order is not void and may not be vacated under Rule 60(b)(4) because the confirmation order is not premised on a jurisdictional error or on a violation of due process that deprives the creditor of notice or the opportunity to be heard.

i. The bankruptcy court's confirmation order is not void because of a jurisdictional error. Rule 60(b)(4) is reserved only for the exceptional case in which the court that rendered judgment lacked even an "arguable basis" for

jurisdiction. Neither party argued that the bankruptcy court's error was jurisdictional.

ii. The bankruptcy court's confirmation order is not void because of a violation of due process of law. Though the debtor failed to serve the creditor with an adversary summons and complaint, the creditor did have actual notice of the plan and its contents from the bankruptcy court. According to the Supreme Court, "[t]his more than satisfied [the creditor]'s due process rights."

iii. Though both the creditor and the government asked the Court to expand the possible defects that will support Rule 60(b)(4) relief in student loan discharge cases to include the bankruptcy court's lack of statutory authority to confirm the plan without a finding in an adversary proceeding of undue hardship, the Court declined to do so. In the Court's view, "a failure to find undue hardship" is not "on par with the jurisdictional and notice failings that define void judgments that qualify for relief under Rule 60(b)(4)." However, the Court did note that the statutory requirements for an undue hardship finding are "self-executing," so that a "bankruptcy court must make an independent determination of undue hardship before a plan is confirmed, even if the creditor fails to object or appear in the adversary proceeding."

3. *Hamilton v. Lanning*, 560 U.S. ___ (June 7, 2010).

a. Facts: At the time the debtor filed her petition under Chapter 13, her actual income was not accurately reflected by the result of her Form 22C. The calculation to determine her income for the six months prior to filing included a substantial "buy out" from her former employer. This buy out caused her current monthly income to appear to exceed her State's median income. However, based on her income from her new job, the debtor anticipated earning well below the state median. Thus, the statutory calculation would have required her to pay more to her creditors than her actual budget reflected that she could afford. The bankruptcy court in Kansas confirmed the plan, based on her projected lower income. The Chapter 13 Trustee appealed, arguing that the courts should look only to the actual historical figures when determining "projected disposable income" under 11 U.S.C. § 1325. The BAP and the Tenth Circuit affirmed.

b. Ruling: In an 8 – 1 decision,[4] the Supreme Court held that when a bankruptcy court calculates a debtor's projected disposable income, the court should follow the so-called "forward-looking" view of § 1325 and may account for changes in

[4] Justice Alito wrote the opinion for the Court. Though Justice Scalia did not disagree with the Court's "plain language of the statute" approach, he concluded that the plain language of the text shows that "Congress has commanded that a specific historical figure shall be the basis for the projection [of current monthly income]." Justice Scalia considered that the possible 'bad results' of following this mechanical approach are irrelevant in determining what the statute actually means and that the forward-looking approach adopted by the Court rendered much of the text Congress used to define "disposable income" superfluous.

the debtor's income or expenses that are known or virtually certain at the time of confirmation.[5]

i. In reaching this outcome, Justice Alito relied heavily on the ordinary meaning of "projected," stating "[w]hile a projection takes past events into account, adjustments are often made based on other factors that may affect the final outcome." Similarly, the Court pointed out that "when Congress wishes to mandate simple multiplication, it does so unambiguously—most commonly by using the term 'multiplied'" instead of "projected." Thus, the plain language of the text is evidence that Congress did not intend the term "projected" in § 1325 to mean simple multiplication.

ii. The Court also pointed out that pre-BAPCPA case law reveals that courts had the discretion to account for known or virtually certain changes in debtor's income. The Court refused to read amendments to the Bankruptcy Code as eroding past practices, absent a clear indication from Congress. The Court found no clear statement of congressional intent to depart from past bankruptcy practice regarding the determination of "projected disposable income."

iii. Finally, Justice Alito found the alternative mechanical approach to § 1325 to clash with the terms of the provision and to leave open the possibility of practical problems. Namely, the Court stated its concern that, under the mechanical approach, a debtor whose income has significantly decreased after filing will not be able to make the planned payments, and if a debtor's income has significantly increased after filing, creditors will not receive the full repayment to which they are entitled.

4. *Schwab v. Reilly*, No. 08-538.

a. Facts: Respondent, a caterer and Chapter 7 debtor, claimed an exemption for her kitchen equipment as tools of her trade. On her Schedule C, she listed the current value of the equipment as $10,718 and listed her claimed exemptions for it as $10,718.[6] Under 11 U.S.C. § 522(*l*), unless the trustee or another party in interest objects, the property claimed as exempt on such list is exempt. The petitioner Trustee did not object. However, he believed that the equipment was worth more, perhaps substantially more, than $10,718 and sought to sell it for the benefit of the estate, paying the debtor the $10,718 amount of her exemption. The Pennsylvania bankruptcy court, the district court, and the Third Circuit all held that since the Trustee did not object to the exemption within the 30-day time set by Rule 4003, he was barred from later selling the equipment and

[5] In contrast to the forward-looking view, the so-called "mechanical" view, which Justice Scalia supported, calls for the court to look only at the net result of the Form 22C calculation when determining "projected disposable income" and to disregard other factors or changes in income.

[6] She combined the exemption she claimed for the equipment as a tool of the trade and under her wild card exemption, §§ 522(d)(6) and (5).

recovering for the estate any value in excess of the claimed amount. The Supreme Court heard oral arguments on November 3, 2009, so the case has been pending unresolved for seven months since argument. This suggests that, whatever the outcome, there will be a dissenting view in the Supreme Court.

b. Petitioner's Arguments:

i. The Trustee argues that the plain language of Rule 4003 and§ 522(*l*) does not preclude objections to the debtor's estimated value of property past the 30-day deadline. The Trustee claims that the debtor's Schedule C exempts her $10,718 interest in the equipment rather than the entire value of it. Furthermore, the Trustee argues that, to claim an exemption, a debtor must provide only three pieces of information, (1) a description of the property; (2) the statutory basis for the claimed exemption; and (3) the amount of the claimed exemption. Therefore, according to the Trustee, Rule 4003 and § 522(*l*) apply only to objections respecting these three pieces of information. Because a debtor is not required to list the current market value of property to claim an exemption, the trustee is not required to object to a debtor's estimation of the property's value.

ii. The Trustee also contends that debtor's and the Court of Appeals' reliance on the Supreme Court's ruling in *Taylor v. Freeland & Kronz*, 503 U.S. 638 (1992)[7] is misplaced. Since all three of the pieces of required information were present and unobjectionable in Schedule C as filed, the Trustee maintains that this case is distinguishable from *Taylor*, where both parties conceded that the claimed exemption was improper. But in this case, the Trustee asserts that the disputed exemption was proper (necessarily arguing that a mistaken valuation by the debtor does not make a claim for exemption improper).

iii. The Trustee's brief also contains argument that requiring trustees to object to the debtor's estimated valuation of property within 30 days would impose an unworkable burden on trustees who do not have the time or resources to properly value all of the property that debtors claim as exempt.

iv. Finally, the Trustee argues that including objections to valuation in Rule 4003 and § 522(*l*) would encourage debtors to game the system by

[7] In *Taylor*, the Supreme Court held that a trustee may not contest the validity of a claimed exemption after the Rule 4003 30-day deadline has expired, even though the debtor has no statutory basis for claiming the exemption. In that case, the debtor had filed for bankruptcy while pursuing an employment discrimination suit. The debtor claimed the suit as exempt and listed the value of the suit and of the exemption amount to be "unknown." Both parties later agreed that the debtor had no colorable basis for claiming the exemption. Despite that fact, and though he was told that the suit might lead to a settlement of $110,000, the trustee did not object, because he felt that the suit had no value. After the 30-day deadline had passed, the debtor did in fact settle the suit for $110,000. The trustee then unsuccessfully demanded that the debtor turn over the proceeds to him.

undervaluing the property they claim exempt in the hope that the trustee will not be able to object within 30 days.

c. Respondent's Arguments:

i. The debtor asserts that the plain language of Rule 4003 and § 522(*l*) supports her position. She contends that, since neither provision expressly distinguishes between different kinds of objections, objections to valuation should be included within the meaning of both Rule 4003 and § 522(*l*). While the Trustee argues that, when trustees do not object to claimed exemptions, the property listed becomes exempt only to the extent of the value limit set forth on the schedule, the debtor maintains that all of the property and all the rights associated with it also become exempt.

ii. The debtor's argument also rests heavily on *Taylor*, claiming that it is indistinguishable from her case. According to the debtor, just as labeling the claimed exemption of the lawsuit and the value of the suit as "unknown" put the trustee in *Taylor* on notice that the debtor intended to claim the entire value of the suit as exempt, similarly here, she says, the Trustee was put on notice that she intended to claim all of her kitchen equipment as exempt when she listed the claimed exemption and the market value of the equipment in an identical amount.

iii. Finally, the debtor contends that the Trustee's interpretations of Rule 4003 and § 522(*l*) are inconsistent with the historical treatment of exemptions in bankruptcy, and the policies of finality under Rule 4003 and § 522(*l*) and of providing debtors with a "fresh start."