

New U.S. Supreme Court Rulings

July/August 2010

Mark G. Douglas

When a bankruptcy court calculates the “projected disposable income” in a repayment plan proposed by an above-median-income chapter 13 debtor, the court may “account for changes in the debtor’s income or expenses that are known or virtually certain at the time of confirmation,” the U.S. Supreme Court held in *Hamilton v. Lanning* on June 7. Writing for the 8-1 majority, Justice Samuel A. Alito, Jr., agreed with the Tenth Circuit Court of Appeals and concluded that a “forward-looking approach” is the proper way to calculate projected disposable income under section 1325(b)(1)(B) of the Bankruptcy Code, rather than the “mechanical approach” advocated by the chapter 13 trustee.

The forward-looking approach permits the amount of projected disposable income to be rebutted upon a showing of special circumstances at the time of plan confirmation. In reaching this conclusion, the court resolved a split among the circuits on the issue. The Eighth and Tenth Circuits had ruled in favor of the forward-looking approach, while the Ninth Circuit favored the mechanical approach. Justice Antonin Scalia dissented on grounds that the “plain meaning” of section 1325(b)(1)(B) requires application of the mechanical approach. It is the role of Congress, Justice Scalia wrote, to correct the law if “what it previously prescribed is wrong.”

On June 17, the Supreme Court handed down its ruling in *Schwab v. Reilly*, where it considered whether a chapter 7 trustee who does not lodge a timely objection to a debtor’s claimed exemption of personal property may nevertheless sell the property if he later learns that the

property value exceeds the amount of the claimed exemption. The Third Circuit Court of Appeals ruled in 2008 that, where the debtor indicates the intent to exempt her entire interest in given property by claiming an exemption of its full value and the trustee does not object in a timely manner, the debtor is entitled to the property in its entirety. The Supreme Court agreed to review the ruling on November 3, 2009, to resolve a split in the federal circuit courts of appeal on the issue.

When a debtor files a chapter 7 petition, all of the debtor's assets become property of the bankruptcy estate pursuant to section 541 of the Bankruptcy Code, subject to the debtor's right to reclaim certain property as "exempt" under section 522(l). Sections 522(b) and 522(d) of the Bankruptcy Code (unless the debtor's state of residence has opted out of the federal exemption scheme) specify the types of property debtors may exempt, as well as the maximum value of the exemptions a debtor may claim in certain assets.

Section 522(l) of the Bankruptcy Code provides that the debtor must "file a list of property that the debtor claims as exempt under subsection (b) of this section" and that "[u]nless a party in interest objects, the property claimed as exempt on such list is exempt." That list of property is filed on Schedule C to Official Bankruptcy Form 6. Rule 4003(b) of the Federal Rules of Bankruptcy Procedure provides that, with certain exceptions, any objections to a debtor's claimed exemptions must be filed within 30 days of the conclusion of the creditors' meeting held pursuant to Bankruptcy Rule 2003(a).

Writing for the 6-3 majority, Justice Clarence Thomas concluded that where a debtor gives “the value of claimed exemptions” on Schedule C dollar amounts within the range the Bankruptcy Code allows for what it defines as “property claimed as exempt,” a chapter 7 trustee is not required to object to the exemptions in order to preserve the estate’s right to retain any value in the equipment beyond the value of the exempt interest. The trustee, the majority ruled, is entitled to sell the property subject to the exemption claim and distribute to the debtor the amounts claimed as exempt, retaining for the estate any excess.

Justice Ruth Bader Ginsburg filed a dissenting opinion, in which Chief Justice Roberts and Justice Breyer joined. The majority ruling, Justice Ginsburg wrote, “drastically reduces Rule 4003’s governance, for challenges to valuation have been, until today, the most common type of objection leveled against exemption claims.” According to the dissent, “[i]n addition to departing from the prevailing understanding and practice, the Court’s decision exposes debtors to protracted uncertainty concerning their right to retain exempt property, thereby impeding the ‘fresh start’ [that] exemptions are designed to foster.”

Hamilton v. Lanning, 2010 WL 2243704 (June 7, 2010), *affirming* 545 F.3d 1269 (10th Cir. 2008).

Coop v. Frederickson (In re Frederickson), 545 F.3d 652 (8th Cir. 2008).

Maney v. Kagenveama (In re Kagenveama), 541 F.3d 868 (9th Cir. 2008).

Schwab v. Reilly, 2010 WL 2400094 (June 17, 2010), *reversing In re Reilly*, 534 F.3d 173 (3d Cir. 2008).

In re Williams, 104 F. 3d 688 (4th Cir. 1997).

In re Wick, 276 F.3d 412 (8th Cir. 2002).

In re Green, 31 F.3d 1098 (11th Cir. 1994).

In re Barroso-Herrans, 524 F.3d 341 (1st Cir. 2008).

In re Hyman, 967 F.2d 1316 (9th Cir. 1992).