BANKRUPTCY—EXEMPTIONS: WHEN AN INTERESTED PARTY MUST OBJECT, AND EXEMPTING PROPERTY WITH THE INTENTION OF RETAINING POSSESSION

Schwab v. Reilly, 130 S. Ct. 2652 (2010)

ABSTRACT

In *Schwab v. Reilly*, the United States Supreme Court partially frustrated the primary purpose of bankruptcy by making it more difficult for the debtor to exempt property itself, rather than a liquidated interest in that property. The Supreme Court held that when a debtor lists the value of the property the debtor wishes to exempt as equal to the fair market value of the property as listed on the debtor's schedules, the debtor has not effectively exempted the property itself, but rather only an interest in the property up to the value the debtor has listed on his or her schedule. The debtor must list the value of the exemptible property as "100% of FMV" or use similar language in order to put the trustee on notice the debtor intends to keep the property. Because this method is not standard practice, there will be several rather large problems in the interim until this practice becomes more well-known.

I. FACTS

Nadejda Reilly filed for Chapter 7 bankruptcy after the catering business she owned failed.[1] In support of her petition, Reilly filed a list of her assets on a Schedule B and a list of the property she wished to exempt from the bankruptcy estate on a Schedule C.[2] On Schedule B, Reilly listed assets she described as "business equipment," which she valued at $10,718.[3] The list of assets included various items of kitchen and cooking equipment,

1. Schwab v. Reilly, 130 S. Ct. 2652, 2657 (2010).
2. *Id.*
3. *Id.*

which Reilly used in the operation of her business, and the estimated values of each item.[4]

Schedule C contained the various exemptions Reilly claimed for her property.[5] Among the exemptions were two separate claims of exemption in the kitchen and cooking equipment in her attached list to Schedule B.[6] Pursuant to 11 U.S.C. § 522(d)(6), Reilly claimed a "tools of the trade" exemption permitting her to exempt an "aggregate interest, not to exceed $1850 in value, in any implements, professional books, or tools, of [the] trade."[7] Reilly claimed the full "tools of the trade" exemption, $1850, in the items listed as "business equipment" on her schedules.[8] She then claimed the rest of the value of her equipment, $8868, as a "wildcard exemption" pursuant to § 522(d)(5).[9] The wildcard exemption allows the debtor to exempt "interest in any property," up to $10,225 in value.[10]

Prior to the meeting of the creditors, William Schwab, the trustee appointed to Reilly's case, inquired with an auctioneer as to the value of the kitchen and cooking equipment.[11] The auctioneer informed Schwab the equipment may have been worth as much as $17,000, much more than Reilly's estimate of the value of the equipment.[12] At the meeting of the creditors, held on June 22, 2005, Schwab informed Reilly he intended to auction the equipment to retrieve any excess value in it beyond her exemptions.[13] Reilly responded she would rather dismiss her bankruptcy case than lose her cooking equipment.[14] Reilly subsequently moved to dismiss her bankruptcy petition on June 29, 2005.[15] Schwab did not object to Reilly's exemptions, and, before the court ruled on Reilly's motion to dismiss, filed a motion to sell the equipment on August 10, 2005.[16] Reilly

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4. *Id.*

5. *Id.*

6. *Id.*

7. *Id.*; *see also* 11 U.S.C. § 522(d)(6) (2006). Reilly filed her bankruptcy petition in 2005. Brief for Respondent at 5, *Schwab*, 130 S. Ct. 2652 (No. 08-538). The amount which can be exempted under this statute was subsequently adjusted in 2007 and again in 2010 to the current level of $2175. *See* 11 U.S.C. § 104 (Supp. 2009).

8. *Schwab*, 130 S. Ct. at 2657.

9. *Id.*

10. *Id.*; *see also* 11 U.S.C. § 522(d)(5). This value has also been adjusted pursuant to 11 U.S.C. § 104. *See Schwab*, 130 S. Ct. at 2657 n.1.

11. Brief for Petitioner at 15, *Schwab*, 130 S. Ct. 2652 (No. 08-538).

12. *Id.*

13. *Id.*

14. Brief for Respondent, *supra* note 7, at 11. The equipment held sentimental value for the debtor because it had been purchased for her by her parents. *Id.* at 11-12. In addition, the debtor stated she wished to continue with her catering business post-bankruptcy, which would be impossible without the equipment. *Id.* at 12.

15. *Id.* at 11.

16. Brief for Petitioner, *supra* note 11, at 16.

then claimed because she equated the value of the exemption on Schedule C to the value of the equipment listed on Schedule B, she put the trustee on notice that she intended to exempt the equipment itself, not just the value listed on Schedule C.[17] She argued because no party in interest objected to her exemption within thirty days, as required by Rule 4003(b) of the Federal Rules of Bankruptcy Procedure, the equipment became fully exempt regardless of its value.[18] Schwab argued he was not required to object because the amounts listed were clearly within statutory limits and the exemption of her interest at those values was proper.[19] The bankruptcy court denied Schwab's motion to sell the equipment and also denied Reilly's motion to dismiss the bankruptcy case.[20] Schwab appealed to the district court, which rejected his claims, and the Third Circuit Court of Appeals affirmed.[21]

II. LEGAL BACKGROUND

Bankruptcy has a long and complex history and touches nearly every corner of society.[22] The Bankruptcy Clause of the United States Constitution, contained in Article 1, section 8, gives Congress the power to create "uniform laws on the subject of Bankruptcies throughout the United States."[23] James Madison wrote in 1788, regarding the Bankruptcy Clause, that "bankruptcy is so intimately connected with the regulation of commerce . . . that the expediency of it seems not likely to be drawn into question."[24] First, this section briefly discusses the history of bankruptcy and its modern evolution.[25] Then, it considers the subject of modern bankruptcy discharge and its purposes.[26] Finally, this section addresses exemptions and objecting to exemptions.[27]

17. Schwab v. Reilly, 130 S. Ct. 2652, 2658 (2010).
18. *Id.*
19. *Id.* at 2659.
20. *Id.*
21. *Id.*
22. Charles Jordan Tabb, *The Historical Evolution of the Bankruptcy Discharge*, 65 AM. BANKR. L.J. 325, 325 (1991).
23. U.S. CONST. art. I, § 8, cl. 4.
24. The FEDERALIST NO. 42 (James Madison).
25. *See infra* Part II.A.
26. *See infra* Part II.B.1.
27. *See infra* Part II.B.2.

A. THE HISTORY OF BANKRUPTCY: FROM BRUTAL ENDS TO FRESH STARTS

The concept and focus of bankruptcy has changed dramatically since its most primitive forms.[28] Reviewing bankruptcy's history is key to understanding how modern bankruptcy protections work and how those protections shield debtors.[29] This section first describes early forms of bankruptcy and attitudes toward debtors.[30] Next, this section discusses early English bankruptcy law as the foundation for American bankruptcy law, including the concept of discharge.[31] Finally, this section examines the evolution of both American law since the Constitution and the concept of discharge.[32]

1. *Ancient Bankruptcy*

Historically, bankruptcy was a "ghastly evil," an unthinkable slight in early commerce.[33] Bankruptcy laws were severe and entirely unconcerned with the welfare of the debtor.[34] In early Rome, the "Twelve Tables of Roman Law" allowed creditors to enslave a debtor if the debtor defaulted, or, if the debtor had many creditors, to divide the debtor's body into pieces and distribute to the creditors in proportion to the amount owed each of them.[35] Medieval Europe permitted a debtor to avoid imprisonment for bankruptcy if the debtor allowed all of the debtor's possessions to be taken by the creditors "amidst shame."[36] "Shame" meant very public sanctions upon the debtor, which took various humiliating and almost absurd forms.[37] For example, in Italy, a debtor was made to walk nude into the public square and strike his backside against "The Rock of Shame" three times while crying "I declare bankruptcy."[38] French bankrupts, upon defaulting, were made to wear the "*bonnet vert*," a green cap announcing, to the

28. Charles Jordan Tabb, *The History of Bankruptcy Laws in the United States*, 3 AM. BANKR. INST. L. REV. 5, 5 (1995).

29. *See generally id.* (suggesting Congress should seriously consider the long history of bankruptcy law before taking radical action to reform the bankruptcy system).

30. *See infra* Part II.A.1.

31. *See infra* Part II.A.2.

32. *See infra* Part II.A.3.

33. James Q. Whitman, *The Moral Menace of Roman Law and the Making of Commerce: Some Dutch Evidence*, 105 YALE L.J. 1841, 1871 (1996).

34. *See* Vern Countryman, *Bankruptcy and the Individual Debtor—and a Modest Proposal to Return to the Seventeenth Century*, 32 CATH. U. L. REV. 809, 810 (1983).

35. *Id.* at 809-10; *see also* 2 WILLIAM BLACKSTONE, COMMENTARIES *472.

36. Whitman, *supra* note 33, at 1873.

37. *Id.*

38. *Id.* Many times, the debtor was also banished after this humiliating ceremony. *Id.* at 1874.

debtor's humiliation, that the debtor had declared bankruptcy.[39] As a leading bankruptcy scholar stated, "History's annals are replete with tales of draconian treatment of debtors."[40]

2. *Early English Law: Laying the Foundations of Discharge*

Similar to medieval and ancient laws of bankruptcy, early English bankruptcy law was singularly concerned with the rights of the creditor.[41] "Protecting creditors protected commerce, and commerce was king."[42] Early English bankruptcy laws, the first of which was enacted in 1542, were created exclusively for the benefit of creditors.[43] The first bankruptcy laws were enacted to keep creditors from fighting over assets, not to provide rights to the debtor.[44] The "[r]elief was not *for* debtors, but *from* debtors."[45]

Creditors forced bankruptcy upon debtors in an entirely involuntary proceeding.[46] Debtors were considered "offenders," and the laws enacted in 1542 and 1570 still threatened the imprisonment of debtors.[47] The foundation of modern liquidation proceedings could be seen in this process, though.[48] The debtor's assets were sold and distributed pro rata to the creditors in a similar fashion to a liquidation case today.[49] Even after this distribution, there was no discharge of the debt.[50] "[C]reditors were free after bankruptcy to continue to pursue individual collection remedies against the debtor."[51] The laws of 1542 and 1570 would continue to be the standard for nearly 150 years, with changes only strengthening the ability of creditors to collect.[52]

The origins of the discharge of debt in bankruptcy came in 1705, when England passed a statute allowing debtors a discharge if they were cooperative in the distribution of their assets.[53] This statute was passed not out of good will to the debtor, but in an effort to increase the amounts collected and the ease of collection from the debtor in bankruptcy by encouraging

39. *Id.*
40. *Id.*
41. Tabb, *supra* note 22, at 327.
42. *Id.*
43. *Id.* at 329.
44. *Id.*
45. Tabb, *supra* note 28, at 8.
46. *Id.*
47. Tabb, *supra* note 22, at 329.
48. Tabb, *supra* note 28, at 8.
49. *Id.*
50. *Id.*
51. *Id.*
52. Tabb, *supra* note 22, at 331-32.
53. *Id.* at 333.

debtors to refrain from concealing assets and engaging in other fraud in order to hinder their creditors.[54] Under the Statute of 4 Anne, honest but unfortunate debtors who cooperated in the administration of their estate could receive a discharge of their debts if the commissioners, a position similar to that of the modern trustee, certified the debtor had conformed to the requirements of the bankruptcy proceeding.[55] The power of the commissioner to grant a discharge was mitigated the very next year by passage of an act requiring creditors' consent to grant the debtor discharge.[56] The requirement of creditors' consent seriously hampered the debtor's ability to obtain a discharge.[57]

The 1705 acts also created the precursors to the modern concept of the exemption.[58] The debtor was allowed to keep necessary clothing for his family.[59] In addition, the debtor was granted an allowance out of the estate, which could not exceed 200 pounds and was contingent on the creditors receiving a certain percentage of the estate after administrative costs.[60]

3. *Bankruptcy in America: The Debtor Sees Relief*

It is quite likely the Framers of the U.S. Constitution had the British bankruptcy system in mind when formulating the Bankruptcy Clause.[61] James Madison believed bankruptcy was such an important force in commerce that it should be addressed on a national level.[62] Congress sparsely used the Bankruptcy Clause and never successfully created a national bankruptcy system in the first hundred years of the nation's existence,[63] despite being granted the incredibly broad power to pass uniform laws concerning bankruptcy.[64]

Finally, in 1898, a permanent Bankruptcy Act was passed.[65] This Act provided the basis for modern American thought about bankruptcy.[66] Most significantly, the Bankruptcy Act of 1898 formed a marked change in

54. *Id.*
55. Tabb, *supra* note 28, at 11.
56. *Id.*
57. *Id.*
58. Vern Countryman, *A History of American Bankruptcy Law*, 81 COM. L.J. 226, 227 (1976).
59. *Id.*
60. *Id.*
61. Tabb, *supra* note 22, at 326.
62. Tabb, *supra* note 28, at 13.
63. *Id.*
64. U.S. CONST. art. I, § 8, cl. 4.
65. *Id.* at 23.
66. Tabb, *supra* note 22, at 364.

attitude toward discharge of debt.[67] The Act specifically and unequivocally rejected the notion that discharge is conditioned on the assent of creditors.[68] Discharge was automatically granted unless the debtor acted dishonestly in his or her bankruptcy.[69] Creditors were not required to collect a certain amount before the debtor could obtain a discharge.[70] As the committee report for the bill noted, "The granting or withholding of [discharge] is dependent upon the honesty of the man, not upon the value of his estate."[71] Unless the debtor committed certain dishonest infractions prohibited in the Act, the debtor would obtain a discharge.[72]

Exemption laws, which were originally used in the eighteenth century as an incentive for debtors to cooperate in the bankruptcy,[73] had also come full circle through a slow evolution of humanitarian laws enacted in the individual states.[74] The most important evolution, though, was the substance of the exemption laws.[75] First, there were exemptions for clothes.[76] Next came exemptions for tools of the trade and homesteads, and, finally, exemptions for household items.[77] These exemptions held a dual purpose that still rings true today: helping the debtor emerge as a productive member of society and protecting the debtor and his family from abject poverty.[78]

It is vitally important to see the distinction between the purpose of bankruptcy law historically and the purpose of bankruptcy in the United States today. As Professor Seligson wrote:

> [T]he attitude towards and the treatment of delinquent debtors have been subjected to significant changes since the days of torture and slavery under the Roman law and the days of pillory and imprisonment under English law. The enlightened approach of today is to give the unfortunate but honest debtor an opportunity to

67. *Id.* at 363.

68. *Id.* at 364.

69. *Id.* According to the committee report, a debtor acts dishonestly "by committing certain acts forbidden in the bill." *Id.* (quoting H.R. REP. NO. 55-65, at 43 (1897)).

70. *Id.*

71. *Id.* (quoting H.R. REP. NO. 55-65, at 43 (1897)).

72. *Id.* at 366.

73. *Id.* at 341.

74. William J. Woodward, Jr., *Exemption, Opting Out, and Bankruptcy Reform*, 43 OHIO ST. L.J. 335, 337-38 (1982).

75. *Id.* at 338.

76. Countryman, *supra* note 58, at 228.

77. Woodward, *supra* note 74, at 337-38.

78. *Id.* at 337.

> free himself from the burden of debt. The Bankruptcy Act treats the delinquent debtor with compassionate regard.[79]

American law's sharp move from a pro-creditor to a pro-debtor stance signals the attitude that the United States has toward the bankrupt.[80] Excessive debt is no longer a crime, but an unfortunate turn of events.[81] The bankrupt is not in need of punishment, but in need of revival.[82]

B. A FRESH START: CURRENT BANKRUPTCY LAW IN THE UNITED STATES

The two most important concepts to a debtor's fresh start in American bankruptcy law are the concepts of discharge and exemption. This section considers these issues in turn. First, this section discusses discharge and objections to discharge. Next, this section focuses on exemptions and objections to exemptions.

1. *Discharge: A Fresh Start*

Discharge is the most basic and overarching concept of American bankruptcy and is what provides the debtor with a new financial life, more commonly known as a "fresh start."[83] In Chapter 7 bankruptcy, § 727(a) instructs that the court "shall" grant discharge to the debtor,[84] and § 524(a) describes how discharge is achieved.[85]

First, § 524(a)(1) voids any judgment that was obtained against the debtor in the determination of his debts prior to filing bankruptcy.[86] Therefore, if a creditor obtained a judgment against the debtor in a state court, the minute the debtor's discharge is granted, that judgment would have no effect against the debtor personally.[87] The creditor would have no right to levy upon any of the debtor's property or to pursue the debtor any further in collection of the judgment.[88]

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79. Charles Seligson, *Major Problems for Consideration by the Commission on the Bankruptcy Laws of the United States*, 45 AM. BANKR. L.J. 73, 78 (1971).

80. Tabb, *supra* note 22, at 370.

81. *Id.* at 364-65.

82. *Id.*

83. 1 COLLIER ON BANKRUPTCY ¶ 1.01[1], at 1-4 (Alan N. Resnick & Henry J. Sommer eds., 16th ed. 2010).

84. 11 U.S.C. § 727(a) (2006).

85. *Id.* § 524(a).

86. *Id.* § 524(a)(1). Note the statute voids any personal liability of the debtor for judgments against the debtor. Judgments against the property of the debtor are not affected by the discharge. 4 COLLIER ON BANKRUPTCY ¶ 524.02[1], at 524-20 (Alan N. Resnick & Henry J. Sommer eds., 16th ed. 2010).

87. 4 COLLIER ON BANKRUPTCY, *supra* note 86.

88. *Id.*

Second, § 524(a)(2) to (3) enjoins creditors from pursuing or continuing to pursue prosecution of any debt owed to them by the debtor.[89] This means the creditor cannot begin any action, whether it be a lawsuit or any other action, to collect the debt from the debtor.[90] Because the creditors cannot enforce a judgment against the debtor and cannot prosecute or continue to prosecute any debts after the discharge, the bankruptcy proceeding is the creditor's only remedy.[91] Any violation of these sections is considered contempt of court.[92]

Before 1978, although the bankruptcy court determined whether the debtor had the right to discharge, the effects of that discharge were left up to the forum state.[93] Debtors during this period faced multiple state lawsuits from creditors after receiving a discharge from the bankruptcy court.[94] At that time, discharge was not an automatic injunction to state court actions, but rather an affirmative defense to the action.[95] The debtor, who had just lost all but the bare essentials, paid a filing fee, paid his or her attorney's fee, and had no money left to defend the lawsuits.[96] Thus, the creditors would receive default judgments against the debtor and would levy on the property the debtor had claimed as exempt.[97] The modern system enjoining the prosecution or enforcement of these lawsuits serves to protect the debtor from ongoing prosecution of discharged debts.[98]

The only condition upon the debtor's discharge is that the debtor does not violate any of the exceptions detailed in § 727.[99] Most of these exceptions involve fraud, usually an attempt by the debtor to conceal assets or debt so the creditors receive fewer assets.[100] To deny the debtor discharge based on a § 727 exception, a party in interest, either the trustee or a creditor, may object to the discharge and state the grounds for denial of the discharge.[101] This burden reflects the ultimate principle behind modern

89. 11 U.S.C. § 524(a)(2)-(3).

90. 4 COLLIER ON BANKRUPTCY, *supra* note 86, ¶ 524.02[2][a], at 524-21.

91. *Id.* at 524-22.

92. *Id.*

93. *Hearing on S.J. Res. 100 Before the Subcomm. on Bankr. of the S. Comm. on the Judiciary*, 90th Cong. 22 (1968) [hereinafter *Hearing on S.J. Res. 100*].

94. *Id.*

95. 1 COLLIER ON BANKRUPTCY, *supra* note 83, ¶ 20.01[2][d], at 20-10.

96. *Hearing on S.J. Res. 100*, *supra* note 93, at 22.

97. *Id.*

98. 4 COLLIER ON BANKRUPTCY, *supra* note 86, ¶ 524.02[2][a], at 524-21.

99. 11 U.S.C. § 727(a) (2006).

100. *See id.* § 727(a)(1)-(12) (describing exceptions that do not grant discharge to a debtor due to fraud).

101. *Id.* § 727(c)(1)-(2).

discharge: that an honest debtor will receive his discharge unless a party in interest proves the debtor has acted dishonestly.[102]

2. *Exemptions: Something upon Which to Build*

At the outset of a Chapter 7 bankruptcy, all of the debtor's assets become property of the estate.[103] Some of the property in the estate may then be reclaimed by the debtor as exempt.[104] Essentially, the debtor may set aside some property and keep it from the claims of creditors.[105]

The purpose of exemptions is undoubtedly clear: "to provide [the debtor] with the basic necessities of life so that even if his creditors levy on all of his nonexempt property, the debtor will not be left destitute and a public charge."[106] In other words, the debtor is allowed to retain enough possessions to begin life anew.[107] Since 1978, federal bankruptcy law has allowed the individual states to choose between allowing the debtor to use the federal exemptions or to opt-out and only allow the debtor to use the exemptions provided for in state law.[108] The exemptions the debtor can take and how much property he or she can exempt vary significantly from state to state.[109] Because the way a debtor exempts property in bankruptcy is unaffected by the substance of the exemptions, whether supplied by state or federal law, *Schwab v. Reilly* has a universal effect on the process of exemption.[110]

Under § 522(1), a debtor must file a list of property the debtor claims as exempt.[111] Rule 4003(a) of the Federal Rules of Bankruptcy Procedure requires the debtor file this list as part of his or her schedule of assets required by Rule 1007(b)(1)(A).[112] Official Form 6 contains a Schedule C, on which the debtor is required to list the property he or she is claiming as exempt.[113] Schedule C instructs the debtor to: describe the property, specify the law "authorizing" the exemption, and give the value of the exemption along with the current market value of the property without

102. Tabb, *supra* note 22, at 365-66.
103. Schwab v. Reilly, 130 S. Ct. 2652, 2657 (2010).
104. *Id.*
105. 4 COLLIER ON BANKRUPTCY, *supra* note 86, ¶ 522.01, at 522-14.
106. H.R. REP. NO. 95-595, at 126 (1978).
107. *Id.*
108. 11 U.S.C. § 522(b)(2) (2010).
109. 4 COLLIER ON BANKRUPTCY, *supra* note 86, ¶ 522.02[2], at 522-17.
110. FED. R. BANKR. P. 4003(a).
111. *Id.*
112. FED. R. BANKR. P. 4003(b).
113. FED. R. BANKR. P. form 6.

deduction for the exemption.[114] In other words, the debtor must show the propriety of the exemption by stating which law authorizes it and how the exemption fits within the strictures of that law both categorically and monetarily.[115]

There are several different types of exemptions available to the debtor under § 522, including the general exemption, also known as the "wild card" exemption, and the "implements of trade" exemption.[116] In 2004, the general exemption, as codified in § 522(d)(5), allowed for the exemption of the debtor's interest up to $975 of any of his or her property.[117] In addition, the general exemption allowed the debtor to add to its limit any unused portion of the homestead exemption up to $9250.[118] Thus, the maximum value of the "wild card" exemption was $10,225.[119] The wild card exemption "may be applied to any property that is property of the estate . . . ."[120] The primary purpose of this exemption is to allow the debtor greater flexibility in the use of other exemptions, as well as preventing discrimination against nonhomeowners by allowing them to use a large portion of the homestead exemption for personal property.[121]

The "implements of trade" exemption allows the debtor to exempt his or her interest in "implements, professional books, or tools, of the trade of the debtor . . . ."[122] The maximum interest exemptible was limited to $1850 in 2004.[123] The reason for this exemption is quite clear: "to help preserve the debtor's means of earning a living."[124]

According to § 522(l), after the debtor has listed exemptions on Schedule C, the property is exempt unless a party in interest timely objects.[125] Timeliness of the objection is determined by Rule 4003(b), which states objections made to a claim of exemption must be made within thirty days after the meeting of the creditors.[126] This limitation is strictly enforced.[127] In *Taylor v. Freeland and Kronz*,[128] the debtor listed a cause of action on a

114. *Id.*
115. 4 COLLIER ON BANKRUPTCY, *supra* note 86, ¶ 522.05[1], at 522-30.
116. 11 U.S.C.A. § 522(d)(1)-(12) (West Supp. 2010).
117. 11 U.S.C. § 522(d)(5) (2006). This amount has been adjusted. *See supra* note 9.
118. 11 U.S.C. § 522(d)(5) (Supp. IV 2004).
119. *Id.*
120. 4 COLLIER ON BANKRUPTCY, *supra* note 86, ¶ 522.09[5], at 522-68.
121. *Id.* at 522-67.
122. 11 U.S.C. § 522(d)(6).
123. *Id.* (Supp. IV 2004).
124. 4 COLLIER ON BANKRUPTCY, *supra* note 86, ¶ 522.09[6], at 522-68.
125. 11 U.S.C. § 522(l) (2006).
126. FED. R. BANKR. P. 4003(b).
127. *Id.*
128. 503 U.S. 638 (1992).

Schedule B list of assets and noted the value of the claim was "unknown."[129] She then listed the proceeds from the cause of action as exempt.[130] The trustee took no action to object to the claim of exemption, and when the debtor received a significant recovery—much higher than the trustee had anticipated—the trustee sought to recover those funds for the estate.[131] In *Taylor,* the U.S. Supreme Court held that, despite the fact the lawsuit was not a proper exemption, the trustee's failure to object in a timely fashion, pursuant to section 522(l) and Rule 4003(b), barred him from challenging the validity of the exemption.[132] The debtor and the trustee agreed the debtor was only entitled to a small amount of the proceeds from the lawsuit, but because the debtor exempted on her schedules all of the proceeds and the trustee failed to object, all of the proceeds became exempt.[133]

III. ANALYSIS

In *Schwab v. Reilly*, Justice Thomas wrote the majority opinion to which Justices Stevens, Scalia, Kennedy, Alito and Sotomayor joined.[134] Justice Ginsburg wrote a dissenting opinion, whereby Chief Justice Roberts and Justice Breyer joined.[135] In reversing the Third Circuit Court of Appeals, the majority held Schwab did not have an obligation to object to a claimed exemption because the exemption was proper on its face and, therefore, his motion to sell Reilly's equipment to recover excess value should have been granted.[136] The dissent argued that because Reilly indicated she intended to exempt the property itself, rather than just an interest in the property, Schwab had an obligation to object and, therefore, his motion to sell should have been denied.[137]

A. THE MAJORITY

First, the Court addressed whether an interested party has an obligation to object under § 522(l) when the code specifies that the debtor is exempting an interest up to a certain amount and the debtor's valuation of the

129. *Taylor*, 503 U.S. at 640.
130. *Id.*
131. *Id.* at 640-41.
132. *Id.* at 641-42.
133. *Id.*
134. Schwab v. Reilly, 130 S. Ct. 2652, 2656 (2010).
135. *Id.*
136. *Id.* at 2661.
137. *Id.* at 2672 (Ginsburg, J., dissenting).

exemption is clearly within those limits.[138] Next, the Court addressed the applicability of *Taylor* and whether it dictated the trustee had an obligation to object to the exemption.[139] Finally, the Court discussed foreseeable ramifications with adopting Reilly's view and explained how a debtor may exempt property itself, rather than an interest in that property.[140]

1. *Whether the Interested Party Must Object*

The majority began its analysis by rejecting the debtor's contention that the controlling language in § 522(l) was the provision stating "property claimed as exempt on [such list] is exempt" unless a party objects.[141] The Court instead pointed to the language of the same subsection, stating the target of the objection must be the "list of property that the debtor claims as exempt under subsection (b)."[142] The Court noted the categories of exemptions Reilly invoked defined the property the debtor may exempt as an "interest" up to a certain dollar amount, not the assets themselves.[143] The Court held Reilly's definition of "property" was grounded in language from Schedule C and dictionary definitions, which were superseded by the Code when they differed.[144] Because Reilly only exempted $10,718 of her interest in her property, not the property itself, Schwab was entitled to sell the property to recover any excess value.[145]

While Reilly argued she put Schwab on notice that she intended to exempt the property itself by equating the exemption value to the market value,[146] the Court decided whether the debtor intended to exempt the property itself was not a consideration the trustee must take into account.[147] The Court concluded Schwab was entitled to evaluate the propriety of the exemption based on three considerations: first, the description of the equipment, to ensure it qualified as property the exemption contemplated; second, the specific Code provisions "governing" each exemption; third, the listed value of the claimed exemption.[148] The market valuation of the property is there purely for the purpose of helping the trustee determine whether there may be excess value in property beyond what the exemptions

138. *Id.* at 2661-62.
139. *Id.* at 2665-67.
140. *Id.* at 2667-68.
141. *Id.* at 2661.
142. *Id.*
143. *Id.* at 2661-62.
144. *Id.* at 2662.
145. *See id.* (implying Schwab was entitled to sell the property to recover any excess value).
146. *Id.* at 2661.
147. *Id.* at 2666.
148. *Id.* at 2663.

allow.[149] Thus, because the value exempted and the type of property exempted was within the statutory guidelines in the exemption invoked, there was nothing warranting an objection.[150] The fact that the value of the exemption was equated to the market value of the property on Schedule C had no effect.[151]

2. Taylor v. Freeland and Kronz

The Court held the court of appeals erred in determining *Taylor* was applicable to *Schwab*.[152] The Court explained, "*Taylor* does not rest on what the debtor 'meant' to exempt." Instead, *Taylor* applies to the face of the claim of the exemption.[153] In *Taylor*, the debtor listed the value of a lawsuit as "unknown" when she claimed it as an exemption.[154] Because an unknown value is not plainly within the limits of the exemption, the trustee had an obligation to object.[155] In other words, the *Taylor* test specifies that if the value claimed as exempt is not plainly within statutory limits, the party in interest has an obligation to object.[156]

The Court explicitly rejected the court of appeals' reading of *Taylor*, which focused on the "unstated premise" that "a debtor who exempts the entire reported value of an asset is claiming the 'full amount,' whatever it turns out to be."[157] The Court gave two reasons for rejecting this premise.[158] First, it explained this would require the Court to expand the definition of "property claimed as exempt" beyond an interest in the property.[159] Second, the Court explained the "universe of information" a party in interest must look to when determining the propriety of an exemption would expand because the party would have to look to inferences on the debtor's bankruptcy forms rather than the facial validity of the exemptions themselves.[160] Thus, the Court took Reilly's claim of exemption at face value, that she exempted a $10,718 interest in her property rather than a certain item of property, and ruled *Taylor* inapplicable.[161]

149. *Id.*
150. *Id.* at 2662.
151. *Id.* at 2661.
152. *Id.* at 2665.
153. *Id.*
154. *Id.*
155. *Id.* at 2666.
156. *Id.*
157. *Id.*
158. *Id.*
159. *Id.* (quoting *In re* Reilly, 534 F.3d 173, 179 (3d Cir. 2008)).
160. *Id.*
161. *Id.* at 2667.

3. *The Ramifications*

Reilly argued her reading of § 522(1) was fundamental to the "goal of giving debtors a fresh start" and preventing interested parties from "sleeping on their rights."[162] The Court disagreed, concluding Reilly's approach "threatens to convert a fresh start into a free pass."[163] The Court reasoned that Congress weighed the negative effect exemption limits have on debtors with the negative effect exemptions have on creditors.[164] The Court then refused to alter this balance by adopting Reilly's approach.[165]

The Court proposed how a debtor may exempt the asset itself if the debtor so desires.[166] The Court suggested doing so "in a manner that makes the scope of the exemption clear."[167] For example, the Court recommended the debtor, instead of giving a value for the exemption, write "full fair market value (FMV)" or "100% of FMV."[168] This demarcation, the Court said, would require the trustee to object to recover any value above the statutory limit for the estate.[169] If the trustee failed to object, the full value of the asset would be exempted.[170]

B. THE DISSENT

The dissent, written by Justice Ginsburg, argued Reilly made it clear she intended to exempt the property itself, not an interest up to $10,718 in the property.[171] The dissent further argued that because no party in interest objected, the property should have been excluded from the estate as exempt.[172] The dissent rejected the Court's holding that the trustee did not have to object to the debtor's valuation of her exemption.[173] The dissent stressed the importance of the current-market valuation of the exempt property and argued the majority stripped the current-market valuation of its usefulness.[174] Justice Ginsburg contended the better holding would have been that a debtor who lists a market value below the monetary cap for the exemption and lists an identical amount as the claimed exemption has

162. *Id.*
163. *Id.*
164. *Id.*
165. *Id.*
166. *Id.* at 2668.
167. *Id.*
168. *Id.*
169. *Id.*
170. *Id.*
171. *Id.*
172. *Id.* at 2672 (Ginsburg, J., dissenting).
173. *Id.*
174. *Id.* at 2673

signaled he or she intends to keep the property itself.[175] An item with a market valuation above the cap signals to the trustee the debtor recognizes he or she cannot shield the property from sale but intends to claim an exemption out of the proceeds.[176] If the trustee fails to file a timely objection, the right to keep the property should be secured to the debtor.[177] Essentially, the dissent held that market valuation is key to determining the propriety of the exemption, and thus Rule 4003(b) should be read to require the party in interest to object to a market valuation the party believes is not proper.[178]

The dissent then asserted that requiring objections to market valuation or exempted property facilitates the primary purpose of the exemptions: giving the debtor a fresh start.[179] Most notably, the objection deadline produces finality in the exemption procedure.[180] The debtor may plan for the future with the "knowledge that the possessions she has exempted in their entirety are hers to keep."[181] Under the majority's holding, the dissent noted, a trustee may at any time during the bankruptcy case, until discharge, gain another opinion on the value of the property, then auction off the property and simply hand the debtor a check for the amount listed on the schedule.[182] This, the dissent opined, severely hampers the debtor's ability to plan for the future, and thus harms the fresh start.[183]

The dissent then addressed three concerns the majority had with reading Rule 4003(b) to require objection to market valuation.[184] First, the Court expressed concern that requiring this objection would greatly increase administrative costs by increasing the number of objections the trustee must make.[185] The dissent disagreed, stating the trustee already had the responsibility of determining market valuation in order to determine whether there was excess value in the property, and applying Rule 4003(b) simply puts a deadline on that process.[186] The dissent pointed out if the trustee needed more than thirty days to assess the market value, the trustee had many options available to extend the deadline.[187] A trustee may obtain an extension

175. *Id.*
176. *Id.*
177. *Id.*
178. *Id.*
179. *Id.* at 2674.
180. *Id.*
181. *Id.*
182. *Id.* at 2674-75.
183. *Id.* at 2674.
184. *Id.* at 2675.
185. *Id.*
186. *Id.*
187. *Id.* at 2676.

from the bankruptcy court for cause or may postpone the conclusion of the meeting of the creditors.[188] Thus, trustees have "ample mechanisms at their disposal to gain the time and information they need to lodge objections to valuation."[189]

Secondly, the dissent disputed the majority's contention the trustee would lack fair notice of the need to object.[190] The dissent stated if a debtor listed identical values for the exemption and the market value, the debtor would have on the face of the schedule "reclaimed the entire asset just as surely as if she had recorded '100% of [market value].'"[191] Justice Ginsburg also stated a debtor completing a Schedule C would think it nonsensical to enter "FMV" when the schedule tells the debtor to enter the dollar value.[192] There would be no way for pro se debtors to know they must ignore the instructions and input the correct warning flags.[193]

Finally, the dissent disputed the majority's contention that requiring objections would give debtors the incentive to undervalue their assets in hopes the trustee would fail to object.[194] As the dissent noted, there are many procedural safeguards to protect against falsifying or lying about information on the schedules, including an oath which makes the debtor liable for perjury and the possibility of denial of discharge under § 727.[195] In addition, the objection procedure itself is designed to be a safeguard against undervaluation, and thus the dissent deemed the majority's fears irrational.[196] Therefore, the dissent would have upheld the Third Circuit's ruling that the property was exempt.[197]

IV. IMPACT

The Court based its holding that the trustee does not need to object to an exemption pursuant to Rule 4003(b) when the value of the exemption and the market value of the property are listed as equal values, based on the conclusion that when a value is listed for an exemption, it can only represent a monetary interest, not a possessory interest.[198] This is contrary to the spirit of the bankruptcy code, the history of our bankruptcy laws, and

188. *Id.*
189. *Id.*
190. *Id.*
191. *Id.*
192. *Id.* at 2677.
193. *Id.*
194. *Id.*
195. *Id.*
196. *Id.*
197. *Id.* at 2678.
198. *Id.* at 2660-61.

the plain purpose of the exemptions themselves. Modern American bankruptcy law has overtly stated a social, rather than a financial, purpose.[199] Bankruptcy's primary goal is revitalization of the debtor through discharge, rather than repayment of the creditors.[200] Each exemption has a particular purpose. For instance, the tools of the trade exemption seeks to allow the debtor to keep property which is useful for the debtor's particular line of work.[201] Allowing the debtor to keep this property aids the debtor in continuing in his or her line of work, therefore becoming a productive member of society who can pay his or her debts again.[202] By the Court's formulation, the trustee always has the right to auction the property because the debtor is only entitled to the amount of money the property represents, not the property itself.[203] But the money is less useful to the debtor than the tools themselves.[204] Therefore, the majority's conclusion that an "interest" only refers to a monetary interest, not a possessory interest, is counter-intuitive to the purpose of the exemptions.

The holding of *Schwab v. Reilly* has a potentially far-reaching impact because the standard practice when completing Schedule C is to list identical values of the exemption and the market value if the debtor intends to exempt the property itself.[205] Certainly, a debtor thinks more about keeping his or her property rather than keeping the money the property is worth. As evidence of this, a popular "how to" book on filing Chapter 7 bankruptcy tells its readers to focus on the property they "really want to keep."[206] Because debtors almost always have property they "really want to keep," the holding of *Schwab v. Reilly* will affect almost every Chapter 7 filing.

First, when the debtor wants to exempt the property itself, he or she must list either "100% of fair market value" or "full fair market value" in the "value of the exemption" column of Schedule C.[207] The consequences if the debtor fails to do so could be disastrous, particularly if the debtor is exempting assets that may change in value. A good example of this is if the debtor decides to use the wildcard exemption and fill up the homestead exemption, using § 522(d)(5), by exempting $10,000 in stock the debtor

199. Tabb, *supra* note 22, at 364-65.

200. *Id.* at 365.

201. 4 COLLIER ON BANKRUPTCY, *supra* note 86, ¶ 522.09[6], at 522-68.

202. *Id.*

203. *Schwab*, 130 S. Ct. at 2661-62.

204. H.R. REP. NO. 95-595, at 6087-88 (1977).

205. 4 COLLIER ON BANKRUPTCY, *supra* note 86, ¶ 522.05[2][c], at 522-37. "Normally, if a debtor lists an asset as having a particular value in the schedules and then exempts that value, the schedules should be read as a claim of exemption for the entire asset . . . ." *Id.*

206. STEPHEN ELIAS, ALBIN RENAUER & ROBIN LEONARD, HOW TO FILE FOR CHAPTER 7 BANKRUPTCY 62 (16th ed. 2009).

207. *Schwab*, 130 S. Ct. at 2668.

owns. The debtor lists $10,000 as the market value of the stock on Schedule C and also lists $10,000 as the value of the exemption. Six months later, before the debtor receives his or her discharge, the company in which the debtor owned the stock releases a revolutionary new product that has the effect of doubling the value of the stock to $20,000. Because the debtor only exempted a $10,000 interest in the stock, the trustee, without objecting, can force the sale of the stock and recover the excess for the estate. If the debtor had listed "100% of fair market value," however, he or she would have been able to keep the stock itself, unless the trustee objected before the end of the thirty-day period.

Until the requirement to write "100% of FMV" or similar language is well-known, its short-term effects could hit debtors very hard, particularly in the homestead exemption.[208] Because houses are another category of property that changes value, debtors may encounter the same situation as the stock example, except this time their house is being sold. In addition, the value of the property is, many times, worth less to the debtor than the property itself.[209] If the property is sold, even if the debtor gets the full current market value, the debtor will not be able to get a comparable possession at the same price, nor will those possessions be as useful.[210] In Reilly's case, if the Trustee sold all of Reilly's equipment, it would be practically impossible for Reilly to carry on in her trade as a caterer. This would entirely frustrate the purpose of the tools of the trade exemption. Therefore, debtors will be impeded in regaining their places as productive members of society. This is of special concern, considering the large number of bankruptcy cases that are filed pro se.[211]

Two things must be done immediately to ensure debtors are aware of this change. Schedule C must be immediately changed to instruct the debtor how to exempt the property if the debtor would like to retain possession, as the debtor will likely want to do. This is of the utmost importance because, as the dissent noted, the holding of *Schwab v. Reilly* will seem nonsensical to a debtor who is completing the schedule.[212] Secondly, attorneys must be careful to advise their clients on how to exempt the whole interest in the property to mitigate any possibility that a debtor's fresh start will be hampered.

208. *See id.* at 2674 (Ginsburg, J., dissenting).
209. H.R. REP. NO. 95-598, at 127 (1978).
210. *Id.*
211. *Schwab*, 130 S. Ct. at 2677.
212. *Id.*

V. CONCLUSION

Bankruptcy law has evolved from the early days of violence and imprisonment.[213] Its intent is now more humanitarian and utilitarian, purposing to give debtors a fresh start and make them productive members of society again.[214] As part of this goal, bankruptcy law has allowed for the discharge of debt and for exemptions of property from the estate to ensure debtors can get back on their feet.[215]

In *Schwab v. Reilly*, the Supreme Court partially frustrated this purpose by making it more difficult for the debtor to exempt the property itself, rather than just a liquidated interest in that property.[216] The Supreme Court's holding that the debtor must write "full fair market value" or a similar phrase in the column for the value of the exemption on Schedule C is neither intuitive from the schedule nor the modus operandi.[217] Thus, if debtors intend to exempt the property itself, they must follow the correct procedure, or it will be possible for debtors to lose their property.[218]

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213. *See* discussion *supra* Part II.
214. *See* discussion *supra* Part II.
215. *See* discussion *supra* Part II.
216. *See* discussion *supra* Part IV.
217. *See* discussion *supra* Part IV.
218. *See* discussion *supra* Part IV.

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