No. 08-538

IN THE

Supreme Court of the United States

WILLIAM G. SCHWAB, ESQUIRE,
Trustee for Nadejda Reilly,
Petitioner,

v.

NADEJDA REILLY,
Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

REPLY BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

WILLIAM G. SCHWAB
JOSEPH G. MURRAY
WILLIAM G. SCHWAB & ASSOCIATES
P.O. Box 56
811 Blakeslee Blvd. Drive East
Leighton, PA 18235
(610) 377-5200

JASON ZAC CHRISTMAN
NEWMAN, WILLIAMS, MISHKIN, CORVELEYN, WOLFE & FERERI, P.C.
712 Monroe Street
Stroudsburg, PA 18360
(570) 421-9090

SETH P. WAXMAN
Counsel of Record
CRAIG T. GOLDBLATT
CAROLINE ROGUS
LESLIE S. GARTHWAITE
WILMER CUTLER PICKERING HALE AND DORR LLP
1875 Pennsylvania Ave., NW
Washington, DC 20006
(202) 663-6000

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Reilly's Brief in Opposition correctly and repeatedly acknowledges (at 2, 9, 19-21, 27-37) that the courts of appeals have taken different approaches in addressing the question presented. That question is whether a trustee is required by Fed. R. Bankr. P. 4003(b) and this Court's decision in *Taylor* v. *Freeland & Kronz*, 503 U.S. 638 (1992), to assert an objection to a debtor's claimed exemption when the debtor's schedules *correctly* assert an exemption in a specified amount, but incorrectly list the value of the exempt property as being equal to the amount of the exemption. Despite acknowledging the conflict among the lower courts, Reilly urges that the petition be denied because, she speculates, she might have prevailed in this case even under the approaches more favorable to Schwab. There is absolutely no basis, however, for that speculation.

As the First Circuit recently noted in *In re Barroso-Herrans*, 524 F.3d 341, 345 (1st Cir. 2008) (Boudin, J.), the courts of appeals have offered three different readings of this Court's opinion in *Taylor*. *First*, the Fourth Circuit's reading is squarely in favor of Schwab —a trustee is not required to object under Rule 4003(b) so long as the trustee agrees that the debtor is entitled to an exemption in the amount set forth in the schedules. That is true, according to the Fourth Circuit, even if the schedules erroneously list the value of the property as being is equal to the amount of the exemption. *Second*, the First Circuit, Eighth Circuit, and Ninth Circuit have all ruled for bankruptcy trustees that have contended (as Schwab does here) that the value of the property in fact exceeded the amount of the exemption, but did *not* file objections within 30 days of the initial meeting of creditors (as Reilly con-

tends Rule 4003(b) requires). These courts, however, have employed analyses more dependent on the facts and circumstances than the Fourth Circuit's categorical rule. *Third*, in the decision below, the Third Circuit joined the Eleventh Circuit in reading *Taylor* to require a trustee to object even in circumstances in which the trustee agrees that the debtor is entitled to an exemption in the claimed amount. The Second Circuit, in dicta, has expressed a similar view. The reasoning of these courts, in short, is that by listing the value of the property in an amount equal to the exemption, a debtor manifests an intent to exempt the entire value of the property, even if it exceeds the amount the debtor may lawfully exempt. In that circumstance, these courts have reasoned, a trustee who intends to limit the debtor only to its lawful exemption is required to object to the claimed exemption—even though the trustee has no objection to the debtor taking an exemption in the amount claimed. In addition to these decisions from eight separate courts of appeals, dozens of decisions from bankruptcy appellate panels, district courts, and bankruptcy courts leave no doubt that there is a sharp division of authority among the federal courts that requires this Court's intervention.

Despite Reilly's contrary assertion, there can be no serious question that the outcome of this dispute turns on which of the three approaches this Court adopts. This case is an entirely appropriate vehicle for the resolution of an acknowledged and longstanding split on a significant issue of federal bankruptcy law. And while the stakes in this particular case may be small, there can be no dispute that—with the rate of individual debtor filings skyrocketing as a result of the national economic crisis, *see* Lawless, *Bankruptcy Filings Rising Faster Than Expected* (Mar. 2009), *available at*

www.creditslips.org/creditslips/2009/04 ("bankruptcy filings are rising dramatically")—they are quite substantial in the aggregate. This Court should grant the petition.

I. THE COURTS OF APPEALS HAVE DIVIDED OVER THE MEANING OF THIS COURT'S DECISION IN *TAYLOR*

In a bankruptcy case filed by an individual debtor, certain of the debtor's assets are "exempted" from the bankruptcy estate—meaning the debtor is entitled to keep those assets, rather than turn them over to the trustee for liquidation and distribution to creditors. *See Rousey* v. *Jacoway*, 544 U.S. 320, 322 (2005). Some assets, like the debtor's right to receive social security benefits, 11 U.S.C. § 522(d)(10)(A), the right to a criminal restitution award, *id.* § 522(d)(11)(A), or an unmatured interest in a life insurance contract, *id.* § 522(d)(7), are exempted in their entirety, regardless of their value. Other assets, by contrast, are exempt only up to certain dollar amounts—such as "the debtor's interest, not to exceed $3,225 in value, in one motor vehicle," *id.* § 522(d)(2), or "the debtor's aggregate interest, not to exceed $1,350 in value, in jewelry," *id.* § 522(d)(4). This case involves claimed exemptions in this second category.

Upon the filing of a bankruptcy petition, a debtor is required to file a schedule listing the value of the debtor's assets. Fed. R. Bankr. P. 1007(b). The debtor is also required to file a separate schedule setting forth the property the debtor contends is exempt. Fed. R. Bankr. P. 4003(a).

If any party, such as a creditor or the trustee, disagrees with the debtor's claimed exemptions, Bankruptcy Rule 4003(b) requires that party to assert such

an objection within 30 days of the initial meeting of creditors. *See* Fed. R. Bankr. P. 4003(b).

The issue presented here arises when the debtor's schedules list the value of the property, and the amount of the exemption, in the same amount. Specifically, the question is whether—if the trustee agrees that the debtor is entitled to an exemption in that stated amount, but contends that the property may be worth more than its listed value—a trustee is required by Rule 4003(b), and this Court's decision in *Taylor* to assert an objection within 30 days.

As the First Circuit recently explained, *see In re Barroso-Herrans*, 524 F.3d at 345, the courts of appeals have adopted *three* different approaches to that question.

- In the present case, the Third Circuit joined with the Eleventh Circuit, and the Sixth Circuit Bankruptcy Appellate Panel in holding that if the trustee fails to object, the entire property is deemed exempt, regardless of its actual value. Pet. App. 16a; *In re Green*, 31 F.3d 1098, 1100 (11th Cir. 1994) (permitting full value of lawsuit as exemption even though scheduled with a value of $1); *In re Anderson*, 377 B.R. 865, 875-876 (B.A.P. 6th Cir. 2007). According to these courts, listing the property and the exemption in the same amount necessarily manifests an intent to exempt the entire asset. If a trustee believes that some portion of the asset is not exempt (because its value exceeds the stated amount), the trustee must file a timely objection asserting that position. In dicta, the Second Circuit has taken the same position. *See In re Bell*, 225 F.3d 203, 210 (2d Cir. 2000) (in chapter 11 case in which debtor claimed an exemption of $490, listed asset as having

a value of $490, and the trustee did not object within 30 days, the court observed that if the case were a "simple Chapter 7 case ... the trustee's objections would be barred as untimely under the Bankruptcy Rules themselves and [*Taylor*]").

- The Fourth Circuit has reached the diametrically opposite conclusion, holding that "*Taylor* does not purport to require a trustee to object to a claimed exemption to which the debtor is fully entitled." *In re Williams*, 104 F.3d 688, 690 (4th Cir. 1997). Because the trustee does not object to the debtor's asserting an exemption in precisely the amount stated, Rule 4003(b) has no application. Applying this same line of reasoning, in *In re Grablowsky*, 32 F.3d 562, 1994 WL 410995 (4th Cir. 1994) (table), the Fourth Circuit held that a debtor that listed both the asset and an exemption in the nominal amount of $1 was entitled, when the trustee filed no objection, to an exemption of $1—not the full value of the property.

- Other courts have rejected the bright-line resolutions of the Third, Fourth, and Eleventh Circuits, and engaged in a facts-and-circumstances inquiry into whether the trustee would reasonably understand the debtor's schedules, on the facts of the particular case, to reflect an intent to exempt the entire asset. *See In re Wick*, 276 F.3d 412, 416 (8th Cir. 2002) ("The facts suggest that Ms. Wick, her counsel, and the trustee understood that the options were only partially exempt."); *In re Hyman*, 967 F.2d 1316, 1319 (9th Cir. 1992) ("the Hymans did not sufficiently notify others that they were claiming their entire homestead as exempt property; their schedule only gave notice that they claimed $45,000

as exempt, which is the proper amount of their homestead allowance").

The First Circuit's decision in *Barroso-Herrans* explains that the courts to have addressed this issue have divided into these three camps. The First Circuit joined the Eighth and Ninth Circuits in holding that the mere fact that the debtor lists the value of an asset as being the same amount as the debtor's claimed exemption does not require the trustee to object within 30 days. In *Barroso-Herrans*, the debtor listed the value of certain causes of action as $4,000, and claimed $4,000 of exemptions in the same causes of action. The trustee did not object, and the debtor settled those claims for $100,000. Contrary to the decision below, the First Circuit had no trouble finding that the debtor was entitled to exempt only $4,000, with the balance becoming property of the bankruptcy estate. *See* 524 F.3d at 345-346. The First Circuit rejected the approaches of the Third and Eleventh Circuits that require a trustee to object in those circumstances. The court did not, however, go as far as the Fourth Circuit in adopting a bright-line rule under which a trustee is *never* required to object so long as the schedules are not facially objectionable, finding it "is enough to resolve this case" that it was "objectively reasonable," for the trustee to conclude that the debtor did not intend to exempt the entire property.

Reilly does not—and cannot—dispute the existence of a circuit split, which has been pointed out not only by various of the courts of appeals, but also by academic commentators. *See, e.g.*, Ponoroff, *Procedural Exemptions and the* Taylor *Legacy*, 7 J. Bankr. L & Prac. 397, 398-399 (May/June 1998) ("[p]aradoxically ... a number of interpretational issues have been spawned in the

wake of the decision in *Taylor* over which there is a disturbing lack of consensus in the reported caselaw.").

To the contrary, Reilly repeatedly acknowledges the differences in approach among the various courts of appeals (*see* Opp. 2, 9, 19-21, 27-37), and instead merely speculates that some courts that have adopted approaches that differ from that employed by the Third Circuit might nevertheless have ruled in her favor. That contention, however, is insubstantial. There can be no question that in the Fourth Circuit, where a trustee is not required to object if he does not dispute the debtor's entitlement to an objection in the scheduled amount, Schwab would prevail.

Nor is there any basis to credit Reilly's speculation that she might have prevailed in the First, Eighth or Ninth Circuits. Reilly makes much of the fact that Schwab knew that the value of the property exceeded the scheduled amount. But that is not a factor that would help Reilly in those jurisdictions. To the contrary, the First Circuit pointed to precisely this factor in support of the *opposite* conclusion. *Barroso-Herrans*, 524 F.3d at 346 ("a $4,000 valuation for an entire multi-million dollar law suit including the accounts receivable makes no sense" and thus indicates that the debtor did not intend to exempt the entire claims). The dispositive issue in those courts was *not* whether the trustee knew that the value of the asset exceeded the amount listed on the schedule, but whether the debtors' schedules or the parties' course of dealings made sufficiently clear that the debtor took the position that he was entitled to exempt the entire asset. The Third Circuit below, following the Eleventh Circuit's approach in *Green* (under which the fact that the value of the property was listed in the same amount as the exemption was sufficient to find that the entire asset was exempt),

never engaged in any such analysis. And Reilly's Opposition points to no statement or action taken before the expiration of Rule 4003(b)'s thirty-day deadline that would have put Schwab on notice that Reilly claimed a right to exempt all of her kitchen equipment—not just the $10,718 that she listed on her schedules. *See* Opp. 2-4, 33.

In sum, there can be no serious dispute that this petition presents a question on which the court of appeals have divided, and that the outcome of this case will turn on the answer this Court provides to the question presented. Eight different courts of appeals—in addition to many lower federal courts[1]—have addressed the question. The division of authority, acknowledged by the court of appeals below (*see* Pet.

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[1] *See, e.g., In re DeSoto*, 181 B.R. 704, 708 (Bankr. D. Conn. 1995) (*Taylor* only applies where the trustee was supposed to have objected to the "*nature* of the claimed exemptions" (emphasis in original)); *In re Mitchell*, No. 06-144, 2009 WL 275758, *5 (Bankr. N.D. W. Va. Jan. 28, 2009) ("In holding that the Debtor in this case is limited to a $21,000 homestead exemption ... the court realizes that it is reaching a result directly contrary to *In re Reilly*, 534 F.3d 173 (3d Cir. 2008), which is the case most analogous to the facts before this court.... However, the court cannot conclude—as the Court of Appeals for the Third Circuit did—that the Debtor put her Chapter 7 trustee on notice that she was claiming property as wholly exempt by equating the value of her property and her claim of exemption when the claim of exemption is proper and below the statutory cap."); *In re Heflin*, 215 B.R. 530, 533 (Bankr. W.D. Mich. 1997) ("[T]he Trustee in this case did not object because there was both a valid statutory basis for the exemptions and the amount was within the statutory limits."); *Anderson*, 377 B.R. at 875 (adopting reasoning of Eleventh Circuit in *Green*, ultimately approved by the court of appeals in the case at bar); *In re Cormier*, 382 B.R. 377, 409 (Bankr. W.D. Mich. 2008) (expressly rejecting and declining to follow *Anderson*).

App. 12a ("In reaching our holding today, we recognize that there is a split of authority on this issue among courts that have considered it.")), is deep and entrenched, and cannot be resolved absent this Court's intervention.

II. THE COURT OF APPEALS WAS INCORRECT ON THE MERITS

The Third Circuit erred in its application of this Court's decision in *Taylor*. Because there was no statutory basis for the claimed exemption, 503 U.S. at 639, 642, this Court unsurprisingly held in *Taylor* that the trustee was required to assert its objection to claimed exemption within the time period provided in Rule 4003(b), *id.* at 639, 643. This crucial fact of *Taylor*—a fact that makes that case decisively different from this one—was that the exemption the debtor claimed there was invalid on its face, triggering the trustee's obligation to object.

The debtor here, by contrast, listed $10,718 on her schedule of exemptions, an amount she was fully entitled to exempt under Sections 522(d)(5) and 522(d)(6) of the Bankruptcy Code. Schwab therefore has no objection to Reilly's claimed objection—his only concern related to the valuation of the property, a subject to which the text of Rule 4003(b) does not speak at all. Because *Taylor* has no application to this case, Schwab was not obligated to object within the thirty-day time period. Applying *Taylor* to extend to cases in which the trustee takes no issue with the debtor's claimed exemption—only its valuation—requires "an erroneous leap of logic." *In re Heflin*, 215 B.R. 530, 534 (Bankr. W.D. Mich. 1997).

Schwab's reading also accords with the text of Rule 4003(b). That provision addresses objections that must

be filed to a "claim of exemption." The rule sets out no procedure for objecting to the debtor's "valuation" of its property. The proper mechanism for resolving questions of valuation is to test the debtor's contention in the marketplace by offering the property for sale. Indeed, to construe Rule 4003(b) to require a trustee to object to a debtor's valuation—not just his claimed exemption—in the time set out in the Rule would effectively require the trustee to administer the entire estate within 30 days, a result that Congress could never have intended.

A trustee would have no reason to sell property in which a debtor claims an exemption if the highest and best offer would not generate proceeds, after paying any secured creditor the value of its lien, in excess of the asserted exemption. In such a case, the trustee would allow the debtor to retain the property. But if the trustee is able to obtain a price that generates value for unsecured creditors in excess of the debtor's asserted exemption, the trustee would then sell the property, delivering to the debtor the full value of the asserted exemption, with the excess value distributed to creditors. Authorizing a trustee to take that action would give the debtor precisely the rights Congress provided in Section 522 of the Bankruptcy Code, avoiding the gamesmanship (and the windfall) encouraged by the rule adopted by the court of appeals.[2]

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[2] While Reilly responds separately to the Petition's suggestion that the court of appeals' decision encroaches on Congress' authority (Opp. 38-42), Schwab did not intend to present that argument as a separate question, only a reason in support of his (more natural) reading of Rule 4003(b) and this Court's decision in *Taylor*. It may therefore be appropriate for the Court to limit the grant of certiorari to the first question presented in the petition.

CONCLUSION

For the foregoing reasons, the petition should be granted.

Respectfully submitted.

WILLIAM G. SCHWAB
JOSEPH G. MURRAY
WILLIAM G. SCHWAB & ASSOCIATES
P.O. Box 56
811 Blakeslee Blvd. Drive East
Leighton, PA 18235
(610) 377-5200

JASON ZAC CHRISTMAN
NEWMAN, WILLIAMS, MISHKIN, CORVELEYN, WOLFE & FERERI, P.C.
712 Monroe Street
Stroudsburg, PA 18360
(570) 421-9090

SETH P. WAXMAN
Counsel of Record
CRAIG T. GOLDBLATT
CAROLINE ROGUS
LESLIE S. GARTHWAITE
WILMER CUTLER PICKERING HALE AND DORR LLP
1875 Pennsylvania Ave., NW
Washington, DC 20006
(202) 663-6000

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