***Louisville Joint Stock Land Bank v. Radford*, 295 U.S. 555 (1935)**

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I. Issue

Can bankruptcy laws promulgated under the Bankruptcy Clause of the U.S. Constitution override the provisions of the Taking Clause of the U.S. Constitution so as to impair the rights of a secured creditor without compensation?

II. Statutory Context

This case was decided under the Bankruptcy Act of 1898.

III. Facts

In *Radford*, the Supreme Court considered a challenge to the 1934 Frazier-Lemke Faun Bank Act, a cornerstone of President Roosevelt's New Deal policies aimed at providing relief to distressed farmers. Radford, a Kentucky farmer, had twice mortgaged the family farm to the Louisville Joint Stock Land Bank as security for approximately $9,000 in debt. Radford made regular principal and interest payments on the mortgages until 1931, when, like hundreds of thousands of other American farmers, Radford fell victim to the Great Depression and defaulted in payment of property taxes and mortgage obligations. After Radford declined to refinance the mortgages in early 1933, the Bank declared the indebtedness secured thereby immediately due and payable, filed for foreclosure of the mortgages, and requested the appointment of a receiver to take possession and control of the farm.

Shortly after the Bank's foreclosure and receivership actions commenced, Radford petitioned for relief under Section 75 of the Bankruptcy Act, requesting a stay of the Bank's state court actions and proposing a composition of his debts in Kentucky federal court. Though Radford's petition was approved, he failed to obtain the requisite creditor consent to his proposed composition. The Bank thereafter obtained a Kentucky state court order authorizing a foreclosure sale of the farm.

Two days before the issuance of the foreclosure sale order, Congress enacted the Frazier-Lemke Emergency Farm Mortgage Act (the "Act") which, among other things, allowed farmers to stay foreclosure proceedings and restructure farm mortgage debt on more favorable terms. Two provisions of that Act provided farmers, who were adjudged bankrupt but unable to successfully complete a composition proceeding under Section 75 of the Bankruptcy Act, with attractive restructuring options. Paragraph 3 of the Act provided that a bankrupt farmer could, with the mortgagee's consent, purchase the mortgaged farm at its then-appraised value and immediately acquire title and possession to the farm, with deferred payments due over the course of six years. If the mortgagee refused consent for such a sale, under paragraph 7, the mortgagor could petition the bankruptcy court for a five year stay on all proceedings against the mortgaged farm. During this five-year period, the farmer would retain possession of the farm, subject to payment of a reasonable rental amount, and mortgage payments would be deferred and accrue interest at 1.0% per year. At any time within this five-year period, the mortgagor could elect to purchase the

mortgaged farm at its then-appraised value or, at the request of the mortgagor, at a price equal to any subsequent, court-approved re-appraisal value. These alternatives applied to mortgage debt arising prior to the enactment of the Act, as well as to all future farm mortgages.

A Kentucky federal court adjudged Radford bankrupt and appointed a bankruptcy referee. Radford invoked paragraph 3's provisions and sought to purchase the property at the referee-appraised value, which equaled only half of Radford's indebtedness to the Bank. The Bank refused to consent to the sale and instead offered to pay the mortgage in full in exchange for the farm. The referee rejected the Bank's proposal and ordered all pending foreclosure actions against the farm stayed under paragraph 7 of the Act. Radford retained possession of the farm, subject to his obligation to pay the referee-established annual rent. The Bank appealed the referee's orders, asserting that the Act resulted in an unconstitutional taking of certain property rights under the mortgage. The orders were affirmed on appeal by the district court and again by the Sixth Circuit Court of Appeals.

IV. Holding

Writing for a unanimous Court, Justice Brandeis struck down the Act, holding that paragraphs 3 and 7 of the Act affected an unconstitutional taking of private property prohibited by the Fifth Amendment as it was applied to existing mortgages. Looking first to centuries of equity court practice concerning the defense of mortgagee rights, the Court noted that "the right of the mortgagee to insist on full payment before giving up his security" was the quintessence of a mortgage. *Id*. at 580-81. Prior legislation providing mortgagor-friendly relief had always hewed to this principle, by refraining from disturbing the mortgagee's right to receive payment in full of the mortgage debt. *Id*. at 581.

The Act also impaired other property rights of the Bank. Whether the Bank consented to a sale under paragraph 3 or not, the Bank would forfeit its right to repossess the property and endure the risk of waste or destruction of the farm while Radford retained possession. *Id*. at 592-93. Specifically, if the Bank consented to a sale under paragraph 3, it would be forced to forfeit its security, in exchange for six years of deferred payments and an unsecured promise to pay the balance at the end of this six-year period. If the Bank refused to consent to such a sale, it would similarly forfeit its right to security, in exchange for five years of rent payments and the opportunity costs associated with uncertainty as to if, or when, the mortgagor might elect to purchase the property for the appraisal price during this five-year period. Additionally, the Court noted that sales free and clear of liens were not permitted when the debt exceeded the value of the property, and no court had ever authorized a sale of property at a price less than the mortgagee's cash offer. *Id*. at 584. In sum, the Act represented "the first instance of an attempt [... to impair] a substantive right of [a] mortgagee in specific property held as security." *Id*.

In rejecting this attempt, the Court stated that the Act infringed on five key state property rights provided under Kentucky state law:

1) The right to retain the lien until the indebtedness thereby secured is paid.
2) The right to realize upon the security by a judicial public sale.
3) The right to determine when such sale shall be held, subject only to the discretion of the court.

4) The right to protect its interest in the property, by bidding at such sale whenever held, to then assure having the mortgaged property devoted primarily to the satisfaction of the debt, either through receipt of the proceeds of a fair competitive sale or by taking the property itself.
5) The right to control the property during the period of default, subject only to the discretion of the court, and to have the rents and profits collected by a receiver for the satisfaction of the debt.

Id. at 594-95. These property rights could not be subverted by Congress's power to establish uniform bankruptcy laws under the Bankruptcy Clause of Article I of the Constitution and remained subject to the Fifth Amendment's prohibition against uncompensated public takings. *Id*. at 586-88. Even the most compelling public policy justifications, such as Congress's interest in combating the scourge of farm foreclosures and staving off the eradication of the American owner-operator farmer, could not justify Congressional overreach. "[T]he Fifth Amendment commands that, however great then Nation's need, private property shall not be thus taken even for a wholly public use without just compensation." *Id*. at 602. The Court struck down the Act and voided the actions taken against the Bank under the Act.

V. Significance

Radford stands today as an early—and significant—check on the scope of Congress's bankruptcy power in respect of the rights of secured creditors. It is credited as being the first case to rely on the Fifth Amendment in limiting the operation of the Bankruptcy Clause, an approach which has since been employed in numerous other cases to rein in the bankruptcy power. *See* Kenneth N. Klee, BANKRUPTCY AND THE SUPREME COURT (LexisNexis 2009), 440-41; Charles J. Tabb, *Illinois ABI Symposium on Chapter 11 Reform: The Bankruptcy Clause, the Fifth Amendment, and the Limited Rights of Secured Creditors in Bankruptcy*, 2015 U. ILL. L. REV. 765, 790 (2015). The Supreme Court has relied on *Radford* in invalidating numerous Congressional attempts to use the bankruptcy power to impair existing liens. *See, e.g., Ashton v. Cameron Cty. Water Impr. Dist.*, 298 U.S. 513 (1936) (striking down a municipal bankruptcy statute that unconstitutionally altered municipal bondholders' rights); *Armstrong v. United States*, 364 U.S. 40 (1960) (rejecting a Congressional attempt to eliminate valid mechanic's liens on certain manufacturing property).

The Supreme Court's later decision in *Wright v. Vinton Branch of the Mountain Trust Bank of Roanoke*, 300 U.S. 440, 458 (1937), seemingly narrowed the five protected rights cited in *Radford* to three: the right to retain the lien until the secured indebtedness is paid, the right to realize on the security by a judicial public sale, and the right to bid in the secured debt at a foreclosure sale. Nevertheless, these three rights survive today as baseline protections for secured creditors against the bankruptcy power throughout the United States. Klee, BANKRUPTCY AND THE SUPREME COURT, at 441.

More recently, the Ninth Circuit Court of Appeals appears to limit *Radford's* application to takings claims that accrue *prior* to the enactment of the Bankruptcy Code. *See Cobb v. City of Stockton (In re City of Stockton)*, 909 F.3d 1256, 1268 (9th Cir. 2018) ("The Supreme Court has never held that the Takings Clause renders claims that accrued after the Bankruptcy Code was enacted immune from the Bankruptcy power, or the bankruptcy process. In short, *Radford* does not reach

as far as [claimant] asserts"). *Stockton* further puts *Radford's* potential impact in the Ninth Circuit in question, by further noting that the case is "unremarkable", "does not mean … that secured creditors are immune from the bankruptcy process" and that "the Code expressly permits the adjustments of debts of secured creditors, including lien rights"

Nevertheless, *Radford* is significant for the contributing role it played in shaping American history. The *Radford* Court's steadfast adherence to the Fifth Amendment's protection of private property, particularly in the face of calamitous financial hardships faced by American farmers during the Depression, was a blow to President Roosevelt's New Deal legislation. The Court's unwillingness to yield to the necessities of the times challenged President Roosevelt's agenda and placed the Court at loggerheads with Congress and the President. Scholars have considered *Radford* to be among a handful of landmark cases that inspired President Roosevelt's unsuccessful attempt to "pack" the Supreme Court through the Judicial Procedures Reform Bill of 1937 and later appointment of justices more sympathetic to the New Deal. *See* Howard Ball, Hugo L. Black: Cold Steel Warrior, 90 (Oxford U. Press 2006).

***Mission Prod. Holdings v. Tempnology, LLC*, 587 U.S. 370 (2019)**

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I. Issue

Does a debtor-licensor's rejection of trademark license agreement deprive the licensee of its rights to use the trademark?

II. Statutory Context

This case was decided under Section 365 of the Bankruptcy Code.

III. Facts

Tempnology, LLC, the debtor-licensor, manufactured clothing and accessories designed to stay cool when used in exercise. Tempnology's products were marketed using the brand name "Coolcore" and related trademarks to distinguish its gear from other athletic apparel. Tempnology entered into an agreement with Mission Products Holdings, Inc. that gave Mission Products an exclusive license to distribute certain Coolcore products throughout the United States. The agreement also granted Mission Products a non-exclusive license to distribute certain Coolcore products worldwide.

Tempnology filed for bankruptcy in September of 2015, several months before the licensing agreement was set to expire. Tempnology sought and secured bankruptcy court approval to reject the licensing agreement under Section 365 of the Bankruptcy Code. Tempnology specifically contended that its rejection of the agreement prevented Mission Products from retaining trademark rights granted under the agreement. The Bankruptcy Court agreed, holding that Tempnology's rejection of the licensing agreement revoked Mission Product's rights to use the Coolcore marks. The Bankruptcy Appellate Panel (the "BAP") reversed, holding that rejection of an executory contract constitutes a "breach" of that contract under Section 365(g) of the Bankruptcy Code, which does not eliminate rights the contract had already conferred on the non-breaching party before that breach occurred. The First Circuit Court of Appeals reversed the BAP. In doing so, the First Circuit endorsed the Bankruptcy Court's view that the non-breaching party to an executory contract cannot retain rights provided to it under a rejected contract, unless specifically authorized by the Bankruptcy Code. Although Section 365(n) of the Bankruptcy Code expressly authorizes a non-debtor to "elect" to retain certain *other* rights in "intellectual property", which statutorily excludes trademarks, no analogous protection exists under the Bankruptcy Code to authorize retained trademark rights.

IV. Holding

The Supreme Court agreed with the BAP and reversed the First Circuit, holding that "Section 365's text and fundamental principles of bankruptcy law command" that contract rejection be treated only as a pre-petition breach of the executory contract, and not as a recission of that contract. When such deemed prepetition contract breach occurs, "the debtor and counterparty do

not go back to their pre-contract positions. Instead, the counterparty retains the rights it has received under the agreement." Therefore, after a trademark license is rejected under Section 365, a licensee "can continue to do whatever the license authorizes." The Court explained that holding otherwise would circumvent the Bankruptcy Code's stringent limits on a debtor's ability to avoid certain transactions under Sections 544-553 of the Bankruptcy Code. In other words, a debtor's ability to reject an executory contract does not authorize the debtor to claw back all prepetition rights provided to the counterparty pursuant to the rejected contract. The Supreme Court rejected the statutory construction argument articulated by the First Circuit and the Bankruptcy Court, noting that the specific provisions of the Bankruptcy Code that provide creditors with certain rights upon contract rejection, such as Section 365(n), do not override the clear directive of Section 365(g), which dictates that contract rejection amounts to a contract breach, and not a contract recission.

V. Significance

Mission Products should make licensors think twice about the license termination provisions contained within their licensing agreements. As Justice Sotomayor notes in her concurring opinion, "the baseline inquiry remains whether the licensee's rights would survive a breach under applicable nonbankruptcy law. Special terms in a licensing contract or state law could bear on that question in individual cases." Therefore, licensors now need to consider whether they would like their own hypothetical bankruptcy to permit termination of a trademark license and draft accordingly. Where such protections for licensors are not in place, *Mission Products* leaves rejection of a trademark agreement by a debtor-licensor with little value. Where a trademark agreement is rejected by the debtor-licensor, the licensee will still be able to use the trademarks granted prepetition, and the rejection will still likely trigger a rejection damages claim.

Mission Products' holding has application beyond the trademark license setting and has been applied by bankruptcy courts to enforce the other provisions in rejected executory contracts. *See In re Chrisholm Oil & Gas Nominee, Inc.* 660 B.R. 593 (Bankr. D. Del. 2024) (relying on *Mission Products* to enforce claimant's pre-petition relinquishment of rights pursuant to a rejected joint operating agreement's non-consent provision in which claimant elected not to participate in new oil and gas wells); *see also Pirteck USA, LLC v. Lager (In re Lager)*, 2022 Bankr. LEXIS 2224 (Bankr. N.D. Tex. Aug. 10, 2022) (authorizing claimant to seek equitable relief on account of debtor's violation of a non-disparagement clause in rejected executory contract). Section 365 of the Bankruptcy Code only authorizes debtors to breach their executory contracts. What comes of that breach will likely be determined by contractual language and applicable non-bankruptcy law, even outside of the trademark context.

Bartenwerfer v. Buckley, 598 U.S. 69 (2023)

Nondischargeability Regardless of Mental Culpability under 523(a)(2)(A)

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I. Issue

Is a debt obtained by fraud under 523(a)(2)(A) nondischargeable, regardless of the debtor's culpability?

II. Statutory Context

This case was decided under Section 523(a)(2)(A) of the Bankruptcy Code.

III. Facts

Section 523(a)(2)(A) provides that debt "(2) for money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained by: (A) false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor's or an insider's financial condition" is nondischargeable.

The facts of *Bartenwerfer* involve a couple who jointly purchased a home in San Francisco. At the time the couple was dating, but later married. The couple, acting as business partners, elected to remodel and sell the home. The boyfriend, David, undertook most if not all of the remodeling effort. Kate, the girlfriend, and petitioner Bartenwerfer in this proceeding, was totally uninvolved with the work on the house. The Bartenwerfers eventually sold the home, attesting that they had disclosed all material facts relating to the property. The buyer, Buckley, later uncovered several defects, successfully sued the Bartenwerfers, and was awarded $200,000.00 in damages.

The Bartenwerfers could not afford to pay the damages and filed for Chapter 7 bankruptcy relief. Buckley argued that the judgment debt of both debtors was nondischargeable pursuant to §523(a)(2)(A). The bankruptcy court imputed David's fraudulent intent onto Kate as his business partner and held that neither David nor Kate could discharge the court-ordered debt. The Ninth Circuit BAP reversed as to Kate's debt and remanded. The bankruptcy court found that Kate lacked knowledge of the fraud and thus could discharge her debt. The BAP affirmed, but the Ninth Circuit reversed. The Supreme Court affirmed the Ninth Circuit's decision.

The Supreme Court's decision reads like a grammar lesson. The Court considers the passive voice adopted by Congress in §523(a)(2)(A). The Court reasoned that the passive tone does not provide who must commit the fraud for the debt to be nondischargeable, but rather that the debt must have been incurred by some form of fraud. The Court relied on the common law definition of fraud for support. "The relevant legal context—the

common law of fraud—has long maintained that fraud liability is *not* limited to the wrongdoer." *Bartenwerfer v. Buckley,* 598 U.S. 69, 76 (2023). The Court spins the petitioner's own argument against her, by considering the analogous phrase "Jane's clerkship was obtained through hard work." *Id* at 75. The Court opined that the phrase is open-ended, the clerkship could have been obtained through the hard work of Jane's professor who drafted a letter of recommendation. Similarly, the Court reasoned that the debt incurred by fraud in §523(a)(2)(A) could be obtained by Kate's business partner and still render Kate's debt nondischargeable.

Finally, the Court considered legislative history. The relevant Code section previously read "No debt created by the fraud of embezzlement *of the bankrupt…*shall be discharged under this act." *Id* at 79. The Court reasoned that Congress's amendment to remove "of the bankrupt" conveys its intention that the fraud be open beyond the actions of the fraudster. According to the Court's decision in *Bartenwerfer,* pursuant to §523(a)(2)(A), the critical inquiry for nondischargeability is whether the debt was incurred by fraud, not whether the debtor committed the fraud.

IV. Holding

The Supreme Court held, in a unanimous decision, that Kate could be liable, as §523(a)(2)(A) hinges on how the fraudulent money was obtained, not on who committed the fraud to obtain it. The Court held that the use of passive voice focuses on events rather than a specific actor. Based on common law, courts have long recognized fraud liability is not limited to the actual wrong doer.

Additionally, the Court found that 523(a)(2)(B) and (C) are limited to culpable actions by the Debtor. When Congress includes particular language in one section but omits it in another, it does so intentionally.

Finally, the Court recognized historically, the applicability of vicarious liability in dischargeability litigation is applicable to 523(a)(2)(A). Invoking its decision in *Strang v. Bradner*, 114 U.S. 555 (1885), it held that a debtor who is liable for her partner's fraud cannot discharge that debt in bankruptcy regardless of her own culpability.

V. Significance

Justice Barrett's Opinion does rely on the passive voice used in the Code section. The conclusion that Congress was "agnostic" regarding whose fraud caused the harm seems to pass over the importance of the fresh start.

The Concurrence by Justice Sotomayor highlights the fact that there was an agency relationship between the debtors. Does any quasi-commercial activity between husband and wife create an agency relationship? Some commentors have suggested that aggressive creditors may use this concept to attempt to enlarge the notion of agency relationships, particularly between spouses.

This decision can potentially lead to difficult results for debtors who lack any culpability in the underlying fraud but are otherwise connected to the debt.

Bullock v BankChampaign, N.A., 569 U.S. 267 (2013)

Culpable State of Mind Requirement under 523(a)(4)

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I. Issue

Is there an applicable mental state required to hold a debt nondischargeable under 523(a)(4) for defalcation while acting as a fiduciary.

II. Statutory Context

This case was decided under Section 523(a)(4) of the Bankruptcy Code.

III. Facts

Section 523(a)(4) of the Bankruptcy Code provides that any debt "for fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny" is nondischargeable. The Supreme Court of the United States sought to define "defalcation" in *Bullock v BankChampaign, N.A.* and developed a "culpable state of mind" requirement in the process.

The facts of *Bullock* involved a father who established a trust containing his life insurance policy for the benefit of his five children. The father made his son, petitioner Bullock, the trustee. Bullock, at his father's direction and according to the terms of his father's insurance policy, borrowed money from the trust for the benefit of Bullock and his mother and father. Bullock repaid the trust in full, including interest as set by the insurance company. Nearly 20 years later, Bullock's brothers sued Bullock. The state court held that Bullock had committed a breach of fiduciary duty and imposed constructive trusts with BankChampaign serving as trustee to recover damages. Bullock eventually filed for bankruptcy. BankChampaign opposed the discharge of Bullock's debts to the trust imposed by the state court. The bankruptcy court issued summary judgment in BankChampaign's favor, the Federal District Court affirmed the bankruptcy court, and the Court of Appeals affirmed the District Court. The Supreme Court vacated and remanded based on its heightened culpable state of mind requirement.

IV. Holding

The central issue in the *Bullock* decision was the definition of "defalcation." Justice Breyer delivered the opinion for the unanimous Court which ultimately elected to treat the term "defalcation" similar to the term "fraud," whereby the definition requires some intentional wrong or reckless conduct. The Court stated, "[W]here the conduct at issue does not involve bad faith, moral turpitude, or other immoral conduct, the term requires an intentional wrong. We include as intentional not only conduct that the fiduciary knows is improper but also reckless conduct of the kind that the criminal law often treats as equivalent." *Bullock v.*

BankChampaign, N.A., 569 U.S. 267, 273 (2013). The Court also provided that "Where actual knowledge of wrongdoing is lacking, we consider conduct as equivalent if the fiduciary "consciously disregards" (or is willfully blind to) "a substantial and unjustifiable risk" that his conduct will turn out to violate a fiduciary duty." *Id.* citing ALI, Model Penal Code §2.02(2)(c), p. 226 (1985).

To support its holding, the Court undertakes a logic-driven route of analysis. The Court considered the context of 523(a)(4) and defalcation amongst other terms like fraud, embezzlement, and larceny. The court held that all of these neighboring terms require some form of wrongful intent. Further, by requiring defalcation to carry a showing of wrongful intent or recklessness, it would not make the term redundant of its statutory companions. Rather, it differs from the other terms contained in 523(a)(4), as it can encompass breach of fiduciary obligations that do not involve conversion, falsity, or taking another's property. Ultimately, according to *Bullock,* in order to find a debt nondischargeable under 523(a)(4), one must demonstrate that the debtor's wrongful conduct was intentional or was committed with recklessness.

V. Significance

The honest but unfortunate debtor enjoys the power of a fresh start. However, not all debts are discharged. Courts have struggled to apply a consistent framework for determining what legal relationships amount to fiduciary capacity, and what behavior is nondischargeable as a fiduciary.

The decision in *Bullock* resolved the split among the Circuit Courts of Appeal on the question of the requisite mental state, if any, and measure of loss that must be established to show defalcation by a trustee sufficient to except related debts from discharge in bankruptcy. The decision in *Bullock* provides a definitive answer to lower courts and fiduciaries with respect to liability arising from their use of trust assets.

Given the standard set by the Supreme Court in *Bullock*, a debtor's credibility will be highly relevant to a discharge determination under 523 (a)(4). Evidence from 341 meetings, deposition testimony under Rule 2004, and other sources will impact the court in determining the requisite state of mind. This analysis will be fact intensive and the debtor's credibility will be supremely important in the Court's decision.

Butner v. U.S., 440 U.S. 48 (1978)

I. Issue

Are property rights determined by state law or substantive federal law?

II. Facts

Golden Enterprises, Inc. filed a petition for arrangement under Chapter XI of the Bankruptcy Act. The court approved a plan that, in relevant part, consolidated numerous liens on Golden-owned real estate located in North Carolina. As a result, Butner acquired a second mortgage securing a $360,000 debt, but he did not obtain an assignment of rents generated by the property nor any express security interest in them. Upon Golden's motion, the court appointed an agent to collect rents and make disbursements authorized by the court.

The court did not confirm the arrangement plan, Golden was adjudicated a bankrupt, and a trustee was appointed. At that time, the first and second mortgages were in default, and the trustee was directed to collect and hold all rents subject to further orders from the court. Butner ultimately purchased the property via a credit bid leaving an indebtedness of $186,000. As of the date of the sale, the trustee held $169,971.32 in collected rents.

Butner filed a motion claiming a security interest in the rents and seeking application of those funds to the remaining indebtedness secured by the second mortgage he held. The bankruptcy judge held the amount owed to Butner was an unsecured claim and denied the motion. The district court reversed holding that, under North Carolina law, a change in possession of the mortgaged property gives a mortgage holder an interest in the rents and the appointment of the agent by the bankruptcy court was equivalent to a change in possession. The Fourth Circuit Court of Appeals reversed upon finding that Butner's failure to request a sequestration of rents or the appointment of a receiver during the bankruptcy meant he did not take the action necessary to provide an interest in the rents under North Carolina law. The Supreme Court granted certiorari to address a circuit split. The Third and Seventh Circuits adopted a federal rule of equity that grants mortgagees an interest in rents even if state law did not. The Second, Fourth, Sixth, Eighth, and Ninth Circuits applied state law to determine whether a mortgage interest in real property could extend to rents.

III. Holding

In a unanimous decision, the Supreme Court rejected the federal rule of equity used in the Third and Seventh Circuits. In doing so, Justice Stevens wrote:

> Property interests are created and defined by state law. Unless some federal interest requires a difference result, there is no reason why such interests should be analyzed differently simply because an interested party is involved in a bankruptcy proceeding.

The Supreme Court summarized the practical basis for the holding. It noted that "uniform treatment of property interests" by all courts within a state reduces uncertainty, discourages forum shopping, and prevents a party from receiving a windfall due to a bankruptcy filing.

While acknowledging the importance of a bankruptcy court's equitable powers, the Supreme Court cautioned against the creation of a general rule without either a statutory basis or a specific federal interest.

> The equity powers of the bankruptcy court play an important part in the administration of bankrupt estates in countless situations in which the judge is required to deal with particular, individualized problems. But undefined considerations of equity provide no basis for adoption of a uniform federal rule affording mortgagees an automatic interest in the rents as soon as the mortgagor is declared bankrupt.

IV. Significance

It is difficult to understate the importance of *Butner*. Of primary significance, *Butner* provides the starting point for property-related questions in the context of a bankruptcy case: state law. And without federal law that provides to the contrary or a compelling interest, applicable state law controls. Property interests are front and center in every bankruptcy case, so whether cited or even expressly considered, *Butner* is likewise front and center in every bankruptcy case. Because "property" is of fundamental importance in bankruptcy, *Butner* attempts to promote uniformity between bankruptcy and state courts and thereby discourage forum shopping and windfalls. Consistency is important; a higher degree of certainty often results in a more efficient, accessible system. By determining property rights by reference to state law, subject to the exceptions that are often widely known, the forum may change, but the bargained-for rights and relationships to assets will largely remain the same.

Of much lesser significance, *Butner* also addresses the equitable power of bankruptcy courts, at least under the Bankruptcy Act of 1898, but in a way that remains instructive. While acknowledging the importance—perhaps even the necessity—of a bankruptcy court's equitable powers, the Supreme Court would not allow equity to serve as a basis for a uniform rule the way some lower courts had. *Butner* stands for the proposition that equitable powers should address particularized issues and situations. Effectively, the Supreme Court suggested that equitable powers are to be used as a scalpel, not a hatchet.

Law v. Siegel, 571 U.S. 415 (2014)

I. Issue

May exempt assets be surcharged to pay administrative expenses incurred as a result of the debtor's misconduct?

II. Facts

Stephen Law filed Chapter 7 bankruptcy in 2004, and the only significant asset of the bankruptcy estate was his home. The Debtor's schedules valued the home at $363,348, and, pursuant to 11 U.S.C. § 522, the Debtor claimed the $75,000 California homestead exemption. His schedules also reported that the home was subject to two voluntary notes and deeds of trust: one in favor of a bank for approximately $147,000; the other in favor of "Lin's Mortgage & Associates" for approximately $156,000. Thus, according to the schedules, the sum of the two liens exceeded the house's nonexempt value and there was no equity left in the home. The Chapter 7 Trustee subsequently filed an adversary proceeding challenging the validity of the lien in favor of Lin's Mortgage & Associates.

The deed of trust supporting this lien was recorded by the Debtor himself in 1999 and purportedly evidenced a debt owed to "Lili Lin." Two different individuals claiming to be Lili Lin responded to the Trustee's adversary complaint: one, a former acquaintance of the Debtor who denied ever having loaned him money and disclaimed any interest in the property; the second "Lili Lin" claimed to be the true beneficiary of this deed of trust. Despite supposedly living in China and speaking no English, this "Lili Lin" managed to engage in more than five years of extensive and costly litigation contesting the Trustee's avoidance of the deed of trust and the subsequent sale of the home. However, in 2009, the bankruptcy court entered an order finding that "the loan was a fiction, meant to preserve Law's equity in his residence beyond what he was entitled to exempt by perpetrating a fraud on his creditors and the court." As to the alleged existence of the "Lili Lin," the court determined that the Debtor himself had "authored, signed, and filed some or all of the papers" which ostensibly came from Lili Lin in China.

The Trustee had incurred more than $500,000 in attorneys' fees during this litigation. Based on the Debtor's fraudulent misrepresentations, the court granted the Trustee's motion to surcharge the entirety of the Debtor's $75,000 homestead exemption and made those funds available to defray his attorney's fees. Both the Ninth Circuit Bankruptcy Appellate Panel and the Ninth Circuit Court of Appeals affirmed.

III. Holding

In a unanimous decision, the Supreme Court held that the bankruptcy court's surcharge was unauthorized because it directly violated the provisions of Section 522. Pursuant to applicable state laws, Section 522(b)(3)(A) entitled the Debtor to exempt $75,000 of equity in his home from the bankruptcy estate. Section 522(k) establishes that the $75,000 exemption is "not liable for payment of any administrative expense." The attorneys' fees the trustee incurred in defeating the fraudulent lien were clearly an administrative expense. The Court emphasized that "while § 105(a) confers authority to 'carry out' the provisions of the Code, it is impossible to do that by taking

action that the Code prohibits.” Thus, the Supreme Court held that the bankruptcy court exceeded its authority under Section 105(a) and violated Section 522’s express terms when it ordered the surcharge of the debtor’s homestead exemption.

According to the Supreme Court, Section 105(a) does not give bankruptcy courts the discretion to grant or withhold exemptions based on whatever considerations they deem appropriate. “A debtor need not invoke an exemption to which the statute entitles him; but if he does, the court may not refuse to honor the exemption, absent a valid statutory basis for doing so.” The Court noted that there is “ample authority to deny the dishonest debtor a discharge” as well as authority to "impose sanctions for bad-faith litigation conduct" or criminal prosecution for fraudulent conduct in a bankruptcy case. However, “whatever other sanctions a court may impose on a dishonest debtor, it may not contravene express provisions of the Code by ordering that the debtor’s exempt property be used to pay debts and expenses for which that property is not liable under the Code.”

IV. Significance

The application of *Siegel* is interesting, particularly as to its effect on bankruptcy courts who have the same toolbox to deal with huge and small cases, involving sophisticated and unsophisticated parties, and often concerning wildly different competing interests and underlying facts. Against this backdrop, bankruptcy courts used their equitable powers—via Section 105(a) or otherwise—to fashion appropriate relief when the Bankruptcy Code did not expressly do so. However, many have interpreted *Law v. Siegel* as limiting authority under Section 105(a) for any sort of remedy that is not set out in the Bankruptcy Code, which implies that what is *not* in the Bankruptcy Code is necessarily meant to be excluded. While Section 105(a) may be used to amplify existing code provisions as a bankruptcy judge deems warranted, that judge will have less flexibility and creativity to tailor remedies to further the overarching goals of bankruptcy, which can be particularly necessary given the great variety of cases and parties in interest.