No. 12-1298

IN THE
UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF KANSAS

In re ANTHONY AND MEREDITH LEA
Debtors.

EDWARD J. NAZAR
Trustee-Appellant
— v. —
ANTHONY AND MEREDITH LEA
Debtors-Appellees
and
DEREK SCHMIDT,
Kansas Attorney General, Intervenor-Appellee

ON APPEAL FROM THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF KANSAS

BRIEF OF AMICUS CURIAE NATIONAL ASSOCIATION OF CONSUMER BANKRUPTCY ATTORNEYS IN SUPPORT OF DEBTOR AND SEEKING AFFIRMANCE OF THE BANKRUPTCY COURT'S DECISION

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December 18, 2012

CERTIFICATE OF INTEREST AND
CORPORATE DISCLOSURE STATEMENT

Edward J. Nazar v. Anthony and Meredith Lea – No. 12-1298

Pursuant to Rule 26.1 of the Federal Rules of Appellate Procedure Amicus Curiae the National Association of Consumer Bankruptcy Attorneys makes the following disclosure:

1) For non-governmental corporate parties please list all parent corporations. NONE.

2) For non-governmental corporate parties please list all publicly held companies that hold 10% or more of the party's stock. NONE.

3) If there is a publicly held corporation which is not a party to the proceeding before this Court but which has a financial interest in the outcome of the proceeding, please identify all such parties and specify the nature of the financial interest or interests. NONE.

4) In all bankruptcy appeals counsel for the debtor or trustee of the bankruptcy estate must list: 1) the debtor, if not identified in the case caption; 2) the members of the creditors' committee or the top 20 unsecured creditors; and, 3) any entity not named in the caption which is an active participant in the bankruptcy proceedings. If the debtor or trustee is not participating in the appeal, this information must be provided by appellant.
NOT APPLICABLE.

/s/ Jill A. Michaux
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STATEMENT OF INTEREST

Incorporated in 1992, the National Association of Consumer Bankruptcy Attorneys ("NACBA") is a non-profit organization of more than 4,000 consumer bankruptcy attorneys nationwide. NACBA's corporate purposes include education of the bankruptcy bar and the community at large on the uses and misuses of the consumer bankruptcy process. Additionally, NACBA advocates nationally on issues that cannot adequately be addressed by individual member attorneys. It is the only national association of attorneys organized for the specific purpose of protecting the rights of consumer bankruptcy debtors.

The NACBA membership has a vital interest in the outcome of this case. The Bankruptcy Code permits individual debtors to exempt certain property from the bankruptcy estate pursuant to state law, thereby putting that property beyond the reach of the trustee and creditors. In the bankruptcy context, exemptions serve the overriding purpose of helping the debtor to obtain a fresh start. The trustee has challenged the constitutionality of Kansas' exemption for earned income tax credit in bankruptcy cases. The trustee's argument strikes at the heart of debtors' fresh start by seeking to deny them the benefit of an exemption properly enacted by the State of Kansas and made applicable to debtors by Congress through section 522(b)(3)(A).

ARGUMENT

The debtors in these consolidated appeals claimed exemptions under K.S.A. § 60-2315, a Kansas law that provides:

> An individual debtor under the federal bankruptcy reform act of 1978 (11 U.S.C. § 101 et seq.), may exempt the debtor's right to receive tax credits allowed pursuant to section 32 of the federal internal revenue code of 1986, as amended, and K.S.A. 2011 Supp. 79-32,205, and amendments thereto. An exemption pursuant to this section shall not exceed the maximum credit allowed to the debtor under section 32 of the federal internal revenue code of 1986, as amended, for one tax year. Nothing in this section shall be construed to limit the right of offset, attachment or other process with respect to the earned income tax credit for the payment of child support or spousal maintenance. K.S.A. § 60-2315.

The trustees objected to the exemption and the bankruptcy court denied the objection finding that the exemption statute is constitutional.

I. The Bankruptcy Court Properly Concluded that Kansas' Bankruptcy-Specific Exemption Functions Consistently with Congress's Power to Establish Uniform Bankruptcy Laws.

A. The Uniformity Requirement of the Bankruptcy Clause does not Apply to State Laws

The Bankruptcy Clause grants to Congress the power "[t]o establish . . . uniform Laws on the subject of Bankruptcies throughout the United States." U.S. Const. Art. I, § 8, cl. 4.[1] By its express language, the Bankruptcy Clause refers only to

[1] The Framers of the Constitution included the Bankruptcy Clause to create a "uniform federal response" to the problem raised by the states' conflicting treatment of debtors who had obtained discharge of their debts in one state only to be imprisoned on the basis of those same debts by another state. Central Virginia

Congress's authority to enact uniform bankruptcy laws. As the court below correctly found, the Bankruptcy Clause is inapplicable to state legislation. *See In re McFarland*, 481 B.R. 242 (Bankr. S.D. Ga. 2012) (uniformity requirement "is an affirmative limitation or restriction upon Congress's power, not a limitation on the states' exercise of their own power."); *In re Jones*, 428 B.R. 720, 729 n.9 (Bankr. W.D. Mich. 2010). Nonetheless, the Trustee argues that Congress could not authorize enforcement of the Kansas EIC exemption, K.S.A. § 60-2315, under section 522(b)(3)(A) because to do so would give effect to a bankruptcy law that is not "uniform."

Federal bankruptcy laws are "uniform" when they operate the same way throughout the country even though application of state laws may cause variations in results from state to state. *Vanston Bondholders Protective Committee v. Green*, 329 U.S. 156, --- (1946) (Frankfurter, J, concurrence); *In re Urban*, 375 B.R. 882 (B.A.P. 9th Cir. 2007). The Bankruptcy Clause is not violated by Congress's adoption of state exemptions, whether specific to bankruptcy debtors or applicable to the general population of the state, so long as the federal bankruptcy law operates uniformly.

Nothing in the Clause prohibits the states from legislating in bankruptcy where Congress has left the field open, or where, as here, Congress has specifically deferred to state legislation. *Central Virginia Community College v. Katz*, 546 U.S. 356, 386 n.3 (2006)("the Bankruptcy Clause does not vest exclusive power in Congress, but instead

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Community College v. Katz, 546 U.S. 356, 369 (2006)(discussing Bankruptcy Clause's effect on state sovereign immunity).

leaves an ample role for the States.") (Justice Thomas dissenting). *See also In re Schafer*, 689 F. 3d 601, 606 (6th Cir. 2012)("states [can], in the absence of federal legislation, pass laws on bankruptcy.")(quoting *Hood v. Tennessee Student Assistance Corp.*, 319 F.3d 755, 765 (6th Cir. 2003), *aff'd on other grounds*, 541 U.S. 440 (2004)).

It is well established that Congress may defer to state property laws without compromising its obligation to enact uniform bankruptcy laws. *Comm'r of Internal Rev. v. Stern*, 357 U.S. 39, 45 (1958). In fact, state property laws are frequently incorporated into the federal bankruptcy scheme despite the fact that their inclusion may lead to disparate results from state to state and within states. Courts have routinely found that this disparity does not violate the uniformity requirement. *See e.g. In re Schafer*, 689 F.3d 601, 612 (6th Cir. 2012). *See also Jafari v. Wynn Las Vegas*, 569 F.3d 644, 648 (7th Cir. 2009) (property rights in bankruptcy determined by reference to state law despite resulting lack of uniformity); *Herrin v. GreenTree*-AL, L.L.C., 376 B.R. 316, 321 (S.D. Ala. 2007) (applying state law to determine real property interests subject to modification under 11 U.S.C. § 1322(b)(2) does not violate the Bankruptcy Clause); *In re Simon*, 311 B.R. 641 (Bankr. S.D. Fla. 2004).

Reference to disparate state exemption laws, even those aimed only at bankruptcy debtors, does not violate the uniformity requirement because states have no obligation to create uniformity in their exemption laws under the Bankruptcy Clause.

B. A Bankruptcy Law Is Uniform When it Applies to Defined Classes of Debtors.

Even if state bankruptcy laws were subject to the uniformity requirement of the Bankruptcy Clause, K.S.A. § 60-2315 would pass constitutional muster. Addressing the application of state exemption laws in bankruptcy, the Supreme Court in Hanover National Bank v. Moyses, approved an existing practice under federal law in which bankruptcy debtors could claim the exemptions applicable under the law of the state where they had lived for the greater portion of the preceding six months. 186 U.S. 181, 189-90 (1902). The debtor claimed exemptions under Tennessee law where he was domiciled, rather than under Mississippi law where there was a judgment against him. In validating the reference to state exemptions in federal bankruptcy cases, the Court found that the differences between state exemption laws and the resulting differing outcomes under the federal laws between citizens of different states, did not result in violation of the uniformity requirement because that requirement was "geographical, not personal" and the federal bankruptcy law operated identically throughout the United States. Id.

Two later decisions reflect the post-Hanover evolution of the Supreme Court's standard for determining uniformity under the Bankruptcy Clause. Railway Labor Executive Ass'n v. Gibbons, 455 U.S. 457 (1982); Blanchette v. Connecticut Gen. Ins. Corp., 419 U.S. 102 (1974). In these cases, the Court established that if the bankruptcy law in question applies to debtors differently over a common geographic area, it can

nevertheless withstand constitutional challenge if it treats the debtors differently based upon a reasonable classification.

In *Blanchette.*, the Court addressed a challenge to legislation creating a special insolvency reorganization system for regional railroads. Certain railroads challenged the statute as violating the Bankruptcy Clause's uniformity requirement because it treated debtors differently based on geographic location. The Supreme Court rejected this contention concluding that the bankruptcy laws may designate an "evil to be remedied" and adopt classifications for addressing the problem. 419 U.S. at 160-61 (*quoting The Head Money Cases*, 112 U.S. 580, 594-95 (1884)). Despite disparate geographical impact, legislation may be uniform if the classifications apply to defined parties as necessary to address a particular government objective.

The concept of class uniformity was reinforced in *Gibbons* which is the only case in which the Supreme Court has struck down a bankruptcy statute for failure to comply with the Bankruptcy Clause. In that case Congress enacted the statute in question to regulate labor relations of a single insolvent railroad. Because the statute applied to only one entity it was deemed "nothing more than a private bill," which could not possibly apply uniformly to a class of similarly situated entities. 455 U.S. at 471. In striking down the law, the Court summarized the limited situations in which it was appropriate to invalidate a statute under the Bankruptcy Clause:

> Prior to today, the Court has never invalidated a bankruptcy law for lack of uniformity. The uniformity requirement is not a straightjacket that forbids Congress to distinguish among classes of debtors, nor does it prohibit

> Congress from recognizing that state laws do not treat commercial transactions in a uniform manner.

Id. at 469. Recognizing that lack of geographic uniformity is not fatal to a bankruptcy law the Gibbons Court said, "[t]o survive scrutiny under the Bankruptcy Clause, a law must at least apply uniformly to a defined class of debtors." Id. at 473.

The Sixth Circuit and the Bankruptcy Appellate Panel for the Ninth Circuit have both addressed a Uniformity Clause challenge to bankruptcy-specific exemptions and found the exemptions constitutional. In re Schafer, 689 F.3d 601 (6th Cir. 2012) rev'g 455 B.R. 590 (B.A.P. 6th Cir. 2011); In re Applebaum, 422 B.R. 684 (B.A.P. 9th Cir. 2009). The issue is currently pending before the Tenth Circuit BAP. Williams v. Westby (In re Westby), No. 12-27 (B.A.P. 10th Cir.).

In Schafer, the exemption scheme at issue permitted debtors to choose between the federal exemptions found in section 522(d), Michigan exemptions available to all state residents, or state exemptions available only to those debtors in bankruptcy. Schafer, 689 F.3d at 601. The debtor opted to take a homestead exemption under the state bankruptcy-specific scheme which yielded a significantly greater exemption amount than either of the other two options. Without deciding whether the uniformity requirement applies to state legislation, the court found that the disparity between the non-bankruptcy exemptions and the bankruptcy-specific exemptions did not offend the Uniformity Clause because that clause prohibits a process that is not uniform without regard to whether that process may lead to disparate outcomes. Id. at

611. *See also McFarland*, 481 B.R. 242, 254 ("The Georgia exemption statute applies uniformly to all debtors in bankruptcy, and therefore, I find it is sufficient to pass muster under the Uniformity Clause.").

The *Schafer* court also rejected the argument that, pursuant to dictum in *Hanover*, the Uniformity Clause requires that the trustee in bankruptcy be able to take whatever would have been available to creditors under non-bankruptcy laws. The court said simply, "In [Hanover] the Supreme Court did not hold that a bankruptcy exemption scheme is uniform in the constitutional sense only if the trustee takes in each state whatever would have been available if the bankruptcy law had not been passed." *Id.* at 610. Imposition of that requirement would "call into doubt the constitutionality of the federal exemptions set forth in section 522(d)." *Id.*

The constitutional provision applicable to laws establishing duties and excise taxes, which provides that Congress's power to lay and collect "all Duties and Excises shall be uniform throughout the United States," U.S. Const. Art. 1, sec. 8 cl. 1, generally sets a higher standard for uniformity than the Bankruptcy Clause. *Schultz v. U.S.*, 529 F.3d 343, 355 (6th Cir. 2008). Nonetheless, the Supreme Court has interpreted its uniformity requirement to permit distinctions based on class rather than location. In *United States v. Ptasynski*, the Supreme Court upheld a federal statute creating an oil production excise tax exemption that clearly preferred one geographic area over all others. The Court deferred to Congress's finding that there was a reasonable basis for the classification and that the uniformity clause "does not prevent

Congress from defining the subject of a tax by drawing distinctions between similar classes." 462 U.S. 74, 82 (1983).

Other courts have likewise found that class-wide uniformity satisfies the Bankruptcy Clause. See Matter of Reese, 91 F.3d 37, 39 (7th Cir. 1996) ("[T]he [Bankruptcy] Clause forbids only two things: The first is arbitrary regional differences in the provisions of the Bankruptcy Code. The second is private bankruptcy bills – that is, bankruptcy laws limited to a single debtor – or the equivalent."); Wood v. U.S., 866 F.2d 1367, 1372 (11th Cir. 1989) (the Uniformity Clause "requires that bankruptcy laws apply uniformly among classes of debtors.").; In re Applebaum, 422 B.R. 684, 692 (B.A.P. 9th Cir. 2009) ("The concept of uniformity requires that federal bankruptcy laws apply equally in form (but not necessarily in effect) to all creditors and debtors, or to 'defined classes' of debtors and creditors," (quoting Gibbons, 455 U.S. at 473)); In re Urban, 375 B.R. 882, 890 (B.A.P. 9th Cir. 2007); In re Chandler, 362 B.R. 723, 728-29 (Bankr. N.D. W.Va. 2007) ("Geographical uniformity and class uniformity are separate concepts, and when a law is applied to a specified class of debtors, the uniformity requirement is met, so long as the law applies uniformly to that defined class of debtors."). See also Dan J. Schulman, The Constitution, Interest Groups, and the Requirements of Uniformity: The United States Trustee and the Bankruptcy Administrator Programs. 74 Neb. L. Rev. 91, 105 (1995) ("[T]he Supreme Court has held that debtors may be classified and dealt with differently provided that the bankruptcy statute applies uniformly to a defined class, which class must have more than one

member."). *Compare St. Angelo v. Victoria Farms, Inc.*, 38 F.3d 1525 (9th Cir. 1994) (striking bankruptcy law as non-uniform based on fundamentally arbitrary regional classification).

The Tenth Circuit spoke on the issue over two decades ago. In *In re Kulp*, the court rejected the argument that bankruptcy-only exemptions violate the uniformity clause. In so holding, the court specifically rejected contrary cases stating, "[t]he *In re Mata*, [115 B.R. 288 (Bankr. D. Colo. 1990)] and *In re Lennen*, [71 B.R. 80 (Bankr. N.D. Cal. 1987)] cases confuse the geographical uniformity doctrine with the well-established principle that states may pass laws which do not conflict with the federal scheme. . . . In this case, we have no conflict because 11 U.S.C. § 522 expressly delegates to states the power to create bankruptcy exemptions." *In re Kulp*, 949 F.2d 1106, 1109 n.3. (10th Cir. 1991).

While Amicus does not concede that the Bankruptcy Clause applies to state legislation, even if it did, the Kansas statute at issue here, which applies uniformly to all Kansas debtors in bankruptcy, passes that test.

II. In Enacting K.S.A. § 60-2315 the State Legislature Did Not Exceed its Power Under Section 522(d).

The trustee argues that K.S.A. § 60-2315 exceeds the power Congress delegated to the states in section 522. Citing *In re Cross*, 255 B.R. 25 (Bankr. N.D. Ind. 2000) and *In re Pontius*, 421 B.R. 814 (Bankr. W.D. Mich. 2009), the trustee argues that the opt-out power given to the states in section 522(d) consists of the "power to forbid" use

of federal exemptions rather than the "power to create" bankruptcy-specific exemptions.

Article 1, section 1, of the U.S. Constitution which provides that "all legislative Powers herein granted shall be vested in a Congress of the United States," is not a prohibition against delegation. Iske v. United States, 396 F.2d 28, 31 (10th Cir. 1968). "This Court established long ago that Congress must be permitted to delegate to others at least some authority that it could exercise itself." Loving v. United States, 517 U.S. 748 (1996) (quoting Wayman v. Southard, 10 Wheat. 1, 42 (1825)). There are many areas where, despite Congress' plenary power and a requirement of uniformity, broad freedom is accorded the states to affect federal law. See, e.g., Prudential Insurance Co. v. Benjamin, 328 U.S. 408 (1946)(Congress may permit states to apply tax on out-of-state insurance companies despite Congress' plenary power in the area of taxation and interstate commerce and its regulation of insurance); Phillips v. Commissioner of Internal Revenue, 283 U.S. 589, 602 (1931) ("The extent and incidence of federal taxes not infrequently are affected by differences in state laws; but such variations do not infringe the constitutional prohibitions against delegation of the taxing power or the requirement of geographical uniformity.").

The Hanover Court specifically found that Congress' incorporation of state exemption schemes in bankruptcy was not an unconstitutional delegation of legislative power. Hanover, 186 U.S. at 190 ("Nor can we perceive in the recognition of

the local law in the matter of exemptions, dower, priority of payments, and the like, any attempt by Congress to unlawfully delegate its legislative power.”).

With section 522(b)(3)(A), Congress did not limit the authority of the states to fashion the exemption laws to be recognized in bankruptcy cases and there is no textual or historical support for the insertion of qualifiers into this plain language. Rather, Congress expressly authorized states to use their own exemptions in the context of federal bankruptcy law without limitation as to those exemptions. "Congress has not seen fit to restrict the authority delegated to the states by requiring that state exemptions apply equally to bankruptcy and non-bankruptcy cases," such that "we are without authority to impose such a requirement." Schafer, 689 F.3d at 607 (quoting Sheehan v. Peveich, 574 F.3d 248, 252 (4th Cir. 2009)).

The court in Schafer rejected the strained reading of section 522(b), advanced by the trustees in this case that section 522(b)(3)(A) limits the states to the power to “forbid” rather than the power to “enact” exemptions, finding that this “interpretation misunderstands the concept of concurrent jurisdiction in the area of bankruptcy exemptions, and imputes, without a basis to do so, a limit onto a state's power to act.” Id. at 608. See also In re Shumaker, 124 B.R. 820, 826 (Bankr. D. Mont. 1991)(“Therefore, the underlying premise of Mata and Lennen that it is not permissible for states to seek to enact two different levels of exemptions, one applicable in bankruptcy and one without, simply misstates the applicable

constitutional power of a state to enact bankruptcy laws where Congress has not sought to act.").

The Tenth Circuit has also rejected this arbitrary distinction. In In re Walker, 959 F.2d 894 (10th Cir. 1992), the trustee challenged an Oklahoma exemption statute that permitted the exemption of certain retirement accounts on the basis that the statute exceeded the power Congress had bestowed upon the states in section 522. The Tenth Circuit stated:

> Pursuant to Congress' authority to establish uniform bankruptcy laws, it may delegate to the States the authority to legislate bankruptcy exemptions. Trustee argues that the Oklahoma exemption statute exceeds the scope of this authority, but he cites no persuasive authority from case law or from the structure of legislative history of the current Bankruptcy Act. . . . Congress certainly was aware of the "wide disparity in the type and amount of exemptions allowed by the various states," and by delegating to the states the option to legislate bankruptcy exemptions Congress implicitly acknowledged the disparity.

Id. at 900-01 (citations omitted).

Clearly, there is no limit in section 522(b)(3)(A) or in the Supreme Court's consistent interpretation of Congress' legislative power that limits states to the power to "forbid" and precludes the power to "enact" as the courts in Pontius and Cross found. Indeed, how could Congress "reference" a scheme of state exemptions unless a state has first decided what the scheme of state exemptions to be referenced will be? States have the power to enact and amend their own exemptions, and under section 522(b)(3)(A), Congress unquestionably authorized states to supply the exemption scheme that will be recognized in bankruptcy cases.

The trustees' reliance on the 1920 case of Knickerbocker Ice Co. v. Stewart, 253 U.S. 149 (1920) is unavailing. In that case, the plaintiff sought compensation under New York's Worker's Compensation Law for the death of her husband while working as a bargeman on the Hudson River. In finding that a principle purpose behind the maritime laws was to create uniformity, the Court held that Congress could not allow states to apply their own worker's compensation laws in maritime cases, stating: "since the beginning, federal courts have recognized and applied the rules and principles of maritime law as something distinct from laws of the several states—not derived from or dependent on their will." Id. at 160.

Knickerbocker has been limited in its scope by subsequent congressional enactments and Supreme Court decisions. Askew v. American Waterways Operators, 411 US. 325, 338 (1973) (referring to Knickerbocker as an example of "isolated instances where 'state law must yield to the needs of a uniform federal maritime law'" and acknowledging that there are many instances in which states may legislate in the area of maritime law); Travelers Ins. Co. v. McManigal, 139 F.2d 949 (4th Cir. 1944) (Despite the apparently restrictive holding in Knickerbocker, Congress may make laws placing maritime injuries within jurisdiction of state worker's compensation commission).

In Prudential Insurance Co. v. Benjamin, 328 U.S. 408 (1946), the Court drew a distinction between Congress delegating legislative power to the states and Congress merely incorporating evolving state laws. In that case, the Court upheld a state law that taxed out-of-state insurance companies at greater rates than in-state companies.

Prudential challenged the law, inter alia, as an unconstitutional delegation of legislative power.

The Court rejected this argument stating, "The . . . contention that Congress' 'adoption' of South Carolina's statute amounts to an unconstitutional delegation of Congress' legislative power to the states obviously confuses Congress' power to legislate with its power to consent to state legislation. They are not identical, though exercised in the same formal manner." Prudential, 328 U.S. at 438 n. 51. See also In re Sullivan, 680 F.2d 1131, 1137 (7th Cir. 1982) (applying reasoning in Prudential to uphold bankruptcy-specific exemptions against unconstitutional delegation challenge); Waterfront Comm'n of New York Harbor v. Constr. & Marine Equip. Co., 928 F.Supp. 1388, 1404 (D. N.J. 1996) (citing Prudential for the proposition that "While Congress may not delegate to the states power to legislate in areas that are reserved to Congress, such as interstate Commerce Clause powers, it may by federal legislation, adopt and incorporate by reference, state laws which exist or which may exist in the future".).

Likewise, the courts in Cross and Pontius have confused Congress' power to consent to state legislation in the area of bankruptcy exemptions and its power to legislate. Arguments such as those offered by the Trustees offer inconsistent and illogical views of the congressional power exercised in section 522(b)(3)(A). They essentially write new text into the Bankruptcy Code which allows reference to general state exemption laws while prohibiting reference to bankruptcy-specific exemption laws.

The reach of the federal exclusivity doctrine espoused by the Trustee and the bankruptcy courts in *Cross*, and *Pontius* is extraordinary. If followed consistently, it would disrupt the interplay between state and federal law that is a cornerstone of American bankruptcy practice. The attempt to interject this doctrine into the sphere of bankruptcy exemptions in which deference to state law has a deeply entrenched history is particularly inappropriate.

III. The Bankruptcy Court Properly Concluded That the K.S.A. § 60-2315 Is Not Preempted by Section 522(b)(3)(A) and Does Not Violate the Supremacy Clause.

A. Where Congress Has Explicitly Permitted Reference to State Exemption Laws those Laws Are not Preempted.

The bankruptcy court correctly rejected the trustees' argument that K.S.A. § 60-2315 is preempted.

A state law may violate the Supremacy Clause in one of three ways. "Express preemption" renders a state law unconstitutional when it encroaches on an area in which Congress has explicitly preempted state law. "Field preemption" preempts state laws that fall within a field Congress has evidenced an intent to occupy. "Conflict preemption" applies to state laws that actually conflict with federal law. *Schafer*, 689 F.3d at 614-15. *See also Pacific Gas & Electric Co. v. State Energy Resources Conservation & Development Comm'n*, 461 U.S. 190, 203-04 (1983); *Perez v. Campbell*, 402 U.S. 637, 652 (1971) (state law preempted if it "frustrates the full effectiveness of the federal law."); *Florida Lime & Avocado Growers, Inc. v. Paul*, 373 U.S. 132, 142-43 (1963); *Hines v.*

Davidowitz, 312 U.S. 52, 67 (1941); In re Vasko, 6 B.R. 317, 323 (Bankr D. Ohio 1980) ("The state law must in its effect, obstruct the basic objectives of the federal law."). In keeping with these proscriptions, "[s]tates may not pass or enforce laws to interfere with or complement the Bankruptcy Act or to provide additional or auxiliary regulations." International Shoe, Inc. v. Pinkus, 278 U.S. 261, 265 (1929).

Bankruptcy-specific state exemptions do not fall under any of these three categories of preempted state legislation. Sheehan v. Peveich, 574 F.3d 248 (4th Cir. 2009). Section 522(b)(3)(A) provides that a debtor may exempt from the bankruptcy estate "any property that is exempt under federal law . . . or State or local law that is applicable on the date of the filing of the petition." This provision "allows the States to define what property a debtor may exempt from the bankruptcy estate that will be distributed among his creditors." Owen v. Owen, 500 U.S. 305, 306 (1991).

Although in section 522(b)(3)(B) Congress specified that property held as tenant in the entirety be exempt according to non-bankruptcy law, it did not place similar restriction on the broader opt-out provision of section 522(b)(3)(A). To the contrary, Congress placed no limits on the content of state law exemptions to be recognized in bankruptcy cases. Applebaum, 422 B.R. at 690. Where Congress includes particular language in one section of a statute but omits it from another, it is presumed that Congress acted intentionally. Russello v. United States, 464 U.S. 16, 23 (1983).

Courts have consistently acknowledged that Congress chose not to preempt state law in the area of defining the exemptions to be allowed in bankruptcy cases. Sheehan v. Peveich, 574 F.3d 248 (4th Cir. 2009)("There can be no preemption, however, where Congress 'expressly and concurrently authorizes' state legislation on the subject.");Storer v. French, 58 F.3d 1125, 1128 (6th Cir. 1995); In re Kulp, 949 F.2d 1106, 1109 n.3 (10th Cir. 1991) (no conflict because Congress expressly delegated the power to create bankruptcy exemptions to states); Rhodes v. Stewart, 705 F.2d 159, 163 (6th Cir. 1983) (Congress "vested in the states the ultimate authority to determine their own bankruptcy exemptions"); In re Sullivan, 680 F.2d 1131, 1136 (7th Cir. 1982) ("To apply a preemption analysis in this context is to ignore totally the explicit language of the section 522(b)(1) opt-out provision."); In re Stephens, 402 B.R. 1 (B.A.P. 10th Cir. 2009) ("Rather than preempting the [exemption] area, Congress expressly authorizes the states to 'preempt' the federal legislation.") (internal quotation omitted); McFarland, 481 B.R. 242, 252("Georgia's creation of a bankruptcy exemption statute does not conflict with [section 522] as Congress expressly delegated that power to the States.").

The opt-out provision operates consistently with the Bankruptcy Code's general approach of allowing state law to determine property rights in bankruptcy cases. Butner v. United States, 440 U.S. 48, 54 (1979) ("Congress has generally left the determination of property rights in the assets of a bankruptcy estate to state law."). See also In re Borgman, No. 11-1369 (10th Cir. Oct. 23, 2012)(application of state

exemptions is determined by state law); *Rhodes*, 705 F.2d at 163 (states and the federal government have concurrent jurisdiction in the area of defining exemptions that are to be applied in bankruptcy cases). Since its genesis, the federal bankruptcy construct has incorporated varied state exemption laws. *See Smalley v. Laugenour*, 196 U.S. 93 (1904)(discussing state exemptions in the context of section 6 of the 1878 Bankruptcy Act); *Reese*, 91 F.3d at 39.

Given the range of exemptions that are routinely enforced in bankruptcy cases nationally, it cannot be seriously argued that K.S.A. § 60-2315 actually conflicts with or interferes with the operation of federal bankruptcy laws. *In re Applebaum*, 422 B.R. 684, 691(B.A.P. 9th Cir. 2009) ("There is no conflict between the purposes and goals of the Bankruptcy Code and the California bankruptcy-only exemption statute. Simply because the exemptions differ from the federal exemptions (or from its non-bankruptcy counterpart), does not mean that such differences create a conflict that impedes the accomplishment and execution of the Bankruptcy Code.").

In fact, bankruptcy-specific exemptions may further federal bankruptcy goals. As noted by the Sixth Circuit in *Schafer*, "[b]y permitting debtors in bankruptcy a higher homestead exemption than either the general state exemption statute or the federal exemption statute allow, bankruptcy debtors in Michigan are better able to achieve a fresh start and to obtain 'a new opportunity in life with a clear field for future effort, unhampered by the pressure and discouragement of preexisting debt.'" *Schafer*, 689 F.3d at 616.

Where Congress has specifically authorized the states to act, the prohibition set forth in International Shoe, Inc. v. Pinkus, 278 U.S. 261, 265 (1929), and cited by the trustee in this case is inapplicable. In Pinkus the state statute in question purported to operate as a full-service bankruptcy law, setting out a scheme for liquidation of assets, distribution to creditors, and discharge of debts. The debtor in that case was barred from obtaining a discharge of debts under the federal Bankruptcy Act because he had obtained a federal bankruptcy discharge within the past six years. So the debtor sought relief through the state law. The complementary state law in that case, was not a law that functioned in accordance with federal bankruptcy law, but one that usurped it altogether. This is a far cry from the situation here where state legislators have acted in accordance with federal invitation.

B. There is No Actual Conflict Between K.S.A. § 60-2315 and Federal Law

The trustees also contend that K.S.A. § 60-2315 conflicts with federal law because it alters the balance between creditors and debtors by allowing debtors to withhold assets from creditors that were previously accessible to them. This argument fails for two reasons. First, it proves too much. To say that a state exemption is preempted when it shifts the balance between debtors and creditors would invalidate every state exemption, whether bankruptcy-specific or not, so long as it differed from the federal exemptions. Where Congress enacted legislation for the express purpose of permitting debtors to choose between federal and state exemptions, it would be

absurd to impose a restriction on the state exemptions that they not change the creditor's potential recovery.

Second, as the trustee acknowledges, the underlying principle of bankruptcy is two-fold, to afford debtors a fresh start and to optimize repayment to creditors. Clearly, these two goals often conflict. By allowing the use of state exemptions, Congress has left it to the states to determine how that balance should best be struck. *Schafer*, 689 F.3d at 616 (adopting state bankruptcy-only exemption furthers Congress's goal of providing debtors a fresh start). States that accept this invitation are not obstructing the basic objectives of the federal law; they are furthering those objectives.

In accordance with Congress's clear edict to the contrary, it cannot reasonably be concluded that Congress has preempted state bankruptcy-specific exemption laws.

C. K.S.A. § 60-2315 does not conflict with other provision of the Bankruptcy Code.

The trustee argues that K.S.A. § 60-2315 conflicts with section 544 of the Bankruptcy Code. That section provides in part:

> (a) The trustee shall have, as of the commencement of the case, and without regard to any knowledge of the trustee or of any creditor, the rights and powers of, or may avoid any transfer of property of the debtor or any obligation incurred by the debtor that is voidable by – (2) a creditor that extends credit to the debtor at the time of the commencement of the case, and obtains, at such time and with respect to such credit, an execution against the debtor that is returned unsatisfied at such time, whether or not such a creditor exists.

These "strong arm" powers come into existence upon commencement of the bankruptcy case and extend only to those causes of action possessed by the estate. 5 COLLIER ON BANKRUPTCY ¶ 544.01 (A. Resnick and H. Sommer, eds., 16th ed). "What property belonged to the bankrupt as of the date of bankruptcy, what liens, if any, existed thereon, validity of such liens, order or priority among creditors having liens and other cognate questions are governed by the law of the state and not by any provision of the Bankruptcy Act." In re Dean and Jean Fashions, Inc., 329 F. Supp. 663, 666 (W.D. Okla. 1971) (citing Seymour v. Wildgen, 137 F.2d 160, 161 (10th Cir. 1943)(interpreting the strong arm clause in section 70(c) of the Bankruptcy Act of 1878)); PM Denver, Inc. v. Porter (in re Porter McLeod, Inc.), 231 B.R. 786, 792 (D. Colo. 1999).

As the lower court correctly pointed out, the trustee's right to step into the shoes of the creditor extends only with respect to property of the estate and K.S.A § 60-2315 removes the EIC from the estate corpus. The same is true of all exemptions which by their very nature remove property from the reach of creditors and, therefore, from the reach of trustees standing in the shoes of the creditor.

Contrary to the trustees' argument section 544 does not authorize her to reach the debtors' exempt assets. Rupp v. Duffin (In re Duffin), 457 B.R. 820 (B.A.P. 10th Cir. 2011), is inapposite because it addresses the trustee's ability to gain access to non-exempt funds. In her opinion in Westby, Judge Karlin, who was member of the

unanimous panel in Duffin, dispensed with a preemption argument based on that case, explaining:

> For this reason, among many others, the Tenth Circuit BAP opinion in Rupp v. Duffin (In re Duffin), 457 B.R. 820 (10th Cir. BAP 2011), upon which the Trustee relies, is inapplicable. In Duffin, the BAP considered whether a trustee could object to an exemption under 11 U.S.C. §544(a), utilizing his "rights and powers" under that statute as a hypothetical creditor. Id at 827-29. The BAP analyzed a Utah exemption that excluded from its reach prepetition payments on life insurance policies. Id at 829. The BAP concluded that, "[t]hrough the use of a trustee's hypothetical powers" under §544, the trustee could stand as a creditor would, and gain access to the non-exempt funds. As should be abundantly clear from the discussion herein, [K.S.A. § 60-2315] makes a debtor's EIC exempt, and no creditor of a debtor in bankruptcy could reach that exempt asset, just as the Trustee may not.

In re Westby, No. 11-40986, 473 B.R. 392 (Bankr. D. Kan. 2012).

Further, the trustee ignores section 522(g), under which the Debtors may exempt property that the trustee recovers under section 550 if it was not voluntarily transferred. In this case, the debtors' EIC refund is exempt under Kansas law; the trustee simply may not administer that asset.

The trustee also appears to argue that bankruptcy-specific exemptions somehow deprive the trustee of the power to "object to an exemption" in conflict with section 544(a). That is not the case. The trustee, under section 544 has the identical right to object that the hypothetical creditor would have with respect to any claimed exemption. And, like any other claimed exemption, the court will determine the applicability of the exemption under state law.

The trustees' other assertion of conflict suffers from the same infirmity.

The trustees argue that K.S.A. § 60-2315, which provides in part, "Nothing in this section shall be construed to limit the right of offset, attachment or other process with respect to the earned income tax credit for the payment of child support or spousal maintenance," conflicts with section 507(a) because it elevates child support payment over that of the trustee's administrative costs by permitting use of the refund for the payment of child support debts.

However, as noted by the court below, the exemption does not alter the priority of the administration of the estate because the funds at issue are removed from estate property and are not subject to administration. In re Earned Income Tax Credit Cases (In re Hudson), 477 B.R. 791 (Bankr. D. Kans. 2012). The Bankruptcy Court found that there is no conflict between the Kansas EIC exemption law and section 507, which spells out the duties of the trustee. As the Bankruptcy Court correctly held under the Kansas statute, refunds attributable to the EIC are exempt, removed from the estate, and not subject to administration by the trustee. See 11 U.S.C. § 704(a)(1) (precluding the trustee from selling exempt property). Section 507 contains no grant of authority for a trustee to liquidate exempt assets to pay domestic support obligations when section 507 itself simply provides the priorities for distribution of property of the estate. See In re Quezeda, 368 B.R. 44 (Bankr. S.D. Fla. 2007).

Simply stated, the trustee has no authority under section 507 or otherwise, to administer exempt assets. In re Knapper, No. 11-12942, *10 (Bankr. W.D. Tex. June 13,

2012) ("Here, the IRA is properly exempted and effectively removed from the estate. Therefore, the Trustee has no authority to administer the IRA for the benefit of creditors in general or Anderson, a [domestic support obligation] creditor, in particular."); *In re Westby*, 473 B.R. 392, 2012 WL 1144412 (Bankr. D. Kan. Apr. 4, 2012)("There is no conflict with § 507, because that section only applies to the distribution of estate property, not exempted property."). Congress resolved the conflict between exemptions and creditor's rights by deferring to the states to establish exemption parameters, including the effect of exemptions on non-dischargeable debts. *In re Davis*, 170 F.3d 475 (5th Cir. 1999).

CONCLUSION

For the foregoing reasons, Amicus urges this Court to find that Kansas's bankruptcy specific exemption is constitutional and affirm the decision of the lower court.

Respectfully submitted,

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CERTIFICATE OF COMPLIANCE

This brief, exclusive of the certifications, tables of contents and authorities and the identity of counsel at the end of the brief, is 6333 words in text and footnotes as counted by Microsoft Word, the word processing system used to prepare this brief. This brief has been prepared in a proportionally spaced typeface using Microsoft Word in Garamond14-point font.

I certify under penalty of perjury that the foregoing is true and correct.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that I electronically filed the foregoing with the Clerk of the Court for the United States District Court for the District of Kansas by using the CM/ECF system on December 18, 2012.

I certify that all participants in the case are registered CM/ECF users and that service will be accomplished by the appellate CM/ECF system.

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