

Can a Bankruptcy Court Surcharge Exempt Assets?

In its upcoming term, the United States Supreme Court will likely rule on whether bankruptcy courts may surcharge exempt assets, or more specifically whether they may surcharge constitutionally protected homestead property. See, *Law v. Siegel*, 133 S.Ct. 2824 (Mem), 81USLW3685 (Granting certiorari) (Jun 17, 2013).

Three Circuit Courts of Appeal have issued opinions regarding whether a bankruptcy court has the authority to surcharge exempt assets. The First Circuit, with Justice Souter sitting by designation, in *Malley v. Agin (In re Malley)*, 693 F.3d 28 (1st Cir. 2012) (Souter, J.), and Ninth Circuit, in *Law v. Siegel (In re Law)*, 435 Fed.Appx. 697 (2011) *cert. granted* 133 S.Ct. 2824 and *Latman v. Burdette*, 366 F.3d 774 (9th Cir. 2004), have both held that bankruptcy courts have the authority to surcharge exempt assets “to prevent an abuse of process.” In contrast the Tenth Circuit, in *In re Scrivner*, 535 F.3d 1258 (10th Cir. 2008), held that a bankruptcy court does not have the authority to exercise its equitable powers in such a manner where it is in direct conflict with provisions of the Bankruptcy Code. *Id.* at 1263.

In each of the cases where surcharging exempt assets is sought, the relief is sought to remedy misconduct or abuse of process by a debtor, e.g., concealment or failure to surrender estate assets or failure to comply with permissible discovery requests.

The Supreme Court’s decision will likely come down to statutory interpretation. The Circuit Courts that have held that bankruptcy courts have the equitable power to surcharge exempt assets have grounded their reasoning in the policy that “an honest debtor is entitled to a fresh start, not a head start” and couched in section 105(a), authorizing a bankruptcy court to “issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of ... title [11] ...to prevent an abuse of process. See, 11 U.S.C. 105(a); *Malley*, 693 F.3d at 28-31. The Tenth Circuit, however, has concluded otherwise. In *Scrivner*, the Tenth Circuit held that a bankruptcy court may not exercise the broad equitable powers granted in section 105(a) in a manner which is inconsistent with other more specific provisions of the Bankruptcy Code. *Scrivner*, 535 F.3d at 1263. Accord, *In re Mazon*, 395 B.R. 742 (M.D.Fla. 2008) (Bankruptcy courts lack authority to surcharge exempt assets). The *Scrivner* Court stated that a bankruptcy court is “not at liberty to grant more or less than what the clear language of the [Bankruptcy Code] mandates.” *Id.* at 1264 (internal citation omitted). The bankruptcy code contains specific provisions regarding exemptions, 11 U.S.C. § 522, and if a party in interest does not object, that property is exempt from the estate. *Id.* Furthermore, the Bankruptcy Code provides specific remedies for misconduct of the debtor, such as denial or revocation of the debtor’s discharge, 11 U.S.C. § 727, or dismissal. See, 11 U.S.C. 707(a)(1). See also, *Scrivner*, 1262-1265.

The Supreme Court’s ruling on the surcharge issue could have wide ranging consequences depending on how broadly the court rules. Alternatively, the Court could narrowly tailor its opinion to address only constitutionally protected homestead property. Either way it will be an important decision that all members of the bankruptcy bar should look forward to.

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