

No. \_\_\_\_\_

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**In The  
Supreme Court of the United States**

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H.D. SMITH WHOLESALE DRUG CO., INC.,

*Petitioner,*

v.

W. STEVE SMITH, as Trustee for Michael McCombs;  
ALICIA ATKINSON MCCOMBS,

*Respondents.*

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**On Petition For Writ Of Certiorari  
To The United States Court Of Appeals  
For The Fifth Circuit**

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**PETITION FOR WRIT OF CERTIORARI**

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## **QUESTIONS PRESENTED**

1. Whether the Fifth Circuit's holding that H.D. Smith's perfected judgment lien lost its perfected position in non-exempt property after the filing of a bankruptcy petition conflicts with this Court's jurisprudence that a perfected lien continues to enjoy perfected status after a bankruptcy petition has been filed.
2. Whether the Fifth Circuit's holding that state homestead exemption law controls over bankruptcy law that limits homestead exemptions violates the Supremacy Clause.

**LIST OF PARTIES**

The name of Petitioner is:

H.D. Smith Wholesale Drug Co., Inc.

The name of Respondents are:

Alicia Atkinson McCombs

W. Steve Smith, Trustee

The name of the bankruptcy debtor is:

Michael Ray McCombs

**SUPREME COURT RULE 29.6  
CORPORATE DISCLOSURE STATEMENT**

H.D. Smith Wholesale Drug Co., Inc., pursuant to Supreme Court Rule 29.6, files this “Corporate Disclosure Statement” and shows that it has no parent corporation and no publicly held company owns 10% or more of its stock.

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**PETITION FOR WRIT OF CERTIORARI**

Petitioner, H.D. Smith Wholesale Drug Co., Inc. (“H.D. Smith”), petitions the Court for a Writ of Certiorari to review a final judgment of the United States Court of Appeals for the Fifth Circuit (entered October 4, 2011) reversing and remanding the Bankruptcy Court’s judgment in its favor.

**OPINIONS BELOW**

The United States Bankruptcy Court for the Southern District of Texas granted summary judgment in favor of Petitioner on December 17, 2007. The court’s memorandum opinion is reported at *In re McCombs*, 2007 WL 4411909 (Bankr. S.D. Tex. Dec. 17, 2007). (App. 19-47).

Because of the importance of the issue now presented to this Court, the United States Court of Appeals for the Fifth Circuit granted Respondents leave to directly appeal the Bankruptcy Court’s summary judgment to the Fifth Circuit. (App. 18).

The Fifth Circuit reversed the summary judgment on October 4, 2011. The Fifth Circuit’s opinion is reported at *W. Steve Smith, as Trustee for Michael McCombs v. H.D. Smith Wholesale Drug Co., Inc. (In re Michael Ray McCombs)*, 659 F.3d 503 (5th Cir. 2011). (App. 1-17).

The Fifth Circuit denied Petitioner’s motion for rehearing on November 8, 2011. (App. 48).



### STATEMENT OF JURISDICTION

The Fifth Circuit’s ruling conflicts with prior rulings of this Court as to an important federal question of whether the filing of a bankruptcy petition alters a prior perfected lien and also raises the important federal question of whether federal bankruptcy law preempts state homestead exemption laws. This Court has jurisdiction under 28 U.S.C. § 1254(1). *Foucha v. Louisiana*, 504 U.S. 71, 75 (1992) (“Because the case presents an important issue and was decided by the court below in a manner arguably at odds with prior decisions of this Court, we granted certiorari.”); *Arizona v. Mauro*, 481 U.S. 520, 525 (1987) (“Because the decision below appeared to misconstrue our decision in . . . , we granted the petition [for a writ of certiorari]”); *Pennsylvania R. Co. v. O’Rourke*, 344 U.S. 334, 336 (1953) (“We granted certiorari . . . because of an alleged conflict with an earlier decision of this Court. . . .”).



## **CONSTITUTIONAL, STATUTORY, AND REGULATORY PROVISIONS INVOLVED**

This case involves the Supremacy Clause of the United States Constitution. The Supremacy Clause states:

The Constitution, and the Laws of the United States which shall be made in Pursuance thereof . . . shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, anything in the Constitution or Laws of any State to the Contrary notwithstanding.

U.S. CONST. ART. VI, cl. 2.

This case also involves Bankruptcy Code Section 522(p), which states:

(1) Except as provided in paragraph (2) of this subsection and sections 544 and 548, as a result of electing under subsection (b)(3)(A) to exempt property under State or local law, a debtor may not exempt any amount of interest that was acquired by the debtor during the 1215-day period preceding the date of the filing of the petition that exceeds in the aggregate \$125,000 [Adjusted every 3 years by section 104.] in value in –

...

(D) real or personal property that the debtor or dependent of the debtor claims as a homestead.

11 U.S.C. § 522(p).



## STATEMENT OF THE CASE

### A. H.D. Smith's Perfected Judgment Lien

This case involves Bankruptcy Code Section 522(p), which became law as part of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA). *See* 11 U.S.C. §522(p). Section 522(p) was enacted to close so called “mansion loopholes” allowed by some states, by capping a debtor’s homestead exemption – in this case, limiting the amount of the debtor’s homestead exemption to \$125,000. *See id.* Thus, Section 522(p) not only preempts current Texas law that allows an unlimited dollar exemption for homestead property but also converts amounts exceeding the cap into non-exempt property.

Prior to the filing of the chapter 7 bankruptcy by debtor, Michael Ray McCombs, Petitioner, H.D. Smith, was a perfected judgment lien creditor of debtor. (R. 260-61, 587). Thus, H.D. Smith’s perfected judgment lien was enforceable against debtor’s non-exempt real property before the bankruptcy petition was filed. By virtue of 522(p), and consistent with this Court’s prior rulings, H.D. Smith’s perfected judgment lien should

continue to be enforceable against all of debtor's non-exempt real property after the bankruptcy filing.

## **B. The Bankruptcy Court's Judgment**

On February 9, 2007, H.D. Smith filed an adversary proceeding against Respondents and others in the debtor's bankruptcy, seeking a declaration that its judicial lien was perfected and enforceable as to the portion of the debtor's home that was non-exempt due to Section 522(p). (App. 24) (No. 1). The Bankruptcy Court correctly held that H.D. Smith's judicial lien was properly perfected against debtor's homestead before bankruptcy, and that it maintained its perfected status after bankruptcy. (App. 43-46). The Bankruptcy Court further held that H.D. Smith's perfected lien was valid and enforceable as to the portion of the debtor's home that was rendered non-exempt by operation of Section 522(p). (App. 46).<sup>1</sup>

## **C. The Appellate Court Proceedings**

Both Respondents filed notices of appeal from the Bankruptcy Court's judgment and sought direct

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<sup>1</sup> After the bankruptcy was filed, the debtor's homestead property was sold. (App. 3) (R. 588, No. 12). Out of the sales proceeds, the debtor and his wife, Respondent, Alicia Atkinson McCombs, received their \$125,000 homestead exemption under Section 522(p), and the balance of the proceeds was held in escrow pending the resolution of the adversary proceeding filed by H.D. Smith. (App. 3) (R. 298-300, 590, No. 12).

appeal to the Fifth Circuit Court of Appeals. After the Bankruptcy Court filed its Certification for Direct Appeal, the Fifth Circuit granted the Petition for Leave to Appeal pursuant to 28 U.S.C. § 158(d) on March 17, 2008. (App. 18).

On October 4, 2011, the Fifth Circuit reversed and remanded the Bankruptcy Court's judgment. (App. 2, 17). Contrary to the Bankruptcy Court's judgment and opinion, the Fifth Circuit held that H.D. Smith's perfected judicial lien was not valid or enforceable as to the non-exempt proceeds from the sale of debtor's homestead. (App. 9). The Fifth Circuit held that state law, rather than Section 522(p) of the Bankruptcy Code, controlled the characterization of the debtor's homestead and that, pursuant to Texas law, H.D. Smith's perfected judicial lien remained unenforceable as to the homestead, even though Section 522(p) limited the amount of the homestead exemption to \$125,000. (App. 6-9). Petitioner timely filed a petition for rehearing which was denied on November 8, 2011. (App. 48-49).



### **REASONS FOR GRANTING THE WRIT**

This case deals with the effect of the Section 522(p) homestead exemption limits on the rights of judgment lien creditors whose liens are properly perfected against the debtor's homestead prior to bankruptcy. The Fifth Circuit's opinion as to the effect on properly perfected lien creditors conflicts with this

Court's prior holdings that liens perfected prior to bankruptcy pass through bankruptcy unaffected, and fails to properly apply the preemptive effect of Section 522(p) to limit the amount that can be claimed as exempt from perfected judgment liens with respect to homestead property. The Court should grant certiorari to ensure that Section 522(p) is correctly applied.

**A. THIS COURT HAS CONSISTENTLY HELD THAT A PROPERLY PERFECTED LIEN IS UNAFFECTED BY THE FILING OF A PETITION FOR BANKRUPTCY. THE FIFTH CIRCUIT OPINION CONFLICTS WITH THIS PRINCIPLE BY HOLDING THAT H.D. SMITH'S PERFECTED LIEN IS NO LONGER PERFECTED AS TO NON-EXEMPT HOMESTEAD PROPERTY AFTER A BANKRUPTCY PETITION HAS BEEN FILED.**

On multiple occasions, this Court has held that a pre-petition perfected lien on real property passes through bankruptcy unaffected. *See Dewsnap v. Timm*, 502 U.S. 410, 418 (1992); *Farrey v. Sanderfoot*, 500 U.S. 291, 297 (1991) (“Ordinarily, liens and other secured interests survive bankruptcy”); *Long v. Bullard*, 117 U.S. 617, 620-621 (1886) (holding that a discharge of a debtor does not release real estate from a lien perfected before the bankruptcy).<sup>2</sup> Stated

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<sup>2</sup> *See also Anderson v. Star Rentals, Inc. (In re Anderson)*, 378 B.R. 296, 298 (Bankr. W.D. Wash. 2007) (“[i]t is well established  
(Continued on following page)

another way, “[a] bankruptcy discharge extinguishes only *in personam* claims against the debtor(s), but generally has no effect on an *in rem* claim against the debtor’s property.” *Johnson v. Home State Bank*, 501 U.S. 78, 84 (1991).

The Fifth Circuit’s opinion conflicts with these holdings. Under the Fifth Circuit’s prior precedent, H.D. Smith held a judgment lien that was attached to, and perfected against, the debtor’s homestead (albeit, unenforceable as long as the property remained completely exempt).<sup>3</sup> However, the Fifth Circuit’s opinion assumes that H.D. Smith no longer had a perfected lien after the filing of the bankruptcy. (App. 9). H.D. Smith’s lien should have been given the same effect as any other previously perfected lien. Instead, the Fifth Circuit opinion relegates H.D. Smith to an unsecured creditor status as to all non-exempt amounts in excess of the Section 522(p) homestead limitation – effectively extinguishing H.D. Smith’s perfected judgment lien as to this non-exempt property. (App. 9). Thus, because it effectively invalidates H.D. Smith’s perfected judgment lien as to this non-exempt property, the Fifth Circuit’s holding

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that a discharge in bankruptcy does not extinguish a lien on property which had attached as of the date of the petition.”).

<sup>3</sup> *Henderson v. Belknap (In re Henderson)*, 18 F.3d 1305, 1309 (5th Cir. 1994), *cert. denied*, 513 U.S. 1014 (1994); *In re Davis*, 170 F.3d 475, 482-483 (5th Cir. 1999), *cert. denied*, 528 U.S. 822 (1999).

contradicts this Court's holdings that perfected liens pass through bankruptcy unaffected.

**B. THE SECTION 522(p) LIMITS WERE ENACTED TO LIMIT GENEROUS STATE LAW EXEMPTION STATUTES. NEVERTHELESS, THE FIFTH CIRCUIT OPINION DISREGARDS SECTION 522(p) IN FAVOR OF STATE LAW.**

The Fifth Circuit opinion effectively holds that state law controls both the character *and exemption limits* of homestead property both before and after a bankruptcy is filed. (App. 6-9). However, Section 522(p) preempts state law and limits the homestead exemption to \$125,000. *In re Presto*, 376 B.R. 554, 585-586 (Bankr. S.D. Tex. 2007). Based on this failure to properly apply federal law, the Fifth Circuit held that H.D. Smith's perfected lien was not enforceable, even against any non-exempt proceeds exceeding the Section 522(p) limits. (App. 9).

By failing to properly give effect to the Section 522(p) exemption limits, the Fifth Circuit turned H.D. Smith's status as a creditor on its head. Prior to bankruptcy, H.D. Smith was a perfected, secured creditor as to all non-exempt property.<sup>4</sup> (App. 43).

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<sup>4</sup> The unlimited state homestead exemption in Texas is a relatively recent event from a historical perspective. During the time the homestead exemption was limited, the value of the homestead above the exemption limit – the non-exempt portion – was subject to perfected judgment liens of creditors. *See*  
(Continued on following page)

Under the Fifth Circuit's opinion, H.D. Smith is now only an unsecured creditor to the non-exempt property in excess of the Section 522(p) limits. (App. 9). The Fifth Circuit does not cite any authority to support its premise that Section 522(p) should place unsecured creditors in a better position at the expense of perfected lien creditors. (See App. 9). The court's holding and rationale directly conflict with this Court's prior rulings regarding the continued validity of perfected liens in bankruptcy and the fact that Section 522(p) preempts state law regarding the exemption limits.

The recent economic collapse has led to a skyrocketing number of bankruptcies. According to United States Courts, the number of consumer bankruptcy filings nationally rose from more than 1.1 million in 2008, to more than 1.4 million in 2009 and nearly 1.5 million in 2010.<sup>5</sup> The proper application of the Section 522(p) homestead limits in regard to prepetition, perfected judgment liens is a matter that will be at issue in numerous bankruptcies throughout the country now and in the future. This Court should

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*Clement v. First Nat'l Bank*, 115 Tex. 342, 282 S.W. 558, 562 (1926); *McLane v. Paschal*, 62 Tex. 102 (1884); *Whiteman v. Burkey*, 286 S.W. 350, 351 (Tex. Civ. App. – Galveston 1926, no writ); *Harrison v. First Nat'l Bank of Lewisville*, 224 S.W. 269, 275 (Tex. Civ. App. – Fort Worth 1920), *modified on other grounds*, 238 S.W. 209 (Tex. 1922).

<sup>5</sup> See [www.uscourts.gov/statistics/BankruptcyStatistics.aspx](http://www.uscourts.gov/statistics/BankruptcyStatistics.aspx).

grant certiorari to correct the Fifth Circuit's opinion and ensure that Section 522(p) is properly applied.



**PRAYER**

Petitioner, H.D. Smith Wholesale Drug Co., Inc., requests that its petition for writ of certiorari be granted.

Respectfully submitted,

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