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Over the Hill to the Poor House—The Failure of Section 522 Bankruptcy Exemptions Under the Bankruptcy Reform Act of 1978

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THOMAS J. REED*

What is the use of heapin' on me a pauper's shame?
Am I lazy or crazy? Am I blind or lame?
I am willin an' anxious an' ready any day
To work for a decent livin', an' pay my honest way

Will Carleton

The Bankruptcy Reform Act, in its original version, was considered the answer for real and substantive reform of the bankruptcy system. One of the salient reform measures was the comprehensive federal debtor's exemption program, designed to give debtors in bankruptcy a welfare subsidy drawn from assets otherwise available to their creditors for liquidation. The grand design of this exemption program was reduced to a series of compromises¹ that did not measure up to the constitutional standards for uniform bankruptcy laws or proper delegations of legislative authority to the states.

Using a new federal exemption system, section 522 of the 1978 Bankruptcy Code² prescribes exemptions for debtors under chapters seven,³ eleven⁴ and thirteen.⁵ These exemption rules make all of the debtor's property part of his estate until held exempt.⁶ If the debtor is eligible for these exemptions, he can elect either the federal exemptions, or the federal non-bankruptcy exemptions and state execution exemptions of the debtor's domicile.⁷ Given the extreme diversity of state exemption laws, Congress delegated to each state the authority to restrict a debtor to the state's exemption laws alone.⁸

The theory behind allowing exemptions is to give individual wage earn-

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1. See *infra* text accompanying notes 153-208 (discussing the legislative history and compromises made in enacting the 1978 Bankruptcy Reform Act).

2. 11 U.S.C. § 522(d) (1982). The Federal exemptions are discussed in detail *infra* notes 188-210.

3. 11 U.S.C. § 701-766 (1982) (liquidation chapter).

4. 11 U.S.C. § 1101-174 (1982) (reorganization chapter).

5. 11 U.S.C. § 1301-1330 (1982) (adjustment of debts of an individual with regular income chapter).

6. 11 U.S.C. §§ 522(b), 541 (1981).

7. 11 U.S.C. § 522(b)(2) (1982).

8. This "opting out" clause reads: "Notwithstanding section 541 of this title, an individual debtor may exempt from property of the estate either—(1) property that is specified under subsection (d) of this section, *unless* the State law that is applicable to *the* debtor under paragraph (2)(A) of this subsection *specifically* does not so authorize; or, . . ." 11 U.S.C. § 522(b)(1) (emphasis added).

ers or salaried persons who took bankruptcy relief a "fresh start" after receiving absolution from their debts.⁹ First, the debtor would receive a discharge preventing creditors from taking further action against the debtor. Second, through various exemptions on certain assets, the debtor would receive the basic necessities of life to begin his fresh start.¹⁰ These exemptions are, in the abstract, a form of a welfare payment from the creditors.

Section 522 was an uneasy compromise between the House and the Senate¹¹ because of conflicting special interest group pressures.¹² Section 522 creates a series of problems for the courts to resolve. The opting out clause provided to states in section 522(b)(1) permits states to pass a statute confining their citizens to state bankruptcy exemptions. This "opting out" clause mandates non-uniform treatment of bankruptcy exemptions, because no nationwide federal exemption statute would exist once one state determined to "opt out." The United States Constitution requires Congress to pass "uniform Laws on the subject of bankruptcies."¹³ Consequently, state-drafted exemption schemes have been attacked as unconstitutional, as has section 522(b)(1) authorizing such legislation.¹⁴

The experience with section 522 in bankruptcy courts and in federal appellate courts has been chaos. Unresolved tension among bankruptcy courts on the extent states can enact exemption levels different from the federal exemptions still exist. Some courts have held state exemptions unconstitutional when they do not comply with the "fresh start" purpose of section 522.¹⁵ Other courts have held state exemption statutes constitutional.¹⁶

To alleviate many of the problems with bankruptcy exemptions, the whole scheme should be revised so that the bankruptcy system is more than just providing indirect welfare payments to debtors. This article will begin

9. H.R. REP. NO. 595, 95th Cong., 2d Sess. 5 (1977), *reprinted in* 1978 U.S. CODE CONG. & AD. NEWS 5963, 6087-88 [hereinafter cited as HOUSE REPORT]. *See id.* at 6087 (defining "fresh start" as providing the debtor with the basic necessities of life after discharge in bankruptcy). *See also infra* text accompanying notes 315-19 (discussing the theory behind bankruptcy exemptions).

10. HOUSE REPORT, *supra* note 9, at 6087-88.

11. *See In re Rhodes*, 14 Bankr. 629, 633 (M.D. Tenn. 1981).

12. Several people took part in the hearings on section 522 and addressed the exemption problems. *See, e.g., Bankruptcy Act Revision: Hearings on H.R. 31 & 32 Before the Subcomm. on Civil and Constitutional Rights of the House Comm. on the Judiciary*, 94th Cong. 2d Sess. (February 20, 1976) (statement of Robert Ward, Esq.) (allow state exemptions but remove any federal ceiling on amount) [hereinafter cited as *Hearings*]; *Hearings* (March 8, 1976) (prepared statement of American Life Insurance Association) (retain the 1898 Act exemptions). *See also Hearings* (March 8, 1976) (statement of John Creedon, Senior Vice President of Metropolitan Life Ins. Co. and chairman of American Life Ins. Ass'n's Subcomm. on Fed. Bankruptcy Legis.) (retain the 1898 Act exemptions).

13. U.S. CONST. art. I, § 8, cl. 4.

14. *See, e.g., Rhodes v. Stewart*, 705 F.2d 159 (6th Cir. 1983); *In re Sullivan*, 680 F.2d 1131 (7th Cir.), *cert. denied*, 103 S. Ct. 349 (1982); *In re Kelley*, 21 Bankr. 375 (M.D. Fla. 1982); *In re Parrish*, 19 Bankr. 331 (D. Colo. 1982); *In re Balgemann*, 16 Bankr. 780 (N.D. Ill. 1982); *In re Lausch*, 16 Bankr. 162 (M.D. Fla. 1981); *In re Curry*, 5 Bankr. 282 (N.D. Ohio 1980), *aff'd*, 11 Bankr. 716 (N.D. Ohio 1981).

15. *See, e.g., In re Balgemann*, 16 Bankr. 780 (N.D. Ill. 1982) (states must protect the debtors household goods). *See also, In re Rhodes*, 14 Bankr. 629 (M.D. Tenn. 1981) (state exemption unconstitutional because it discriminated between homeowners and nonhomeowners) *rev'd sub nom. Rhodes v. Stewart*, 705 F.2d 159 (6th Cir. 1983).

16. *See e.g. In re Sullivan*, 680 F.2d 1131 (7th Cir.), *cert. denied*, 103 S. Ct. 349 (1982).

with a brief history of bankruptcy law pointing out its shortcomings and improvements. The main aim of this article is to highlight the major technological and policy shortfalls of section 522 and to suggest a remedy for these failings.

I. HISTORICAL BACKGROUND

A. *English Insolvency Laws and Exemptions*

The common law permitted creditors to use three writs to satisfy an unpaid judgment: *elegit*—a writ allowing the creditor to take over the debtor's land and reap the rents and profits until the judgment was liquidated; *levari facias*—which allowed the creditor to auction off the rents and profits from the debtor's lands; and, *feri facias*—which permitted the creditor to obtain the aid of the sheriff to seize the debtor's personal property and sell it to pay off the judgment.¹⁷ A fourth writ, *capias ad satisfaciendum*, was available to put a debtor in prison.¹⁸ After being clapped in prison, the debtor had no way out unless his judgment was paid by relatives or friends. Privy Council eventually intervened in these cases and forced the creditors of an imprisoned debtor to agree to a composition and discharge the debtor.¹⁹

In 1670, the House of Lords passed an Act which authorized the courts to accept these compositions and to release the debtors from prison retaining their wearing apparel, bedding, and tools of the trade not exceeding £10.²⁰ The Act also provided for a cash allowance to debtors based on a sliding scale tailored to the size of the dividend paid to creditors.²¹ Consequently, the American colonists from England brought with them insolvency laws for poor debtors, bankruptcy laws for merchants and traders in financial distress, and debtor's exemptions from both processes.

17. Riesenfeld, *Collection of Money Judgments in American Law—A Historical Inventory and a Prospectus*, 42 IOWA L. REV. 155, 157 & note 9 (1957). See generally Riesenfeld, *Enforcement of Money Judgments in Early American History*, 71 MICH. L. REV. 691 (1973) (early American Colonies use of these writs).

18. 8 W. HOLDSWORTH, *A HISTORY OF ENGLISH LAW* 231 (1926). If a writ of *capias ad respondendum* could be issued in the action to compel the attendance of the debtor, a further writ of *capias ad satisfaciendum* would issue on the signing of the judgment that ordered the debtor to be jailed in lieu of the writs *elegit*, *levari facias* or *feri facias*. *Id.*

19. *Id.* at 233-34. As for dishonest debtors, Privy Council had no interest in assisting debtors who had gotten themselves into financial trouble through fraud. This is illustrated by the first English bankruptcy law passed during the reign of Henry VIII, which called for imprisonment of merchant traders who had fled to avoid paying debts or who had obtained credit under false pretenses. 34 & 35 Hen. 8 ch. 4 (1542-43). The details of this law and other early English laws are discussed fully in 8 HOLDSWORTH, *supra* note 18, at 236-40.

20. By taking an oath that his assets were not above £10 and that he had not made a fraudulent conveyance of his assets, an innocent debtor could be discharged from custody so long as his creditors were unwilling to pay his weekly expenses in debtors' prison. Debtors who were laborers, however, were first sent to a two year stretch in the workhouse before being released. 8 HOLDSWORTH, *supra* note 18, at 235 (citing 22 & 23 Charles II ch. 20 (1670)).

21. By an act of 1705, if the bankrupt debtors cooperated with the commissioners in locating their assets and assisted them in the liquidation process, they were given a living allowance from their assets and a small percentage of the estate upon distribution. See Glenn, *Property Exempt from Creditors' Rights of Realization*, 26 VA. L. REV. 127, 130 (1935).

B. *American Exemption Laws*

The province of Pennsylvania re-enacted the English Act allowing compositions, retaining most of the same English exemption provisions.²² Other colonies provided exemptions from execution and attachment, and exemptions from distribution similar to the English provisions.²³ Following the American Revolution and Shays' Rebellion, Massachusetts adopted a comprehensive insolvency law and a very forward-looking exemption law which allowed a subsistence farmer or urban mechanic to salvage a considerable nest egg from attachment, execution or the insolvency process.²⁴ Other American states followed Massachusetts' lead.²⁵

Early American exemption statutes exempted some livestock, fodder, and the farmer's or trader's tools from seizure.²⁶ Sentimental objects such as the family bible, church pew, and family portraits were also protected.²⁷ Because there were no federal insolvency or bankruptcy laws, these exemptions laws were the only protection debtors had from their creditors' attacks on their economic subsistence. In their time, these statutes did a fair job of giving a poor debtor a "fresh start" after economic failure.

C. *Federal Bankruptcy Exemptions*

The Articles of Confederation did not provide for any continental insolvency laws. During the constitutional debates in 1787, the Convention inserted into the list of powers available to Congress the power to enact "uniform Laws on the subject of Bankruptcies."²⁸ The constitutional convention minutes on the insertion of this clause give little insight as to why it was included in the Constitution.²⁹ The United States took no immediate

22. See 4 PA. STAT. ch. 315, p. 171 (1730).

23. See, COLEMAN, DEBTORS AND CREDITORS IN AMERICA (1974) (discusses colonial exemption laws).

24. MASS. GEN. LAWS ch. 100 § 1(1805) (current version at MASS. GEN. LAWS ANN. ch. 235 § 34 (West Supp. 1983)).

25. See CONN. GEN. STAT. § 907 (1902) (originally enacted in 1888, current version at CONN. GEN. STAT. ANN. § 52-352b (West Supp. 1984)); ME. REV. STAT. ch. 83, § 64 (1904) (originally enacted in 1887, current version at ME. REV. STAT. ANN. tit. 14, § 4421 (1983 Supp.)); MICH. COMP. LAWS ch. 286, § 27 (1947) (originally enacted in 1857, current version at MICH. COMP. LAWS ANN. § 600.6023 (West 1968)).

26. See *supra* notes 24-25.

27. See generally *id.*

28. U.S. CONST. art. I, § 8 cl. 4.

29. On August 29, 1787, the convention moved to include in the full faith and credit clause with the following proposition: "to establish uniform laws upon the subject of bankruptcies and respecting the damages arising on the protest of foreign bills of exchange." C. WARREN, BANKRUPTCY IN UNITED STATES HISTORY 4-5 (1935). See also 2 M. FARRAND, THE RECORDS OF THE FEDERAL CONVENTION OF 1787, at 489 (1937) (reprint of Madison's journal).

On examining the debate record, Prof. Nadelmann concluded the bankruptcy clause was added to the full faith and credit clause due to problems anticipated by some of the conventioners in dealing with the enforcement of the judgments of one state in the courts of another. Nadelmann, *On the Origin of the Bankruptcy Clause*, 1 AM. J. LEGAL HIST. 215, 216, 227 (1957). On September 3, 1787, the bankruptcy clause was moved to roughly its present position in the enumeration of congressional powers in article I. WARREN, *supra*, at 5; 2 FARRAND, *supra*, at 483 (reprint of Madison's journal).

Madison wrote:

The power of establishing uniform laws of bankruptcy is so intimately connected with the regulation of commerce, and will prevent so many frauds where the parties or

action to enact a bankruptcy law after ratification of the Constitution until the depression caused by the Napoleonic Wars and caused by a number of business failures in eastern mercantile cities at the end of the century.³⁰

1. The 1800 Bankruptcy Act

The Bankruptcy Act of 1800 allowed involuntary bankruptcy petitions to be filed against merchant traders, if the petitioners proved the trader had committed one or more acts of bankruptcy.³¹ The 1800 Act empowered the bankruptcy commissioners in federal courts to examine the bankrupt and his wife on the nature and extent of their assets and debts.³² The debtor received an allowance from his own estate based on what the creditors received similar to the sliding scale used in England.³³ No specific items of property were listed as exempt. The act was repealed in 1803.³⁴ The next federal bankruptcy act did not appear until after the panic of 1837, when President Van Buren and later President Tyler pushed for bankruptcy legislation.³⁵ The new act became the Bankrupt Act of August 19, 1841,³⁶ and was intended to relieve insolvent debtors.

2. The 1841 Bankruptcy Act

The 1841 Bankruptcy Act was the first American bankruptcy act to allow for specific items of property to be exempt from the bankruptcy process. Like the 1800 Act, it provided for involuntary petitions against merchants and traders, but it included an innovative section authorizing in-

their property may lie or be removed into different States that the expediency of it seems not likely to be drawn into question.

THE FEDERALIST No. 42, at 271 (J. Madison) (quoted in WARREN, *supra*, at 7).

Only one other pamphlet of the time carried any reference to the bankruptcy clause:

I am not sufficiently acquainted with the laws and internal policies of all the states to discern fully how general bankrupt laws, made by the union, would effect them or promote the public good. I believe the property of debtors, in the several states, is held responsible for their debts in modes and forms very different. If uniform bankrupt laws can be made without producing real and substantial inconveniences, I wish them to be made by Congress.

LETTERS OF A FEDERAL FARMER (R.H. Lee), reprinted in PAMPHLETS ON THE CONSTITUTION OF THE UNITED STATES 306 (1968).

30. WARREN, *supra* note 29, at 12-13, 18-19. The bill was introduced shortly after the collapse of several western land speculation schemes. *Id.* at 12-13. It was passed when the war with France began to take its toll on American vessels. *Id.* at 18.

31. Bankruptcy Act of 1800, ch. 19, § 1, 2 Stat. 19-21 (repealed Dec. 19, 1803, 2 Stat. 248). The statute gave the federal district courts jurisdiction to hear bankruptcy matters, and, similar to the English model, provided for appointment of bankruptcy commissioners. *id.* at 21-23.

32. *Id.* at 25-28.

33. *Id.* at 30-31. See *supra* note 21 and accompanying text.

34. Act of Dec. 19, 1803, ch. 6, 2 Stat. 248. During its brief life, the 1800 Act was widely condemned in Congress and in the press as oppressive to farmers and mechanics because a merchant in a failing situation could obtain relief from his debts through an involuntary bankruptcy action initiated by a friendly creditor, while no such relief was available to non-merchants, who either paid their debts or went to debtor's prison. WARREN, *supra* note 29, at 19-21.

After the repeal of the 1800 Act several bankruptcy bills were introduced and defeated. See generally WARREN, *supra* note 29, at 27-45.

35. WARREN, *supra* note 29, at 56, 69.

36. 5 Stat. 440 (1841) (repealed Mar. 3, 1843, 5 Stat. 614).

dividual debtors to file voluntary bankruptcy petitions.³⁷ Section three of the 1841 Act directed the bankrupt to surrender all his property to the assignee in bankruptcy for sale, except:

necessary household and kitchen furniture, and such other articles and necessities of such bankrupt as the said assignee shall designate and set apart, having reference in the amount to the family, condition, and circumstances of the bankrupt, but altogether not to exceed in value, in any case, the sum of three hundred dollars; and, also, the wearing apparel of such bankrupt, and that of his wife and children; . . .³⁸

The 1841 Act did not provide for a allowance of a percentage of the estate to the debtor after payment of a dividend to creditors. It, too, was a stop-gap measure. As soon as economic conditions brightened, the 1841 Act was repealed in 1843.³⁹ In 1867, Congress passed a third Federal Bankruptcy Act, to deal with the post-Civil War depression.⁴⁰

3. The 1867 Bankruptcy Act

The 1867 Act allowed voluntary petitions in bankruptcy. Bankrupts would receive a discharge from all liability if the estate paid fifty cents-on-a-dollar dividends.⁴¹ Under court supervision, a debtor could make an arrangement with his creditors and execute a deed of trust to a trustee on all non-exempt assets for benefit of the creditors,⁴² in lieu of voluntary or involuntary bankruptcy. Section fourteen of the act contained a provision similar to section three of the 1841 Act exempting certain property from creditors.⁴³ In contrast to the 1841 Act exemptions, however, the 1867 Act allowed every insolvent debtor a federal exemption floor plus any state exemptions to which the debtor would have been entitled under state execution laws. This was a compromise made to get the bill passed.⁴⁴

4. The 1898 Bankruptcy Act

The 1867 Bankruptcy Act was repealed in 1878.⁴⁵ Twenty years later, following the crash of 1893, Congress passed a new, comprehensive and permanent bankruptcy act. The 1898 Act contained a special section dealing with exemption rights:

[The Bankruptcy Act] shall not affect the allowance to bankrupts of the exemptions which are prescribed by the State laws in force at the time of the filing of the petition in the State wherein they have

37. *Id.* at 442.

38. *Id.* at 443.

39. Act of Mar. 3, 1843, ch. 82, 5 Stat. 614. See WARREN, *supra* note 29, at 85. The act was criticized by pro-debtor interests as unjust because the mandatory federal exemptions deprived debtors of more generous state exemptions. WARREN *supra* note 29, at 82 (citing speech by Rep. James A. McDougall given January 5, 1863, 37th Cong., 3d sess.)

40. Act of March 2, 1867, ch. 176, 14 Stat. 517 (amended at 15 Stat. 227) (containing federal exemptions similar to the 1841 Act) (repealed, 20 Stat. 99 (1878)).

41. 15 Stat. at 228 (as amended).

42. 14 Stat. at 538 (required a majority of the creditors to consent).

43. *Id.* at 522-23, and as changed in 15 Stat. at 228. See *supra* text accompanying note 38.

44. WARREN, *supra* note 29, at 103.

45. WARREN, *supra* note 29, at 122. See Act of June 7, 1878, ch. 168, 20 Stat. 99.

had their domicile for the six months or the greater portion thereof immediately preceding the filing of the petition.⁴⁶

Besides the recognition of state exemptions, the 1898 Act also provided for voluntary petitions in bankruptcy.⁴⁷ The 1898 Act defined the bankrupt's estate so as to exclude any exempt property.⁴⁸ The only duty the trustee had with respect to a debtor's exempt property was to set it aside upon the debtor's filing of an exemption claim.⁴⁹ A 1938 amendment to section six added "federal exemptions" to "state exemptions."⁵⁰ This scheme governed all individual bankruptcies filed from 1899 to 1978.

D. *State Exemption Laws*

By the time the 1898 Bankruptcy Act was adopted, a number of state exemption laws contained exemptions not found under the old colonial exemption programs. These exemptions were the homestead exemption for the debtor's personal residence,⁵¹ the life insurance policy exemption,⁵² and the wage exemptions from garnishment and attachment.⁵³

1. The Homestead Exemption

Texas led the states by incorporating into its' constitution a homestead exemption which guaranteed to all heads of families residing in Texas "two hundred acres of land, . . . or any town or city lot or lots, in value not to exceed \$2,000."⁵⁴ By the end of the 1860's most states had some form of a homestead exemption. Typically, if the debtor was the head of a family, the homestead exemption exempted the debtor's personal residence from seizure on attachment or execution.⁵⁵

Some states today require that the head of the family execute and acknowledge a declaration of homestead to secure the exemption. This declaration would operate prospectively against future creditors, but would not bar creditors' claims which predated the declaration.⁵⁶ Although other states do not require a declaration, they also hold once the homestead is acquired the exemption protects only prospectively.⁵⁷ The homestead ex-

46. Act of July 1, 1898, ch. 541, § 6, 30 Stat. 544, 548.

47. Bankruptcy Act of 1898, ch. 541, § 4, 30 Stat. 544, 547.

48. The trustee shall "be vested by operation of law with the title of the bankrupt, except insofar as it is to property which is exempt. . . ." *Id.* at 565.

49. *Id.* § 47a(11), 30 Stat. at 557.

50. Act of June 22, 1938, ch. 575, § 6 52 Stat. 840, 847.

51. *See, e.g.*, MASS. GEN. LAWS ch. 298, §§ 15-16 (1857).

52. *See, e.g.*, MASS. GEN. LAWS ch. 183, § 11 (1885).

53. MASS. GEN. LAWS ch. 260, §§ 4-5 (1878).

54. TEX. CONST. of 1845, art. VII, § 22 (current version at TEX. CONST. art. 16, §§ 50-51). *See also* GA. CONST. of 1868, art. VII, § 5218; FLA. GEN. STAT. ANN. div. 4, tit. 1, ch. 6, § 2520 (1906); MICH. STAT. ANN. tit. 30, ch. 267, § 7721 (Howell 1882) (originally enacted in 1848); MISS. CODE ANN. ch. 48, §§ 2146-47 (1906); WIS. REV. STAT. ch. 134, § 23 (1858).

55. *See* Vukowich, *Debtors' Exemption Rights*, 62 GEO. L.J. 779, 804 (1974).

56. *See* FLA. STAT. ANN. § 222.01 (West Supp. 1983); KAN. STAT. ANN. § 60-2302 (1983); UTAH CODE ANN. § 78-23-4 (Supp. 1983). These same states permit the declaration to have a retroactive effect if it is made shortly before the sale on execution.

57. *See, e.g.*, KY. REV. STAT. § 427.060 (Supp. 1982); MASS. GEN. LAWS ANN. ch. 188, § 1 (West Supp. 1983) MO. ANN. STAT. § 513.510 (Vernon 1952); VT. STAT. ANN. tit. 27, § 107 (1975); W. VA. CODE § 38-9-3 (Cum. Supp. 1983).

emption is usually limited by a dollar amount which is intended to be a sum sufficient to cover the mortgagor's equity in an ordinary personal residence or family farm.⁵⁸

Under the 1898 Act, the homestead exemption created serious problems for bankruptcy courts. One such problem was the effectiveness of a homestead declaration filed after the bankrupt had subjected his assets to the jurisdiction of the bankruptcy court. Under the "strong arm" clause of the 1898 Act,⁵⁹ a bankruptcy trustee had the power of a levying creditor as against the debtor's assets at the time of the bankruptcy filing.⁶⁰ Without relying on the strong arm clause, the Supreme Court in *White v. Stump*⁶¹ held that a trustee could upset a homestead declaration filed after a voluntary bankruptcy adjudication.⁶² Twenty years later, in *Myers v. Matley*,⁶³ the Supreme Court modified *White v. Stump*. *Myers* holds that a homestead exemption filed after the levy but before the sale will not be destroyed by the trustee if the state law provides such a declaration is effective against a creditor.⁶⁴ The Supreme Court failed to reconcile the *Myers* decision with the earlier decision in *White v. Stump* up to the adoption of the 1978 Bankruptcy Code.⁶⁵ *Myers*, in effect, breaches the cut off point found to exist in *White v. Stump*, and reliance on the strong arm clause is misplaced,⁶⁶ leaving considerable doubt surrounding the trustee's legal position against inchoate homestead exemptions.

2. The Life Insurance Exemption

New York's Verplanck Act of 1840⁶⁷ exempted from seizure by the husband's creditors life insurance contracts purchased by a married woman on her husband's life, up to an annual premium of \$300.⁶⁸ Massachusetts followed suit by exempting life insurance from all claims of the named insured's creditors, not only for married women but for all classes of beneficiaries.⁶⁹ In 1861, Massachusetts further exempted from attachment or execution the cash surrender value of life insurance policies.⁷⁰ By the end of the nineteenth century, many states had passed laws exempting life insur-

58. Vukowich, *supra* note 55, at 800 (in over half the states the exemption is \$5,000 or less). As of June 1982, the average of all thirty-nine jurisdictions using a dollar limit on the homestead exemption was \$14,296.67.

59. Act of June 22, 1938, ch. 575, § 70c, 52 Stat. 840, 880 (1938) (amendment to the 1898 Act).

60. *Id.*

61. 266 U.S. 310 (1924) (decided before section 70 was amended).

62. The decision rested on the Court determining the bankruptcy filing date was the point of time which property not exempted left the debtor's hands. *Id.* at 313.

63. 318 U.S. 622 (1943).

64. *Id.* at 627-28. Applied in *Sampsell v. Straub*, 194 F.2d 228 (9th Cir.), *rev'g on rehearing*, 189 F.2d 379 (9th Cir. 1951), *cert. denied*, 343 U.S. 927 (1952).

65. See Countryman, *For A New Exemption Policy in Bankruptcy*, 14 RUTGERS L. REV. 678, 690-95 (1960).

66. See generally, *id.* at 693-95.

67. Verplanck Act of 1840, NEW YORK LAWS ch. 80.

68. *Id.* See Riesenfeld, *Life Insurance and Creditors' Remedies in the United States*, 4 U.C.L.A. L. REV. 583, 589 (1957).

69. MASS. LAWS ch. 82 (1844).

70. 1861 Mass. Acts ch. 186.

ance proceeds and the cash surrender value of insurance policies from seizure.⁷¹ There is no uniformity among the states on the amount of life insurance exempted or who can be a beneficiary.⁷² Because life insurance represents investment as well as protection, this has led one scholar to argue that the life insurance exemption should be limited to a reasonable dollar amount and apply only to dependent beneficiaries.⁷³

3. Wage Exemption

Toward the end of the nineteenth century, states exempted an individual's wages from attachment or garnishment in whole or in part.⁷⁴ The state wage exemption statutes were not uniform. Many of the states excluded a stated amount of weekly wages from attachment or garnishment.⁷⁵ Through decisional law some states have also exempted wages after they are deposited in the debtor's bank account.⁷⁶ When the 1898 Act was enacted, the amount of wages exempted by the various states was not particularly generous.⁷⁷ Because future wages did not become a part of the bankrupt's estate in "straight" bankruptcy under the 1898 Act, this exemption meant little to the bankruptcy process, except as to debts not dischargeable in bankruptcy.⁷⁸

Besides the basic wage exemptions, other types of payments were classified either as exempt or not exempt prior to the 1978 Act. Future earnings not yet received by the debtor could become part of his bankruptcy estate if the future earnings accrued prior to the date of bankruptcy and were paid in

71. S. RIESENFELD, *CASES AND MATERIALS ON CREDITORS REMEDIES AND DEBTOR'S PROTECTION* 332-36 (3d ed. 1979). See Vukowich, *supra* note 55, at 807.

72. Vukowich, *supra* note 55, at 808-10. There are basically three methods for limiting the amount exempted: 1) no dollar limitation; 2) a face amount limitation; or, 3) a dollar ceiling on the annual premium. See *id.* at 808.

73. *Id.* at 811-13.

74. See TEX. CONST. art. 16, § 28; ALA. CODE § 2823 (1876) (current version at § 6-10-7 (1975)); D.C. Acts of June 19, 1878, ch. 321, 20 stat. 173 (current version at D.C. CODE ENCYCL. § 15-503 (1981)); FLA. LAWS ch. 2065, § 1 (1875) (current version at FLA. STAT. ANN. § 222.11 (1977)); 1861 ILL. LAWS p. 177, § 2 (current version at ILL. ANN. STAT. ch. 110, § 12-803 (Smith-Hurd 1983)); 1886 KAN. SESS. LAWS ch. 111, § 1 (current version at KAN. STAT. ANN. § 60-2310(b) (1983)); 1858 MINN. PUB. STAT. ch. 61, §§ 90-91 (current version at MINN. STAT. ANN. § 550.37(13) (West Supp. 1983)); 1897 N.M. LAWS tit. 13, ch. 1, § 1737 (current version at N.M. Stat. Ann. § 35-12-7 (1978)); 1893 OKLA. STAT. § 4383-84 (current version at OKLA. STAT. ANN. tit. 14A, § 5.105(2) (1983)); 1896 TENN. PUB. ACTS ch. 4, art. I, § 3794 (current version at TENN. CODE ANN. § 26-2-106 (1955)); 1893 WASH. LAWS p. 102, ch. 56, § 23 (current version at WASH. REV. CODE ANN. § 7.33.280 (1984 Supp.)). See also Vukowich, *supra* note 55, at 813-20 (discussing the treatment of wage exemptions).

75. See, e.g., 1861 ILL. LAWS p. 177 § 2 (up to \$25.00); 1858 MINN. PUB. STAT. ch. 61 §§ 90-91 (up to \$25.00).

76. See *Miller v. Monrean*, 507 P.2d 771 (Alaska 1973) (seaman's wages); *Rutter v. Shumway*, 16 Colo. 95, 26 P. 321 (1891); *Staton v. Vernon*, 209 Iowa 1123, 229 N.W. 763 (1930); *Colonial Discount Co. v. Wilhelm*, 40 N.Y.S.2d 298 (1943). But see *Holmes v. Blazer Financial Servs.*, 369 So. 2d 987 (Fla. Dist. Ct. App. 1979) (holding that exempt wages lose their character when deposited in a bank account); *John O. Melby & Co. Bank v. Anderson*, 88 Wis. 2d 252, 276 N.W.2d 274 (1979) (in considering the Federal Consumer Credit Protection Act, held that the exempt wages lose their character when deposited in a bank account).

77. See *supra* notes 74-75. The exempt amounts ranged from \$25-30.00 under the original wage exemption acts, rather than by percentage of wages often used today. See, e.g., ALA. CODE § 6-10-7 (1975); ILL. ANN. STAT. ch. 110, § 12-803 (Smith-Hurd 1983).

78. See *infra* text accompanying notes 106-07, 114-18.

the form of income tax refunds.⁷⁹ Accrued vacation pay, on the other hand, was exempted from the bankruptcy estate as post-bankruptcy "fresh start" assets.⁸⁰ Retirement plans and pension annuities were also exempt from the bankruptcy estate in several states.⁸¹ Alimony and child support payments to persons who filed bankruptcy petitions were generally not exempt under state execution and attachment laws.⁸²

The treatment of wage-based benefits, such as retirement benefits, pension plan payments, and periodic support payments for alimony and child support, by state legislatures has not been consistent. For example, life insurance policies that are settled under an annuity settlement option are exempt, but a comparable payment to a survivor out of a qualified pension plan is not.⁸³ Not all states specifically exempt worker's compensation payments and unemployment compensation benefits from seizure or attachment;⁸⁴ nor, do all states protect the insurance industry from attachment of health insurance or disability insurance payments;⁸⁵ and, only one-fourth of the states exempt welfare payments from execution and attachment.⁸⁶ The 1898 Act did little to combat these inconsistencies. Section six of the 1898 Act did not preclude a debtor from claiming his state wage exemptions.⁸⁷ At the same time nothing in the chapter thirteen amendment to the 1898 Act on wage exemption plans took in account the state exemptions as a limit

79. *Segal v. Rochelle*, 382 U.S. 375 (1966).

80. *Lines v. Frederick*, 400 U.S. 18 (1971).

81. See *Vukowich*, *supra* note 55, at 821-24 (discussing state exemptions for retirement funds and similar "fringe benefits").

82. *Vukowich*, *supra* note 55, at 824-25. Alaska exempts the amount of a divorced man's wages necessary to make child support payments. ALASKA STAT. § 09.35.085 (1973). New York exempts support payments from the creditors of the wife and children. N.Y. CIV. PRAC. LAW § 5205(e)(3) (McKinney 1977).

83. See *Vukowich*, *supra* note 55, at 822-23.

84. *Vukowich*, *supra* note 55, at 826.

The states exempting workers compensation benefits are: ALA. CODE § 25-5-86(b) (1975); ARIZ. REV. STAT. ANN. § 23-1068(B) (1978); CAL. CIV. PRO. CODE § 704.160 (West Supp. 1973); CONN. GEN. STAT. ANN. § 31.320 (West Cum. Supp. 1984); IND. CODE ANN. § 22-3-2-17 (Burns 1974); KAN. STAT. ANN. § 44-514 (1981); MICH. COMP. LAWS ANN. § 418.821 (West Supp. 1983).

The states exempting unemployment compensation are: ALASKA STAT. § 23.20.405(b) (1962 & Supp. 1972); CAL. CIV. PRO. CODE § 704.120 (West Supp. 1984); COLO. REV. STAT. § 8-80-103 (1973); FLA. STAT. ANN. § 443.051 (West Supp. 1983-84); ILL. REV. STAT. ANN., ch. 48, § 540 (Smith-Hurd Supp. 1983); MINN. STAT. ANN. § 268.17(2) (1959); N.M. STAT. ANN. § 59-9-18(c) (1960); N.Y. LABOR LAWS § 595(2) (McKinney 1977); N.C. GEN. STAT. § 96-17(c) (Repl. Vol. 1981); OHIO REV. CODE ANN. § 4141.32 (Page Supp. 1983-84); OKLA. STAT. ANN. tit. 40, § 2-303 (Supp. 1980).

85. For the states that do provide such exemptions see CAL. CIV. PRO. CODE § 704.130 (West Supp. 1983); FLA. STAT. ANN. § 222.18 (1977); IOWA CODE ANN. § 511.37 (1949); ME. REV. STAT. ANN. tit 24A, § 2429 (1974); MASS. GEN. LAWS ANN. ch. 175, § 100A (West Supp. 1983); MINN. STAT. ANN. § 550.39 (1947); TEX. INS. CODE art 21.22(1) (1981); WASH. REV. CODE ANN. § 48.18.400 (1961).

86. See generally CAL. WELF. & INST. CODE § 11002 (West 1980 & Supp. 1984); LA. REV. STAT. § 46.111 (West 1982); MICH. STAT. ANN. § 400.62 (West 1976); OH. REV. CODE ANN. § 5107.12 (1981); ARIZ. REV. STAT. § 46-208 (1956); IOWA CODE ANN. § 239.13 (1969); N.M. STAT. ANN. § 27-2-21 (1982); N.C. GEN. STAT. § 108A.36 (Supp. 1983); R.I. Gen. Laws § 40-6-14 (1956); S.C. Code Ann. § 43-5-190 (Supp. 1983). See also COLO. REV. STAT. § 26-2-131 (1973) (payments to the blind exempted); N.H. REV. STAT. ANN. § 167:25 (1977) (payments to the blind, old age assistance, and disabled aid exempted); ORE. REV. STAT. § 412.115 (1981).

87. 30 Stat. at 548. See *supra* text accompanying note 46.

on what the debtor contributed to his plan.⁸⁸

4. The Spendthrift Trust, a Hidden Exemption

A spendthrift trust is not an exemption, but when spendthrift trusts became popular in the late nineteenth century, state courts consistently refused to enforce attachment, execution, or proceedings supplemental to execution against the trustee for debts contracted by the beneficiary.⁸⁹ Although the spendthrift trust was not included in state-created exemption statutes, judicial enforcement of the spendthrift trust's forfeiture restraints on alienation of income and principal made such trusts practically exempt.⁹⁰ Most bankruptcy courts followed state decisional law and held that spendthrift trust funds were not part of the bankrupt's estate under section 70(a) of the 1898 Act.⁹¹ Because of the variations in state laws, treatment of a spendthrift trust as an exemption was not resolved by the courts under the 1898 Bankruptcy Act.

E. *The 1898 Act and Federal Non-bankruptcy Exemptions*

The federal, non-bankruptcy law exemptions which could be elected in place of state exemptions did provide for many of the exemptions that states provided. The federal exemptions included federal employee wages, military disability payments and others.⁹² But because section six of the 1898 Act allowed the federal exemptions to yield to the elected state exemptions, the federal exemptions did little to make the 1898 Act a uniform act.⁹³

88. See Chandler Act ch. 575, §§ 601-86, 52 Stat. 840 (1938) (amendment to the 1898 Act).

89. See Vukowich, *supra* note 55, at 790-92. See also RESTATEMENT (SECOND) OF TRUSTS § 149 comment a (1959).

90. See Vukowich, *supra* note 55, at 790-92, pointing out the differences between a spendthrift trust and an exemption.

91. Eaton v. Boston Trust Co., 240 U.S. 427 (1916); Danning v. Lederer, 232 F.2d 610 (7th Cir. 1956); Roundtree v. Lane, 155 F.2d 471 (4th Cir. 1946); Suskin & Berry v. Rumley, 37 F.2d 304 (4th Cir. 1930); Jones v. Harrison, 7 F.2d 461 (8th Cir. 1925), *cert. denied*, 270 U.S. 652 (1926); Allen v. Tate, 6 F.2d 139 (8th Cir. 1925). See also *In re Morris*, 204 F. 770 (2d Cir. 1913) (allowing New York bankruptcy trustees to recover against trust assets). Illinois immunizes any trust fund set up for a beneficiary from execution or attachment. ILL. ANN. STAT. ch. 22, § 49 (Smith-Hurd 1958); see Hummel v. Cardwell, 390 Ill. 526, 62 N.E.2d 433 (1945), *cert. denied*, 327 U.S. 793 (1946).

92. See Vukowich, *Debtors' Exemption Rights under the Bankruptcy Reform Act*, 58 N.C. L. REV. 769, 787, 791 (1980).

93. *Id.* at 773. "[T]here is no one thing which makes our uniform Bankruptcy Act more un-uniform than Section 6 . . . which recognizes state laws in the setting aside of exemptions." *Id.*, quoting King, *Proposed Amendments to the Chandler Act*, 45 COM. L.J. 36, 40 (1940). But when considering the 1867 Act, one senator commented:

The idea of some gentlemen is that the law, to be uniform, must be equal in its operations. I do not hold to that idea at all. If we make a rule which operates upon the States equally, that is to say, which is equal in its terms, so far as the States are concerned, it would not be unconstitutional simply because, owing to the particular provisions of the several States, the operation would not be precisely similar. The provision of the Constitution unquestionably was intended to apply to the several States to prevent any distinction being made between them.

WARREN, *supra* note 32, at 106-07.

II. THE FLAWS OF SECTION SIX OF THE 1898 BANKRUPTCY ACT

A. *The Evils of Non-Uniform Bankruptcy Exemptions*

Section 6 of the 1898 Act⁹⁴ condoned a different federal exemption law for each state or territory within the United States. Under the 1898 Act election provision a Delaware debtor in bankruptcy court was able to hold back only \$200 worth of personal property and wearing apparel, \$75 worth of tools of the trade or business, a sewing machine and a rented player piano.⁹⁵ The same individual, had he been residing in Texas at the time of his financial misfortune could have saved a 160 acre tract of land or a half acre town lot from bankruptcy process, regardless of the worth of the property attributable to improvements.⁹⁶ More importantly, within the same state different classes of creditors, presumably operating under the same federal exemption rule, could be treated differently in bankruptcy process. In Massachusetts, for example, a debtor could take advantage of the liberal homestead allowance by filing a recorded declaration of homestead.⁹⁷ This declaration did not affect creditors holding debts predating the declaration.⁹⁸ When the debtor holding the homestead exemption filed his bankruptcy petition, some creditors could later seek satisfaction against the homestead property *if* their debts predated the homestead declaration,⁹⁹ although their debts were supposedly dischargeable in bankruptcy.

In most states, mechanic lien holders and material lien holders had special status against exempt homesteads. Labor and material furnished to improve a homestead were not frustrated by the exempt nature of the homestead property, and could be foreclosed under state law.¹⁰⁰ Such creditors were voluntary creditors of the bankrupt and their claims would otherwise be subject to discharge in bankruptcy. Nonetheless, mechanic lien holders were allowed to foreclose against exempt homestead property even though the owner of the homestead had received a discharge in bankruptcy,¹⁰¹ on logic similar to that of the creditor holding a debt preceding the creation of the homestead. Consequently, the 1898 Act federal bankruptcy exemptions worked arbitrarily and capriciously in individual cases. Section six provided no particular incentive for debtors to file bankruptcy petitions to receive better treatment than they would have had by a general grab of their assets by creditors in state courts.¹⁰²

94. 30 Stat. at 548.

95. DEL. CODE ANN. tit. 10 § 4902-03 (1975).

96. TEX. [PROP.] CODE ANN. § 41.001 (Vernon Supp. 1983) (prior to amendment); *see also* TEX. CONST. art. 16, §§ 50, 51 (200 acres for family outside city, 100 acres for a single person; up to \$10,000 for a lot in the city).

97. MASS. GEN. LAWS ANN. ch. 188 § 2 (West 1977).

98. *Id.* at § 1 (amended 1979).

99. *Id.* at §§ 1-2.

100. ALA. CONST. art. 10, § 207 (1981); GA. CODE ANN. § 44-13-1 (Supp. 1983); MD. [CTS. & JUD. PROC.] CODE ANN. § 11-507 (1984); NEB. REV. STAT. § 40-103 (1978); TEX. [PROP.] CODE ANN. § 41.002 (Vernon Supp. 1983); VT. STAT. ANN. tit. 12, § 2740 (1973).

101. *See supra* note 99.

102. *See Kennedy, Limitations of Exemptions in Bankruptcy*, 45 IOWA L. REV. 445, 450-53 (1960). Kennedy argues against a set of specific federal exemptions because such a provision would encourage creditors to file involuntary petitions against debtors in states which had ex-

Serious doubts about the constitutionality of such a crazy-quilt system of exemptions were often raised. Within a few years after Congress passed the 1898 act, creditors decided to challenge its constitutionality under the bankruptcy clause of the Constitution.¹⁰³ In *Hanover National Bank v. Moyses*,¹⁰⁴ Hanover National Bank sued defendant Moyses on a money judgment entered against Moyses in Mississippi on a promissory note in default.¹⁰⁵ Subsequently, Moyses moved to Tennessee and filed a voluntary bankruptcy petition under the 1898 Act.¹⁰⁶ Moyses received a discharge in bankruptcy from all of his debts.¹⁰⁷ The Supreme Court considered the Bank's constitutional argument that Moyses' discharge should be void because enforcing state exemptions under the 1898 Act¹⁰⁸ violated the uniformity requirement of the bankruptcy clause.

In affirming the circuit court's finding for Moyses, the Supreme Court noted that Congress, unlike the states, was not forbidden to pass statutes impairing contracts.¹⁰⁹ The only limitation imposed was that "[t]he laws passed on the subject must, however, be uniform throughout the United States, but that uniformity is geographical and not personal, . . ."¹¹⁰ Then, without addressing the differences between the exemption scheme of the 1867 Act and that of the 1898 Act,¹¹¹ the Supreme Court adopted the point of view expressed in lower court cases decided under the much different 1867 exemption laws. That view was that the 1898 Act, requiring all federal courts sitting in bankruptcy to use state exemption laws as a rule of decision, did not violate the constitutional requirement of uniform laws on the subject of bankruptcies.¹¹² Justice Fuller claimed uniformity was met because the trustee "takes in each State whatever would have been available to the creditors if the bankrupt law had not been passed."¹¹³ The Supreme Court concluded, without stating its reasons, that Congress had made no unlawful

emptions less generous than the federal exemptions. Cf. *England v. Sanderson*, 236 F.2d 641, 643-44 (9th Cir. 1956) (creditors should not be subject to a haphazard "grab law").

103. The bankruptcy clause of the constitution provides "to establish . . . uniform laws on the subject of Bankruptcies throughout the United States." U.S. CONST. art. I, § 8, cl. 4.

104. 186 U.S. 181 (1902).

105. *Id.* at 181-82.

106. See Bankruptcy Act of 1898 ch. 541, § 4, 30 Stat. 544, 547.

107. 186 U.S. at 182. Claiming no notice of Moyses' voluntary bankruptcy petition, Hanover National Bank continued to prosecute the judgment action against Moyses until Moyses demurred. *Id.* at 183. The demurrer was sustained by the circuit court. *Id.*

108. See *supra* text accompanying note 46.

109. See 186 U.S. at 187-88. In support of this argument, Justice Fuller noted that the 1867 Act applied to persons other than merchants and traders without infringing on the "uniform system of bankruptcy." *Id.* at 187. See also *In re Klein*, appended to *Nelson v. Carland*, 42 U.S. (1 How.) 265, 277 (1843) (quoted in *Moyes*, 186 U.S. at 186). Congressional jurisdiction in bankruptcy extends "to all cases where the law causes to be distributed the property of the debtor among his creditors; this is its least limit. Its greatest, is the discharge of a debtor from his contracts." *Id.* at 281.

110. 186 U.S. at 188.

111. Under section 14 of the 1867 Act debtors were allowed to claim state-created homestead exemptions over and above the federal "floor" exemptions. See *In re Deckert*, 7 F. Cas. 334 (E.D. Va. 1874) (No. 3728) (quoted in *Moyes*, 186 U.S. at 189-90). Such an "over and above" claim was not allowed under the 1898 Act. Therefore the question of uniformity should have been treated differently in *Moyes*.

112. See *supra* text accompanying note 109, 186 U.S. at 188.

113. 186 U.S. at 190.

delegation of legislative power to state assemblies by means of section 6.¹¹⁴ In effect, *Moyes* validates as constitutional the non-uniform treatment of a treatment of a bankrupt's federal bankruptcy exemptions from state to state. This allows the accident of domicile to control a federal rule.

A few years later, in *Lockwood v. Exchange Bank*,¹¹⁵ the Supreme Court approved the non-uniform treatment by states of different classes of creditors as constitutionally permissible under the bankruptcy clause. The issue in *Lockwood* was whether a bankruptcy court had any jurisdiction over the bankrupt's exempt property to enforce the rights of a creditor holding an exemption waiver against the property.¹¹⁶ After *Lockwood* was adjudged bankrupt,¹¹⁷ Exchange Bank objected to the trustee's designation of the homestead and other property as exempt.¹¹⁸ Exchange Bank claimed Lockwood had waived his exemption rights in their favor.¹¹⁹ To meet Exchange Bank's potential levy on Lockwood's exempt property, the district court enforced Lockwood's waiver by reducing Lockwood's exemptions to the lowest permissible amount.¹²⁰ The Supreme Court concluded that Congress did not give the bankruptcy courts jurisdiction to enforce an exemption waiver held by a creditor against the bankrupt's exempt property.

We think that the terms of the bankruptcy act of 1898 . . . clearly evidence the intention of Congress that the title to the property of a bankrupt generally exempted by state laws should remain in the bankrupt and not pass to his representative in bankruptcy, as did the provisions of the act of 1867,¹²¹

A contrary holding would have allowed the bankruptcy court to assume jurisdiction over exempt property, which in the Supreme Court's eyes would cause an "irremediable" inconvenience to the bankrupt and to other parties interested in an orderly liquidation in favor of the waiver-holding creditors.¹²² Therefore, the Supreme Court compromised: although the bankruptcy court had no jurisdiction over the bankrupt's exempt assets, the waiver holding creditor could require a stay of all bankruptcy proceedings while it perfected its levy and execution rights against otherwise exempt property.¹²³

114. *Id.*, citing *In re Rahrer*, 140 U.S. 545, 560 (1891). *In re Rahrer* concerned state's police power and interstate commerce. Charles Rahrer, without a druggist permit, had sold alcohol shipped from Missouri in defiance of the Kansas prohibition act. *In re Rahrer*, 140 U.S. at 546-47. The Supreme Court held Congress' authorization for states to regulate internal sales of alcoholic beverages was not an improper delegation of Congress' authority to regulate commerce. *See id.* at 561-62.

115. 190 U.S. 294 (1903).

116. *Id.* at 298.

117. *Id.* at 296 (Lockwood had filed a voluntary bankruptcy petition).

118. *Id.* at 294-95.

119. *Id.*

120. *Id.* at 296. In allowing exemption waivers Georgia provided a minimum exemption of wearing apparel and household and kitchen furniture, and provisions for not more than three hundred dollars. *See id.* at 297 (citing GA. CONST. of 1877, art. 9, § 3).

121. *Id.* at 299.

122. *Id.* at 300.

123. *Id.* at 300-01.

The *Lockwood* holding is inconsistent.¹²⁴ First, the Supreme Court stated that the bankruptcy courts had no jurisdiction over the debtor's exempt assets,¹²⁵ and as such can not adjudicate a claim by an exemption waiver-holding creditor against exempt assets. Yet, it directed the bankruptcy court to stay its hand while the waiver-holding creditor sought relief in state court against the exempt assets.¹²⁶ This gave the bankruptcy court jurisdiction to suspend its operations until some preferred creditor realized collection against exempt assets. In fact, the Supreme Court conceded the bankruptcy court had jurisdiction over the exempt assets of the bankrupt.¹²⁷ Thus, no creditor or bankrupt could force an approval of a trustee's report on exempt property so long as a single waiver-holding creditor required time to perfect a judgment or execution lien against exempt assets. Non-uniform treatment of exemptions proper¹²⁸ and non-uniform treatment of creditors were condoned under the 1898 Act¹²⁹ despite the bankruptcy clause in the Constitution.

B. *The Question of a Debtor's Domicile*

Because the 1898 Bankruptcy Act allowed debtors to claim the exemptions offered by their state of domicile, the federal bankruptcy courts were plunged into the application of state conflict of laws rules relating to the enforcement of judgments and the applicability of exemptions. The Supreme Court, in dicta in *Chicago, Rock Island & Pacific Railway v. Sturm*,¹³⁰ stated that state exemption laws are not constituent parts of the contract to pay a debt, but should be considered remedies.¹³¹ Thus, it followed that when an out-of-state debtor was sued by an in-state creditor on a contract to pay money, and execution was taken in the forum state, the exemption laws of the forum state would prevail.¹³² Transferring this reasoning to bank-

124. See generally Kennedy, *supra* note 101, at 462 (the *Lockwood* decision has been the subject of much disharmony).

125. See 190 U.S. at 299.

126. See *id.* at 300-01.

The doctrine affords a mode of circumventing the policy and provisions of the Bankruptcy Act which condemn preferences and secret liens. When a waiver holder is permitted to prove the full amount of his claim in bankruptcy and to receive dividends computed thereon and at the same time to enjoy the blessing of the bankruptcy court while he pursues the debtor's exempt property elsewhere, he is surely getting preferential treatment in any ordinary sense of that term.

Kennedy, *supra* note 101, at 463 (footnotes omitted).

127. See *id.* at 298 (quoting bankruptcy act provisions dealing with exempt property).

128. See *supra* notes 102-13 and accompanying text.

129. See *supra* notes 114-26 and accompanying text.

130. 174 U.S. 710 (1899).

131. "Exemption laws are not a part of the contract; they are part of the remedy and subject to the law of the forum." *Id.* at 717 (citations omitted). *Sturm* was an action between Iowa and Kansas domiciliaries on an enforcement of a garnishment judgment. Cf. Currie & Schreter, *Unconstitutional Discrimination in the Conflict of Laws: Equal Protection*, 28 U. CHI. L. REV. 1, 25-26 (1960) (criticizing the Supreme Court for considering the conflict of law issue when it was not necessary to the case).

132. This position was later ratified in the RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 132 (1971):

The local law of the forum determines what property of a debtor within the state is exempt from execution unless another state, by reason of such circumstances as the domicile of the creditor and the debtor within its territory, has the dominant interest

ruptcy practice, this would authorize a debtor to claim exemptions provided for by the forum state in which he filed his bankruptcy petition. But, the federal courts reach a contrary conclusion.

Resting in part on the domiciliary provisions of section 2 in the 1898 Act concerning bankruptcy jurisdiction and the express provisions of section 6, the federal courts held a bankrupt could claim the exemptions of his domiciliary state.¹³³ These exemptions would apply even if part of the bankrupt's property was situated in another state that had different exemption laws applicable to that state's residents.¹³⁴ Consequently, property which would qualify as exempt in the forum state, but not the domicile state, would not be exempt in bankruptcy.¹³⁵ Since residency and domicile are not equivalent terms,¹³⁶ under the 1898 Act a bankrupt could wind up losing exemptions guaranteed to a resident when the bankruptcy court found that the debtor was domiciled in a place other than his residence. Such predicaments were inherent in the federal exemption system in the 1898 Act because the Act depended upon state rules of decision for its operation.

C. *Critical Reactions to the Section Six Exemption Scheme*

Until the 1960's, section 6¹³⁷ was the subject of very little criticism. When the critical commentaries began to mushroom, one of the first commentators, Professor Countryman, immediately pointed out that the federal bankruptcy exemption policy lacked uniformity because it depended on the individual states' execution exemptions to protect the federal interest.¹³⁸

State exemption laws are not designed primarily for use in a system of orderly liquidation where all of the debtor's estate is to be converted to cash, but in a system of piecemeal liquidation where each creditor levies upon and sells such property as he can locate The problem for the bankruptcy court is usually that of identifying property other than cash which fits the description contained in the state exemption law—and of appraising that property where the state law fixes a value limit.¹³⁹

Professor Countryman's solution to have uniformity without using fifty different state exemption laws was to pass a nationwide uniform exemption act

in the question of exemption. In that event, the local law of the other state will be applied.

See Currie & Schreter, *supra* note 130, at 28 (supporting this position because it prevents forum shopping by an in-state creditor).

133. See e.g. *In re Camp*, 17 Am. B.R. (N.S.) 189 (S.D. Cal. 1931).

134. See *in re Reiter*, 58 F.2d 631, 21 Am. B.R. (N.S.) 290 (2d Cir. 1932), *cert. denied*, 287 U.S. 652 (1933) (law of the bankrupt's domicile controlled regarding exemption of life insurance contract even though the policy was located in New York). See also *In re Camp*, 17 Am. B.R. (N.S.) 189 (S.D. Cal. 1931) (Texas homestead exemption applied to Texas property because the bankrupt had not established California as his new domicile).

135. See *In re Stevens*, 23 F. Cas. 1 (W.D. Wis. 1870) (No. 13,392) (applying section 14 of the 1867 Act).

136. See generally Reese & Green, *That Elusive Word, "Residence,"* 6 VAND. L. REV. 561 (1953) (discussing the differences and similarities between the use of residence and domicile).

137. See *supra* text accompanying note 46.

138. See Countryman, *For a New Exemption Policy in Bankruptcy*, 14 RUTGERS L. REV. 678, 680-84 (1960).

139. *Id.* at 681 (footnotes omitted).

that would only provide for a cash allowance to bankrupts from their estates.¹⁴⁰ Such a cash allowance would be similar to the provisions of the 1800 and 1841 bankruptcy acts.¹⁴¹

Another commentator advocated no change in the use of state exemption laws in federal bankruptcy cases.¹⁴² This commentator recognized, as did Professor Countryman,¹⁴³ that state exemption laws were passed in a pre-industrial era for the benefit of self-sufficient subsistence farmers and small town tradesmen, and no longer met the exemption needs of a post-industrial highly interdependent society.¹⁴⁴ Even though the state exemptions may be ill-adapted to serve their original purpose, the recognition of state interests in protecting bankrupts from poverty and a dependence on public assistance should continue.¹⁴⁵

Both commentators neglected to consider some of the "hidden exemptions" of the 1898 Act. For example, real or personal property held by tenancy in the entirety was not part of one tenant's bankrupt estate under section 70(a) unless both tenants filed petitions and the two petitions were consolidated for disposition.¹⁴⁶ Countryman did note, however, that "spendthrift trusts" were not included in the bankrupt's estate, and practically speaking, were treated as exempt.¹⁴⁷ Although future earnings were not exempt, unless they qualified under one of the federal exemption statutes for wages or other benefits, the discharge of the debtor in bankruptcy stopped creditors not holding a reaffirmation agreement from attaching or garnishing the bankrupt's future earnings.¹⁴⁸

Other critical reviews of the state of the bankruptcy law also included attacks on the exemption program of section 6,¹⁴⁹ along with articles directly attacking section 6.¹⁵⁰ Nearly all the criticism concerning section 6 was directed at the use of antique state exemption laws in a modern commercial setting as the means for preserving the economic viability of bankrupt debt-

140. *Id.* at 746-48.

141. *See supra* notes 33-34, 38 and accompanying text.

142. Kennedy, *supra* note 101, at 445-46. *See supra* note 101 and accompanying text.

143. *See* Countryman, *supra* note 137, at 681-84.

144. Kennedy, *supra* note 101, at 446-49.

145. *Id.* If the state exemptions are liberal then creditors should take that into account when dealing with debtors. *Id.* at 450.

146. *See generally* 1A COLLIER ON BANKRUPTCY ¶ 6.06 (14th ed. 1974).

147. Countryman, *supra* note 137, at 669-70. *See supra* notes 88-90 and accompanying text.

148. Under the 1898 Act, a reaffirmation of a debt discharged in bankruptcy was a matter between the bankrupt and his creditors and was supported by an oral promise to pay the debt, disregarding the statute of frauds. Later the Supreme Court ruled, however, that a pre-bankruptcy wage attachment could not continue after the debtor's discharge, even if the wage attachment was neither a fraudulent transfer nor a preference. *See Local Loan Co. v. Hunt*, 292 U.S. 234 (1934). Section 524(c) and (d) of the 1978 Bankruptcy Reform Act severely restricts the debtor's reaffirmation of a debt discharged in bankruptcy and has pre-empted the old common-law rules surrounding reaffirmation. 11 U.S.C. §§ 524(c)-(d) (1982).

149. *See, e.g.*, D. STANLEY & M. GIRTH, *BANKRUPTCY PROBLEMS, PROCESS, REFORM* 81-84 (1971); Countryman, *Consumer Bankruptcy—Some Recent Changes and Some Proposals*, 19 U. KAN. L. REV. 165, 167-68 (1971).

150. *See Note: Bankruptcy Exemptions: Critique and Suggestions*, 68 YALE L.J. 1459 (1959); *See also Note, Bankruptcy Exemptions: A Full Scale Circle Back to the Act of 1800?*, 53 CORNELL L. REV. 662 (1968).

ors.¹⁵¹ When the Commission on Bankruptcy Laws was established¹⁵² to review current bankruptcy laws with a view toward restructuring the entire system, exemptions were included in the areas of concern to be addressed by the Commission.¹⁵³ The results of the Commission's work was the 1973 Bankruptcy Reform Act,¹⁵⁴ which was the basis for the four year long struggle of completing a federal bankruptcy code for Congress' approval.

III. THE BIRTH OF SECTION 522

A. *Legislative History*

The 1973 Bankruptcy Reform Act submitted by the Bankruptcy Commission contained a completely re-worked provision for debtor's exemptions. Section 4-503 of the Commission's report required all debtors, who were entitled to take exemptions, to take a single set of nationwide federal exemptions when they applied for bankruptcy relief.¹⁵⁵ The Commission's menu of federal exemptions provided for the main course a \$5,000 homestead exemption. The homestead exemption would be taken in a personal residence¹⁵⁶ with any remaining amount applied toward other exemptions.¹⁵⁷ The homestead exemption would function as a general cash exemption available to debtors in bankruptcy for use as a shield for various family support and maintenance assets. The Commission served as appetizers a \$1,000 exemption in "livestock, wearing apparel, jewelry, household furnishings, tools of the trade or profession, and motor vehicles."¹⁵⁸

For dessert the Commission would have allowed debtors to claim up to \$500 in accrued vacation pay and bonuses, alimony and support payments without dollar limitation, proceeds from a life insurance policy if the insured was a spouse of a dependent, rights in a pension plan, disability benefits, workman's compensation or unemployment compensation payments, and professionally prescribed health aids.¹⁵⁹ The cash surrender value of life in-

151. See STANLEY & GIRTH, *supra* note 149, at 81. This Brookings Institute study on the bankruptcy process concluded that:

Nevertheless the treatment of exemptions is characterized by both inequities and waste motion.

The inequities are largely due to the often obsolete and extremely diverse provisions of state exemption laws. . . . The state laws now in effect tend to reflect the values of rural life in the nineteenth century and vary greatly in specificity and generosity.

Id. at 81 (footnotes omitted).

152. Act of July 24, 1970, Pub. L. No. 91-354, 84 Stat. 468 (amended Pub. L. No. 93-56, 87 Stat. 140 (1973)) [hereinafter referred to as Commission].

153. For an analysis of the Commission's recommendations on exemptions see generally Plumb, *The Recommendations of the Commission on the Bankruptcy Laws—Exempt and Immune Property*, 61 VA. L. REV. 1 (1975).

154. REPORT OF THE COMMISSION ON THE BANKRUPTCY LAWS OF THE UNITED STATES, Part II, H.R. DOC. NO. 137, 93d Cong., 1st Sess. 125, § 4-503 (1973) [hereinafter referred to as COMMISSION REPORT].

155. *Id.*

156. *Id.*, § 4-503(b)(1). The label given the personal residence would have been irrelevant as long as it was used as a home, i.e. a boat, a condominium. *Id.* at 128 n.4.

157. *Id.* at 125, § 4-503(b)(2).

158. *Id.*, § 4-503(c)(1). Any remaining homestead exemption could be added to this exemption. See *id.* § 4-503(b)(2).

159. *Id.*, § 4-503(c).

insurance contracts owned by the debtor was also exempt up to \$1500,¹⁶⁰ and if the cash surrender value exceeded \$1500, the debtor could redeem the contract by paying the Federal Bankruptcy Administrator the additional cash surrender value.¹⁶¹ A unique aspect of the Commission's report would have allowed the family of a deceased debtor, who died during the pendency of bankruptcy administration, to take a living allowance of \$1,000 per dependent from the undistributed property of the debtor.¹⁶²

Administratively, all property of the debtor, whether exempt or not, would have been part of the debtor's estate, reversing the 1898 Act's exclusion of exempt property from assets administered by the trustee.¹⁶³ The Commission specifically provided federal bankruptcy exemptions could not be waived.¹⁶⁴ If a debtor transferred property, otherwise exempt, to defraud creditors, then the right to claim that property as exempt would be forfeited.¹⁶⁵ Finally, the federal bankruptcy exemptions were to be paramount, and would supersede any state exemption laws with respect to bankruptcy.¹⁶⁶

It is hardly surprising that the Commission's exemption provisions were attacked by other parties interested in bankruptcy reform. The National Conference of Bankruptcy Judges introduced their own counter-reform bill within a few weeks of the filing of the Commission's bill.¹⁶⁷ The Judges' bill contained an exemption list materially different from that in the Commission's list. The Judges' bill would have limited the debtors' claims to federal exemptions to an aggregate of \$25,000 for all property listed as exempt.¹⁶⁸ Unlike the Commission's bill, the Judges' bill would continue to allow a debtor to elect his state-created exemptions in lieu of the federal aggregate exemption scheme.¹⁶⁹

Items of exempt property proposed by the Judges' bill was similar to the Commission's bill, only the treatment of that property changed. The unique family allowance for the survivors of deceased debtors in bankruptcy would

160. *Id.* at 126, § 4-503(d).

161. *Id.*

162. *Id.* § 4-503(e).

163. *Id.* at 147, § 4-601(a). *See supra* note 47.

164. *Id.* at 126, § 503(f). The statute read:

(f) *Waiver; Liens.* A waiver of exemptions is unenforceable by a creditor without security in the property allowed to the debtor pursuant to this section. A lien obtainable by legal or equitable proceedings and, with respect to wearing apparel, household goods, and health aids, any lien created by an agreement to give security other than for a purchase money obligation, is unenforceable against the property allowed to the debtor pursuant to this section as exempt, except that such lien may be preserved for the benefit of the debtor.

Id. This provision would have overruled the *Lockwood* doctrine. *See supra* notes 114-126 and accompanying text.

165. *Id.* 126-27, § 4-504(h).

166. *Id.* at 125, § 4-504(a). This would also apply to any Internal Revenue Service exemptions. *See id.* at 409-10; Plumb, *supra* note 152, at 13.

167. *See Bankruptcy Revision Act: Hearings on H.R. 31 & 32 Before the Subcomm. on Civil & Const. Rights of the House Comm. on the Judiciary*, 94th Cong., 1st & 2d Sess. 1 (1975) (appendix) [hereinafter referred to as *Appendix to Hearings*].

168. *Id.* at 146, § 4-503(a). The \$25,000 ceiling applied only to the federal exemptions and not to the alternative state exemptions.

169. *Id.*

have been also included in the Judges' bill.¹⁷⁰ The Judges would have provided a larger homestead exemption of \$6,000 plus a \$600 additional exemption for each of the debtor's dependents.¹⁷¹ The homestead exemption could be used to exempt a burial plot, *but* no separate exemption existed for such plot.¹⁷² The homestead could have also been used to exempt cash surrender value on any life insurance policy owned by the debtor.¹⁷³ The Judges' bill would have allowed debtors to take a \$3,000 aggregate exemption for "live-stock, wearing apparel, jewelry, household furnishings, tools of the trade or profession, and motor vehicles,"¹⁷⁴ so long as debtors did not elect state exemptions.

The Judges' bill was based on a different system of administration and required the debtor to make an election of exempt property or be deemed to have waived all exemption rights.¹⁷⁵ The Judges did agree with the Commission that the debtor's trustee in bankruptcy would take title to all the debtor's assets, exempt and non-exempt.¹⁷⁶ By permitting debtors to choose to take state exemptions as their federal exemptions, however, the Judges' bill would have dragged into bankruptcy administration the old problems of section 6 of the 1898 Act. If the debtor elected state exemptions in states which permitted waiver of exemptions, then the debtor would have chosen to allow creditors holding exemption waivers the special status allowed by such laws. Because the judges voided waivers of exemptions,¹⁷⁷ this would have given a powerful incentive for the filing of involuntary bankruptcy petitions in the few states recognizing exemption waivers. The "hidden preference" rule would be extended to claims for alimony and support payments and intentional injuries to the person because many states have created exceptions to the exemptions for such claims.¹⁷⁸

The proponents of the Judges' bill were the Federal Bankruptcy Judges seeking status as article three judges. The bankruptcy specialists understood the reason that others supported the bill was because of the creation of debtor havens in states such as California and Texas.¹⁷⁹ The preservation of highly favorable state exemption laws would be an incentive for eligible bankrupts to relocate to these states to take advantage of their generous exemption laws. The adoption of generous federal exemptions as an alternative measure appealed to bankruptcy specialists in states like Pennsylvania

170. *Id.* at 149, § 4-503(g). See *supra* note 161 and accompanying text.

171. *Appendix to Hearings, supra* note 166, at 146, § 4-503(b).

172. *Id.*

173. *Id.* at 149, § 4-503(c). The life insurance policy exemption included "key man" insurance proceeds. The debtor could pay for the cash surrender value that exceeded the limits of the homestead exemption. *Id.*

174. *Id.*, at 147, § 4-503(e)(1). The Judges' did not exempt profit sharing plan rights and stock bonus plan rights from creditors. Cf. COMMISSION REPORT, *supra* note 153, at 126, § 4-503(e)(6).

175. See *Appendix to Hearings, supra* note 166, at 146 § 4-503(a).

176. *Id.* at 163, § 4-601(a). See *supra* text accompanying note 162.

177. See *supra* text accompanying notes 114-126.

178. *Appendix to Hearings, supra* note 166, at 150, § 4-503(h).

179. See, e.g., *Hearings, supra* note 12, 1660, 1663-64 (March 12, 1976) (statement of L.E. Creel, III); *Hearings, supra* note 10, 969, 977-78 (December 10, 1975) (statement of Bernard Shapiro).

and Delaware whose state exemption laws grudgingly gave as little as possible to debtors.¹⁸⁰ Thus, the proponents of the exemption scheme in the Judges' bill were from various special interest groups.

The results of four years of debate, testimony, and congressional pushing and shoving was the final version of the "new" bankruptcy exemptions contained in section 522.¹⁸¹ The final bankruptcy reform bill, contains a mixed set of exemption rules. As drafted, section 522 includes the exemption scheme of the Judges' bill. The debtor can elect either the federal exemptions contained in section 522 or the exemptions of his domiciliary state.¹⁸² If the debtor fails to claim an exemption then he waives all rights in that exempt property.¹⁸³

Section 522 exempts from bankruptcy claims the debtor's interest in property held as a tenant in the entirety.¹⁸⁴ Continuing the 1898 Act's policy on post-discharge exemptions, exempt assets are not liable to the claims of non-dischargeable creditors after bankruptcy.¹⁸⁵ Basically, the federal exemption menu includes a \$7,500 homestead exemption in personal residence and burial plot,¹⁸⁶ \$1200 in a debtor's equity in a single motor vehicle,¹⁸⁷ \$200 per item in household furnishings, household goods, wearing apparel, appliances, books, animals, crops or musical instruments held ordinarily for personal, family or household use,¹⁸⁸ \$500 in personal jewelry,¹⁸⁹ and a \$400 general cash exemption allowable against any property together with any unused homestead.¹⁹⁰ Similar to prior bankruptcy acts, the Committee Hearings on the Bankruptcy Reform Act in 1976 and 1977 contain little testimony on these bankruptcy exemptions.¹⁹¹

During last minute horsetrading between the Senate and the House, major portions of section 522 were revised and submitted to the House without comment. Exempt property was added or stricken from the federal menu, and dollar amounts were altered without explanation.¹⁹² A further administrative change of major proportion was made—allowing states to

180. See e.g., *Hearings, supra* note 12, 1537, 1539 (March 5, 1976) (prepared statement of Louis W. Levit, Chairman of Special Committee of the Judiciary Commercial Law League of America).

181. Bankruptcy Reform Act of 1978, 92 Stat. 2549, 2586 (current version at 11 U.S.C. § 522 (1982)).

182. *Id.* § 522(b)(1).

183. See § 522(b)(1).

184. *Id.* § 522(b)(2).

185. Compare *id.* § 522(b)(2)(B) with *supra* note 145 and accompanying text.

186. *Id.* § 522(c).

187. *Id.* § 522(d)(1). These dollar limitations were lowered from those originally recommended. See Bankruptcy Reform Act of 1978, H.R. 8200, 95th Cong., 2d Sess.

188. *Id.* § 522(d)(2).

189. *Id.* § 522(d)(3).

190. *Id.* § 522(d)(4).

191. *Id.* § 522(d)(5). Other property exemptions allowed are: \$750 for tools of trade, § 522(d)(6); unmaturing life insurance contracts, § 522(d)(7); professionally prescribed health aids, § 522(d)(9); various public assistance benefits, § 522(d)(10); and, victim reparation act awards or wrongful death payments, § 522(d)(11).

192. Two statements located that relate to exemptions are: *Hearings on S2266 & H.R. 8200 Before the Subcomm. on Improvements in Judicial Machinery of the Senate Comm. on the Judiciary*, 95th Cong., 1st Sess. 617, 619 (1978) (supplemental statement of the Commercial Law League of America) [hereinafter cited as *Hearings—Improvements*]; *Hearings—Improvements*, at 650-51, 654-55

vote their citizens out of the federal exemption scheme altogether.¹⁹³ The final product of the federal bankruptcy exemption statute is full of contradictions, unresolved conflicts, and ambivalence.

B. *Provisions of Section 522 as Enacted*

Today, section 522 provides two alternative exemption menus to debtors: the federal menu in section 522(d) or the state-created menus of each state. By statute, a state legislature could deprive its domiciliaries of electing the federal menus, forcing them to take only the state menu. As mentioned above, the federal menu consists of exemptions limited by dollar amounts, along with exemptions limited by a court determination of the amount "reasonably necessary for support" of the debtor, exemptions limited both by dollar amount and a support standard, unlimited exemptions, and alternative exemptions.

1. Exemptions Limited by Dollar Amount

Besides the dollar limited exemptions, any unused portion of the homestead exemption can be used, together with a \$400 allowance,¹⁹⁴ as a "wild card" against any property of the debtor.¹⁹⁵ The debtor can also collect an exemption of up to \$200 for "any item" of household furnishings, household goods, wearing apparel, appliances, books, animals, crops, or musical instruments that are held for personal, family or household use.¹⁹⁶

2. Exemptions Limited by Amount "Reasonably Necessary for Support"

Section 522 exempts benefits payable to the debtor based on a judicial determination by the bankruptcy judge of what the debtor and his dependents require as reasonably necessary for their support.¹⁹⁷ When an exemption requires the bankruptcy judge to determine what is reasonably necessary for the debtor's future support, the judge must exempt what is necessary from the property right,¹⁹⁸ leaving the rest to be turned over to the trustee in bankruptcy for division among the debtor's creditors. These property right exemptions, limited by a support standard, are designed to be

(statements of Alvin O. Wiese, Jr., Chairman, Subcomm. on Bankruptcy, National Consumer Finance Association).

The companion measure of the Bankruptcy Reform Act presented to the Senate adopted the exemption scheme of section 6, of the 1898 Act—eliminating any federal exemptions. *See Hearings—Improvements*, at 835 (prepared statement of the National Bankruptcy Conference) (arguing against returning to such a scheme).

193. 11 U.S.C. § 552(b)(1).

194. *Id.* § 552(d)(5).

195. *Id.* § 552(d)(4).

196. *Id.* § 552(d)(3).

197. *Id.* § 522(d)(10), (11).

198. Property rights that require a "reasonably necessary determination are: alimony, support, or separate maintenance payments, § 522(d)(10)(D); pension, profit sharing, or similar plan, § 522(d)(10)(E); a wrongful death award, § 522(d)(11)(B); if the debtor is a dependent, life insurance payments, § 522(d)(11)(C); and, loss of future earnings compensation, § 522(d)(11)(E).

treated as post-bankruptcy welfare payments to keep the debtor off the relief rolls.

3. Exemptions Limited by Both Dollar Amount and Other Standards

Section 522(d)(11)(D) arbitrarily limits debtors to a \$7,500 exemption for recovery on personal injuries to the debtor or to someone whom the debtor depends on for support.¹⁹⁹ This exemption excludes any compensation for pain and suffering or for "actual pecuniary loss".²⁰⁰ Congress did not provide an explanation for this strange limitation on the exemption for personal injury damages.²⁰¹

4. Unlimited Exemptions

Certain types of welfare-related entitlements are exempted by Congress without any limitations. Some of these entitlements are professionally prescribed health aids, social security, and veterans' benefits."²⁰² Congress offered no particular explanation for its determination that these entitlements should be treated differently than those limited by a reasonable support standard.²⁰³ These exemptions should keep disabled, unemployed, or elderly debtors off the relief rolls.

5. The Alternative Exemptions

If a debtor elected to take the federal non-bankruptcy exemptions, or was forced to do so by his state's "opting out" statute, the debtor can qualify for exemptions covered in other statutes. These other exemptions apply to benefits similar to the ones covered in section 522, such as social security benefits,²⁰⁴ veteran's benefits,²⁰⁵ and compensation and benefits under the Longshoremen's and Harbor Workers' Compensation Act.²⁰⁶ Additionally, the debtor could take whatever exemptions his domiciliary state offered, together with all the headaches associated with administration of state exemption laws as federal bankruptcy exemptions, leaving open the question whether such an "election" destroyed the anti-exemption waiver provisions of section 522(e)²⁰⁷ and the lien avoidance provisions of section 522(f).²⁰⁸

199. 11 U.S.C. § 522(d)(11)(D).

200. *Id.*

201. *Id.* "Actual pecuniary loss" was not defined in the Bankruptcy Reform Act of 1978. *See* H.R. REP. NO. 595, 95th Cong., 2d Sess. 362, *reprinted in* 1978 U.S. CODE CONG. & AD NEWS, 5787, 6318 ("designed to cover payments in compensation of actual bodily injury, such as the loss of a limb, and is not intended to include the attendant costs that accompany such a loss, such as medical payments, pain and suffering, or loss of earnings").

202. *See generally* §§ 522(d)(9), (10).

203. The committee report on the House version of the Bankruptcy Reform Act did not mention why these entitlements were to be totally sheltered. *See* H.R. REP. NO. 595, 95th Cong., 1st Sess. 1 (1977).

204. 42 U.S.C. § 407 (1976).

205. 38 U.S.C. § 3101(a) (1982).

206. 33 U.S.C. § 916 (1982). Other alternative exemptions are: civil service retirement benefits, 5 U.S.C. § 8346(a) (1982); and, railroad unemployment and retirement benefits, 45 U.S.C. § 352(a), § 231(m) (1976).

207. *Cf. supra* notes 162-69 and accompanying text.

IV. SECTION 522 IN THE BANKRUPTCY COURTS

The drafters of section 522 probably did not intend the disasters produced by their much-amended version of the old section 4-503 of the 1973 Bankruptcy Reform Act.²⁰⁹ Because Congress rejected the notion that the best possible exemption scheme for administrative purposes would be a single uniform federal menu of exempt assets, the drafters tried to harmonize the debtor's election provisions of the Judges' bill with the comprehensive scheme of the Commission's bill. During the process of compromising various interests in 1978, the House and Senate agreed to a proviso by which Congress delegated to all fifty states and each territory or district the authority to pass federal bankruptcy exemption laws restricting domiciliaries to the exemptions offered by the state or territory of their domicile.²¹⁰ This ruined the exemption scheme of section 522 because the subsections within section 522 no longer match up into clear categories. As the bankruptcy judges struggle with this section, that problem and other major practical concerns surrounding the section have grown.

A. *The Sore Spots in the Categorical Exemption Menu*

To claim exemptions, debtors have to fit their assets into the congressional pigeonholes of section 522(d) or into the categorical classifications of their state exemption laws. Fitting the assets in becomes a chore when terms used for the exemption have specialized meanings.

1. Automobile as "Tool of the Trade"

Section 522(d)(2) allows a debtor to claim as exempt up to a \$1200 equity in a single automobile. Section 522(d)(6) allows a similar exemption of up to \$750 in tools of the trade. Following tradition many states have identified automobiles as "tools of the trade" for exemption purposes, if the automobile has been used in any remote fashion for business or work purposes.²¹¹ If the automobile can be classified as exempt under both the automobile exemption and the tools of the trade exemption, a debtor can take \$1950 worth of equity in any automobile and, more importantly, claim the right to avoid non-purchase money security interests against the automobile under section 522(f).²¹² Taking one aspect of this possibility, several bank-

208. Recently the Supreme Court has held that the lien avoidance provision of section 522(f) can not be applied retroactively to destroy property rights existing before the Bankruptcy Reform Act. *See* *United States v. Security Indus. Bank*, 103 S. Ct. 407 (1982).

209. *See* COMMISSION REPORT, *supra* note 153, at 125, § 4-503.

210. *See* 11 U.S.C. § 522(b)(1).

211. *See, e.g., In re Sisemore*, 602 F.2d 742 (5th Cir. 1979) (applying Texas law); *Sun, Ltd. v. Casey*, 96 Cal. App. 3d 38, 157 Cal. Rptr. 576 (1979) (applying California law); *see also* Annot., 37 A.L.R.2d 714, 719-32 (1954).

212. *See id.* § 522(f)(2)(B). This subsection provides:

(f) Notwithstanding any waiver of exemptions, the debtor may avoid the fixing of a lien on an interest of the debtor in property to the extent that such lien impairs an exemption to which the debtor would have been entitled under subsection (b) of this section, if such lien is—

(1) a judicial lien; or

(2) a nonpossessory, nonpurchase-money security interest in any—

(A) household furnishings, household goods, wearing apparel, appliances,

ruptcy courts have held that a car or truck can be exempt as a "tool of the trade" under section 522(d)(6) and a non-possessory, nonpurchase money security interest on the vehicle can be set aside under § 522(f).²¹³ The common rationale for these decisions is the absence of congressional intent that each category is distinct and separate,²¹⁴ and the state's own tradition of classifying automobiles used in work roles as "tools of the trade".²¹⁵

Reaching the opposite conclusion of the interacting of the exemption categories, a substantial minority of bankruptcy courts have held that section 522(d)(2)'s itemization for a single automobile as exempt precludes a "double-dip" by also exempting the car as a "tool of the trade" under section 522(d)(6).²¹⁶ The rationale applied is that the separate listing of motor vehicles in section 522(d) infers Congress did not intend motor vehicles to be a "tool of the trade" for purposes of section 522(f).²¹⁷ These courts did not inquire into the actual use of the vehicle, but simply held that mere use of the vehicle as part of the debtor's job would not avoid a lien on the car because it is not a "tool of the trade".²¹⁸

Both of these points of view are equally valid, considering the language of section 522(f)²¹⁹ with the foreknowledge that "tool of the trade" has acquired a "term of art" meaning in debtor-creditor law.²²⁰ From the debtor's viewpoint, setting aside a security interest in a motor vehicle is highly advantageous.

2. Exemptions in Future Rights of Action of the Debtor

Section 522(d)(5) permits a debtor to claim a \$400 exemption against "any property".²²¹ Section 522(d)(4) also authorizes the debtor to claim any

books, animals, crops, musical instruments, or jewelry that are held primarily for the personal, family, or household use of the debtor or a dependent of the debtor;

(B) implements, professional books, or tools, of the trade of the debtor or the trade of a dependent of the debtor; or

(C) professionally prescribed health aids for the debtor or a dependent of the debtor.

213. *In re Eagan*, 16 Bankr. 439 (N.D. N.Y. 1982) (avoided a security interest in a truck, a "tool of the trade"); *In re Bechen*, 11 Bankr. 939 (D. S.D. 1981) (non-possessory, nonpurchase money lien avoided on a pickup truck, a "tool of the trade"); *In re Seacord*, 7 Bankr. 121 (W.D. Mo. 1980) (creditor's lien avoided on a van, a "tool of the trade"). See also *In re Dillon*, 18 Bankr. 252 (E.D. Cal. 1982) (avoided creditor's lien so that wild card exemption could apply towards truck, a "tool of the trade"); cf. *In re Damron*, 5 Bankr. 357 (W.D. Ky. 1980) (evidence insufficient to establish a car as a tool of trade). But see *In re Curry*, 18 Bankr. 358 (N.D. Ga. 1982) (title setter's pickup truck not a tool of trade for lien purposes).

214. See, e.g., *In re Eagan*, 16 Bankr. at 441-42.

215. See, e.g., *In re Bechen*, 11 Bankr. at 942; see also *In re Goosey*, 10 B.R. 285.

216. See, e.g., *In re Steele*, 8 Bankr. 94 (D. S.D. 1980) (automobile not a "tool of the trade," therefore non-possessory, nonpurchase money lien can not be avoided); *In re Sweeney*, 7 Bankr. 814 (E.D. Wis. 1980) (non-possessory, nonpurchase money lien not avoided because automobile not a "tool of the trade").

217. *In re Sweeney*, 7 Bankr. at 818-19. But see *In re Dubrock*, 5 Bankr. 353, 355 (W.D. Ky. 1980) (enumeration elsewhere does not preclude a motor vehicle from being a tool of trade). See *In re Steele*, 8 Bankr. at 95.

218. See, e.g., *In re Curry*, 18 Bankr. at 359.

219. See *supra* note 212.

220. See *supra* note 211.

221. 11 U.S.C. § 522(d)(5) provides: "The following property may be exempted under subsection (b)(1) of this section: . . . (5) The debtor's aggregate interest, not to exceed in value

"spillover" homestead exemption in addition to the \$400 exemption.²²² This section allows a debtor to choose to take a portion of his exemption in unliquidated, contingent claims against other parties. A problem with section 522(d) is its lack of clarity as to whether a debtor is precluded from using his "spillover" homestead exemption to take a larger share of future entitlements, such as alimony, pension plans, or wrongful death payments over and above the amount "reasonably necessary for support". It is also questionable whether a debtor can exempt choses in action or the right to sue some creditor, under section 522(d)(5). The right to sue a creditor for violating the Federal Truth in Lending Act²²³ is one of the more popular rights of action a debtor may have.

Initially, because of policy reasons, the bankruptcy courts refused to allow debtors to take exemptions in pre-filing consumer credit claims.²²⁴ The turning point came in *In re LaFlamme*,²²⁵ decided by the Bankruptcy Appeal Panel for the First Circuit. The lower court bankruptcy had denied the debtor's exemption claim for a Federal Truth in Lending Act action against a creditor.²²⁶ The Appeal Panel reversed, holding that "any property" in section 522(d)(5) meant exactly that, any property which is property of the estate with out limitation.

Apparently, Congress has no intention of limiting the ways in which debtors can use the "wild card" exemption of section 522(d)(5) to protect their assets. Consequently, because of the *In re LaFlamme* decision, any future rights of recovery on claims arising out of credit transactions within the bankruptcy itself should be held exempt on demand, up to the amount of the dollar limitation.²²⁷ Thus, any imbalance created by section 522(d)(5) was intentional.

3. The Joint Petition and "Stacked" Exemptions

In light of section 522(m)²²⁸ permitting married debtors to preserve their own exemption rights upon filing joint petitions, special problems arise

\$400 plus any unused amount of the exemption provided under [the homestead exemption], in any property."

222. See 11 U.S.C. §§ 522(d)(10)-(11).

223. There are various causes of action for a debtor under the Federal Truth in Lending Act: Consumer Protection Act, 15 U.S.C. §§ 1601-1693r *et seq* (1982); Fair Credit Reporting Act, 15 U.S.C. §§ 1681n-o (1982); Equal Credit Opportunity Act, 15 U.S.C. § 1691e (1982); Fair Debt Collection Practices Act, 15 U.S.C. § 1692k (1982). Similar rights of action are conferred by the U.C.C. § 9-507 (1972); U.C.C. § 5.203 (1974); Sherman Anti-trust Act, 15 U.S.C. §§ 1-7 (1982); Clayton Anti-trust Act, 15 U.S.C. §§ 12-14, 19-27 (1982); Robinson, Patman Act, 15 U.S.C. §§ 13a-b & 21a (1982).

Other possible protection acts for the debtor are the: Age Discrimination in Employment Act, 29 U.S.C. § 626(b) (1982); Fair Labor Standards Act, 29 U.S.C. § 216(b) (1982); Taft-Hartley Act, 29 U.S.C. § 187 (1982).

224. See *In re Smith*, 5 Bankr. 500 (D. Ill. 1980).

225. 14 Bankr. 21 (1st Cir. 1981) (construing 15 U.S.C. §§ 1601-1693r and 11 U.S.C. § 522(d)(5)).

226. 14 Bankr. at 21.

227. *Id.* at 24, 26. The limitation would be the \$400 general cash exemption plus any spillover homestead exemption.

228. 11 U.S.C. § 522(m) provides: "This section [522] shall apply separately with respect to each debtor in a joint case."

in administering the exemption rights when one joint debtor takes the federal exemptions and the other takes the state-created exemptions. The debtors are clearly authorized to make their own elections and to agree to combine them, even though the result might be to protect a substantial homestead held as joint or community property and still be able to use the "wild card" exemption with the spillover federal homestead exemption on other property.²²⁹ Several cases have legitimized such a procedure, because the Bankruptcy Reform Act has made no attempt to forbid "stacking" exemptions in this manner.²³⁰ The debtors' creditors gain nothing by the joint filing for bankruptcy, and indeed may have lost an advantage, as both spouses would be discharged, defeating any chance of pursuing the homestead property even after a divorce. Yet this result is what Congress desired by passing section 522(m).

4. The "Any Item" Exemption

According to section 522(d)(3) a debtor can take an exemption in "any item" of "household furnishings, household goods, wearing apparel, appliances, books, crops, or musical instruments" which are owned for personal, family, or household purposes.²³¹ The only intrinsic limitation to this exemption is the dollar limit of \$200 on any single item.²³² Naturally, debtors perceive that an unlimited number of "items" have a fair market value of less than \$100 would be exempt under this provision. Such a notion is supported by one bankruptcy court where it was held that two hundred individual pieces of a family set of sterling silver tableware were exempt under section 522(d)(3) because none of the two hundred pieces alone were worth more than \$200.²³³ The aggregate, however, comprised more than \$6,000 worth of exempt property.²³⁴

The obvious loophole created by section 522(d)(3) has caught the eye of at least one commentator, who considers the "any item" exemption to reflect congressional judgment in permitting debtors to "stockpile" exemptions in household items and books.²³⁵ Also by Congress' encouragement to convert

229. See, e.g., *In re Brennan* 18 Bankr. 312 (D. R.I. 1982) (stacking federal exemptions); *In re Korff* 14 Bankr. 189, (E.D. Mich. 1981) (stacking state exemptions); *In re Maitland*, 13 Bankr. 923 (S.D. Tex. 1980) (stacking state and federal exemptions).

230. Instead, Congress enacted section 522(m) with full knowledge of the large exemption amounts possible. See *In re Maitland*, 13 Bankr. at 926.

231. 11 U.S.C. § 522(d)(3).

232. *Id.*

233. *In re Wahl*, 14 Bankr. 153 (E.D. Wis. 1981). In reaching this conclusion, the court noted "item" is not defined in the Bankruptcy Reform Act.

234. See *id.* at 156.

235. See Vukowich, *supra* note 55, at 783-85.

"[I]tems" seems to indicate that the House was using "items" to refer to the various categories because of the reference back to those categories through the use of the word "similar".

The more likely intention, however, was that the \$200 limitation should apply to items *within* the categories. . . .

Of course the suggested construction does result in a potentially huge exemption. This construction would allow debtors to exempt most of their household goods and personal effects . . . This result is consistent, however, with the House's manifested intention to increase substantially a similar exemption recommended by the Commission.

non-exempt property into exempt property on the eve of bankruptcy filing.²³⁶ Congress did not realize the possibility that a debtor could liquidate non-exempt assets and buy a two thousand volume personal library with each book being priced under \$200, and thus salvage a considerable cash benefit by selling the books as second-hand materials after discharge in bankruptcy. Similar conversion techniques can be used by debtors to turn non-exempt gold Krugerrands into an exempt collection of crystal, or Irish lace, or other high priced consumer goods. An imaginative debtor can use section 522(d)(3) lawfully to shield vast sums against creditors in bankruptcy. Congress provided no limits.

Congress aimed at setting up a system for rehabilitating debtors in failing circumstances. But Congress actually adopted something quite different from what had been originally intended. The grafting of the exemption provisions with the Commission bill and the Judges' bill, plus compromises with other lobbies produced an exemption law which sets aside exemptions categorically for liquidating bankruptcies. The mish-mash of federal and state optional or mandatory exemptions has led to the situation in which cunning debtors' attorneys can use "straight" bankruptcy as a shield for vast amounts of carefully concocted mixtures of state and federal exempt assets. The debtors can employ the act not for rehabilitation, but to escape their creditors.²³⁷

B. "Opting Out"

Section 522(b)(1) of the Bankruptcy Code promised to be a trouble-maker as soon as it was passed. Unlike section 6 of the 1898 Act, this hastily put together compromise delegates to each state the opportunity to forbid its citizens to claim federal bankruptcy exemptions.²³⁸ Section 6 had allowed state-created exemption laws as a federal rule of decision for the bankrupt's

Id. at 784-85.

236. *See id.* at 809-10.

237. At the time the Bankruptcy Reform Act of 1978 was passed, bankruptcy filings began to increase sharply. Many commentators and interest groups have concluded that the new exemption laws were the prime cause of this sharp rise, neglecting other possible causes such as a continuing business recession. *See Shuchman & Rhorer, Personal Bankruptcy Data for Opt-Out Hearings and Other Purposes*, 56 AM. BANKR. L.J. 1, 2 (1982).

According to the House Judiciary Committee, 196,967 personal bankruptcies were filed in 1979, the last year in which a majority of filings were under the 1898 Act. In 1980 the number of personal bankruptcies increased 22.58% to 241,446. In 1981, 312,914 personal bankruptcies were filed, for an increase of 29.6% over the year ending June 30, 1980. *See Shuchman & Rhorer, supra*, at 1 n.3, *citing* House Judiciary Committee, Subcommittee on Monopolies and Commercial Law, Oct. 14, 1981, Table 1.

In a study of bankruptcy exemptions taken in Connecticut, it was found that over a two year period a substantial number of homeowner debtors filed bankruptcy petitions to save their homes from levying creditors. *See id.* at 20-22. The cause for such an increase is the federal law provides a homestead exemption not available in Connecticut and this increase will likely be seen in any state where the federal exemption exceeds the state's exemption. *Id.* at 22.

238. 11 U.S.C. § 522(b)(1) provides:

[A]n individual debtor may exempt from property of the estate either—

(1) property that is specified under subsection (d) of this section, unless the state law that is applicable to the debtor . . . specifically does not so authorize; or, in the alternative, . . .

domiciliary state.²³⁹ Although the Supreme Court held section 6 was constitutional in *Hanover National Bank v. Moyses*,²⁴⁰ the "opting-out" provision of section 522(b)(1) is clearly neither a congressional attempt to establish "uniformity" in bankruptcy, nor is it a decision not to pre-empt state insolvency laws. Thirty-one states adopted "opting-out" statutes within a short time after the passage of the Bankruptcy Reform Act.²⁴¹ Most of the "opting-out" statutes do not allow state citizens the type and quantity of exemptions permitted by section 522(d) for persons eligible to elect the federal bankruptcy exemptions.²⁴²

1. *Cheeseman v. Nachman*

Virginia's "opting out" statute was challenged on constitutional grounds in *Cheeseman v. Nachman*.²⁴³ Virginia allows a homestead exemption of \$5,000 for "every householder or head of a family" residing in Virginia.²⁴⁴ "Householder" is defined as someone "who maintains a separate residence of living quarters, whether or not others are living with him."²⁴⁵ The Cheesemans filed a joint petition and claimed the right to "stack" their homestead exemptions to protect their home.²⁴⁶ The Fourth Circuit held such "stacking" was permissible.²⁴⁷

The Fourth Circuit noted that section 541 of the Bankruptcy Reform Act made exempt property part of the debtor's estate, subject to any exemption claims.²⁴⁸ Then under section 522(m) debtors filing jointly can take the same exemptions as if they had filed separate petitions.²⁴⁹ Because the definition of "householder" was ambiguous the Fourth Circuit recognized that the statute could mean either only one person was entitled to take a home-

239. See *supra* notes 46-47 and accompanying text.

240. See *supra* text accompanying notes 102-13.

241. As of June, 1983, the states which have taken advantage of section 522(b)(1) to "opt-out" of section 522(d) include: ALA. CODE § 6-10-11 (Supp. 1983); ARIZ. REV. STAT. ANN. § 33-1133(B) (Supp. 1983); ARK. STAT. ANN. § 36-211 (Supp. 1983); DEL. CODE ANN. tit. 10, § 4914 (Supp. 1982); FLA. STAT. ANN. § 222.20 (West Supp. 1983); GA. CODE ANN. § 44-13-100(b) (1982); IDAHO CODE § 11-609 (Supp. 1983); ILL. ANN. STAT. ch. 110 ¶ 12-1201 (Smith-Hurd Supp. 1983); IND. CODE ANN. § 34-2-28-0.5 (West Supp. 1983); IOWA CODE ANN. § 627.10 (West Supp. 1983); KAN. STAT. ANN. § 60-2312 (1983); KY. REV. STAT. § 427.170 (Supp. 1982); LA. REV. STAT. ANN. § 13:3881B (West Supp. 1984); ME. REV. STAT. ANN. tit. 14, § 4426 (Supp. 1983); MD. [CTS & JUD. PROC.] CODE ANN. § 11-504(g) (1984); MONT. CODE ANN. § 31-2-106 (1983); NEB. REV. STAT. § 25-15,105 (Supp. 1982); NEV. REV. STAT. § 21.090 (1983); N.H. REV. STAT. ANN. § 511:2-a (1983); N.C. GEN. STAT. § 1C-1601(f) (1983); N.D. CENT. CODE § 28-22-17 (Supp. 1983); OHIO REV. CODE ANN. § 2329.662 (Page 1981) (repealed 138 H674, § 3, effective Jan. 1, 1985); OKLA. STAT. ANN. tit. 31, § 1(B) (West 1983); OR. REV. STAT. § 23.305 (1981); S.C. CODE ANN. § 15-41-425 (Law. Co-op. Supp. 1983); S.D. CODIFIED LAWS ANN. § 43-31-30 (1983); TENN. CODE ANN. § 26-2-112 (1980); UTAH CODE ANN. § 78-23-15 (Supp. 1983); VA. CODE § 34-3.1 (Supp. 1983); W. VA. CODE § 38-10-4 (Supp. 1983); WYO. STAT. ANN. § 1-20-109 (Supp. 1983).

242. See, e.g., MD. CTS. & JUD. PROC. CODE ANN. § 11-504 (1984).

243. 656 F.2d 60 (4th Cir. 1981).

244. VA. CODE § 34-4 (supp. 1983).

245. *Id.* § 34-1.

246. See 656 F.2d at 61 & n.2 (The Cheesemans would apply \$4,700 to their homestead with the remaining \$5,300 used towards other personalty).

247. *Id.* at 64.

248. *Id.* at 62.

249. See *supra* note 229 and accompanying text.

stead exemption in a joint petition or "householder" status can be conferred on any person who contributed to the maintenance of a residence.²⁵⁰ The latter construction was upheld because Virginia intended the statute to be liberally construed to conserve the family home.²⁵¹

More importantly the Fourth Circuit went on to say that such construction was required by section 522(m) "[b]ecause Congress has the power under the Constitution to establish uniform bankruptcy laws, . . . and has enacted a specific provision for exemptions, . . . we must adopt an interpretation of Virginia's law that does not conflict with the Act's exemption provision."²⁵² In light of Congress' desire to give debtors a "fresh start" after bankruptcy, the Fourth Circuit reasoned that the state exemptions forced on debtors by a state "opting out" act must meet all the needs of section 522, including the right to "stack" exemptions.²⁵³ The inference is a construction that would allow only one joint debtor to claim a "homestead" would be unconstitutional, because Congress has pre-empted federal bankruptcy exemption laws by delegating to states the power to pass a federal bankruptcy statute.²⁵⁴ Thus, only an exemption pattern which allowed debtors *all* federal exemption rights would be constitutionally permissible.

2. *In re Parrish*

Other federal bankruptcy courts have held section 522(b)(1) and the "opt-out" statutes of Colorado, Ohio, and Florida as constitutional.²⁵⁵ The Colorado case, *In re Parrish*,²⁵⁶ illustrates how courts have dealt with "opting-out". The debtor argued that Colorado's "opting-out" statute violated the supremacy clause²⁵⁷ because it conflicted with the federal exemption scheme of providing a "floating" exemption.²⁵⁸ The court rejected this contention, holding that Congress *meant* the states to "opt-out" but in doing so, hopefully update their statutes to be more in line with the "fresh start" concept.²⁵⁹ In

250. *See id.* at 63.

251. [T]his purpose can best be promoted by a reading of the statute that allows an exemption to each spouse who contributes to the maintenance of the home: if both spouses are granted exemptions, for example, they are more likely to be left with sufficient equity to allow them to retain their home.

Id. To apply the contrary construction would be "an inducement to separate" so that each may claim the exemption. *Id.*

252. *Id.* (citations omitted).

253. It does not follow, however, that the states should be left free to classify which bankrupt debtors should be entitled to exemptions when the classification conflicts with federal law. If we were to permit a construction of Virginia law that allows only one householder per residence, the construction would be inconsistent with section 522(m) of the Act. . . .

Id. at 64.

254. *Id.*

255. *See In re Parrish*, 19 Bankr. 331 (D. Colo. 1982); *In re Lausch*, 16 Bankr. 162 (M.D. Fla.), *aff'g*, 12 Bankr. 55 (M.D. Fla. 1981); *In re Curry*, 5 Bankr. 282 (N.D. Ohio 1980), *aff'd sub nom.*, *Curry v. Associates Fin. Servs.*, 11 Bankr. 716 (N.D. Ohio 1981), *vacated*, 698 F.2d 298 (6th Cir. 1983); *In re Ambrose*, 4 Bankr. 395 (N.D. Ohio 1980).

256. 19 Bankr. 331 (D. Colo. 1982).

257. U.S. CONST. art. VI, cl. 2. *See* 19 Bankr. at 334.

258. The "floating" exemption refers to the \$7,500 homestead exemption plus the \$400 general cash exemption provided in section 522. *See id.* at 335.

259. 19 Bankr. at 334-35.

rejecting the debtor's argument the court applied the rationale of *Perez v. Campbell*:²⁶⁰ that the court need only compare the two statutes and consider whether there is a conflict of provisions.²⁶¹ The court concluded that both the Colorado "opting-out" statute and the federal exemption statute gave the debtor a "fresh start," therefore, the Colorado opt-out provision is constitutional regardless of the lack of a so-called "floating" exemption.²⁶²

3. *In re Kelley*

*In re Kelley*²⁶³ presented a direct challenge to the Florida opt-out statute.²⁶⁴ A single person claimed she was denied a homestead exemption in bankruptcy because Florida's "opting-out" statute required her to claim the Florida homestead, but to claim the exemption she must be the head of a family.²⁶⁵ The statute had previously been sustained in *In re Lausch*²⁶⁶ on the more typical challenge that section 522(b)(1) violated the "uniformity" requirement of the Constitution.²⁶⁷ Kelley claimed that it was unconstitutional in her case to allow Florida to fail to provide a homestead exemption for a single person; whereas, section 522(d)(1) made express provisions for a single person's homestead.²⁶⁸ Kelley's claim was rejected by the court based on the doctrine of *Reed v. Reed*:²⁶⁹ a classification must be reasonable and have a substantial bearing on the legislative objective.²⁷⁰ Allowing a homestead exemption for married persons bore a fair and substantial relationship to the objectives of the Florida exemption law, that of safeguarding the family.²⁷¹ The court ignored the issue of federal pre-emption of bankruptcy exemptions.

4. *In re Sullivan*

In *In re Sullivan*,²⁷² the Sullivans had claimed an exemption menu from section 522(d) after Illinois had "opted out" and enacted its own homestead and personal property exemptions.²⁷³ The trustee's objection to the claimed federal exemptions was sustained by the bankruptcy judge and affirmed by

260. 402 U.S. 637 (1971).

261. 19 Bankr. at 334, quoting *Perez*, 402 U.S. at 644. Cf. *infra* note 293.

262. 19 Bankr. at 335.

263. 21 Bankr. 375 (M.D. Fla. 1982).

264. FLA. STAT. ANN. § 222.20 (West Supp. 1983).

265. 21 Bankr. at 375-76.

266. 16 Bankr. 162 (M.D. Fla. 1981).

267. See U.S. CONST. art. 1, § 8, cl. 4. See also *supra* notes 93-128 and accompanying text.

268. 21 Bankr. at 376.

269. 404 U.S. 71 (1971). In *Reed*, a state statute that gave males mandatory preference to administer the estate of an intestate relative was held to be the type of arbitrary legislative choice forbidden by the equal protection clause of the fourteenth amendment.

270. See 404 U.S. at 415.

271. 21 Bankr. at 376-77. The court stated that the homestead act was designed to promote the welfare of the state by "preserving a home where the family may be sheltered and live beyond the reach of economic misfortune," thus putting the family on a higher plane than single persons. *Id.* By implication, the court was following the rule of *Sturges v. Crowninshield*, 17 U.S. (4 Wheat.) 122, 195-96 (1819), holding a state may pass its own insolvency law. See *infra* note 291 & notes 327-28 and accompanying text.

272. 680 F.2d 1131 (7th Cir.), *aff'g* 11 Bankr. 432 (C.D. Ill. 1981), *cert. denied*, 103 S. Ct. 349 (1982).

273. 680 F.2d at 1132.

the Seventh Circuit.²⁷⁴ On appeal to the Seventh Circuit, the debtors had contended the Illinois "opting out" statute²⁷⁵ was an unconstitutional act because it was non-uniform, and that section 522(b)(1) of the Bankruptcy Reform Act was an unconstitutional delegation of congressional authority to Illinois.²⁷⁶

In dealing with the issue of uniformity, the Seventh Circuit rejected any contention that section 522(b) requires the state, which "opted-out" of the federal exemption, to adopt an exemption scheme essentially similar to that of section 522(d).²⁷⁷ "In a limited sense, section 522 meets the test of true uniformity because the opt-out provision is applicable to each State. True uniformity as to individual debtors clearly does not exist, however, because the opt-out provision allows exemption levels to differ among the states."²⁷⁸ That assertion is somewhat circular. The court accepted the principle of "geographic uniformity" formulated in *Moses*,²⁷⁹ and applied it to the Illinois act.²⁸⁰ Although the Sullivan's cited precedent supporting the conclusion that Congress could not use state-created laws to establish a federal rule, the court rejected that line of authority because "[w]hatever merit this argument might have, we think it is foreclosed, at least as to the 1898 Act, by *Moses*."²⁸¹

The debtors contended *Moses* was either wrongfully decided or was inapplicable to the Bankruptcy Reform Act because of the fundamentally different way in which the debtor's estate is administered under the 1978 Act. After a cursory examination of the lack of any legislative history on "opting-out" provision, the court stated:

The opt-out provision, section 522(b)(1), for which there is virtually no legislative history, was added to section 522 as a compromise provision . . . [t]he intention of providing a 'fresh start' can be attributed only to the House. A resolve to let states determine the applicable exemptions must be attributed to the Senate. Congress did not resolve this difference. . . This court cannot seize upon the motivation of the House as representative of the entire Congress when the enacted legislation clearly warrants a contrary

274. *Id.* at 1138.

275. ILL. ANN. STAT. ch. 110, § 12-1201 (Smith-Hurd 1983).

276. 680 F.2d at 1131-32. See Comment, *Bankruptcy Exemptions: Whether Illinois's Use of the Federal "Opt-Out" Provision is Constitutional*, 1981 S. ILL. L.J. 65.

Illinois' exemption scheme affords a \$10,000 homestead exemption only for real estate occupied as a residence. ILL. ANN. STAT. ch. 110, § 12-901 (Smith-Hurd 1983) (this has since been lowered to \$7,500). The Illinois personal property exemption was limited to wearing apparel, a bible, school books, and \$300 worth of property, compared to the more generous provisions of section 522(d). See ILL. ANN. STAT. ch. 110, § 12-1001 (Smith-Hurd 1983) (these provisions have been amended). There is no general cash exemption against "any" property in Illinois. See *id.*

277. 680 F.2d at 1136.

278. *Id.* at 1133. See *supra* note 92.

279. See *supra* text accompanying note 109.

280. *Id.* at 1133-36.

281. *Id.* at 1135. The debtors had cited *Nemetz v. INS*, 647 F.2d 432 (4th Cir. 1981), in which the Fourth Circuit held that the United States could not adopt a state law test for the requisite lack of "good moral character" necessary to deport. The rationale being that to apply state law would defeat the uniformity requirement of the naturalization clause. See *id.* at 437.

conclusion.²⁸²

Therefore, the Seventh Circuit concluded that congressional policy did not require it to find the 1978 Act so different from the 1898 Act as to make *Moses* inapplicable.²⁸³

The court then turned to the analysis of the preemption claim based on *In re Rhodes*²⁸⁴ and *Cheeseman v. Nachman*.²⁸⁵ The bankruptcy court decision in *In re Rhodes* was discredited because it applied the preemption argument despite the explicit language of section 522(b)(1).²⁸⁶ The Seventh Circuit refused to accept the line of reasoning in *Cheeseman* that "opting-out" did not permit Virginia to avoid the effects of section 522(m).²⁸⁷ If Congress had the power to delegate to the states the right to set their own exemptions, the Seventh Circuit reasoned, then the Illinois statute was constitutional.²⁸⁸

The *Sullivan* court misapplied the debtors' argument on the constitutionality of the "opt-out" clause in section 522(b)(1).²⁸⁹ First, the debtors contention that the entire scheme of bankruptcy exemptions in the 1978 Bankruptcy Reform Act is so materially different from that of the Bankruptcy Act of 1898 should be given weight. *Moses* is no longer precedent for supporting the exemption scheme granted to states by section 522(b)(1).²⁹⁰ Second, the debtors correctly argue that *Moses*, if held applicable, is not now the policy of the Supreme Court and ought not to be followed as the last word on "uniformity on the subject of bankruptcies".²⁹¹ Section 522(b)(1) cannot be considered uniform in any sense of the word. It neither mandates geographic uniformity nor any other form of uniform exemptions in bankruptcy, but does precisely the opposite. Third, if Congress has the authority to delegate to states the power to pass a federal bankruptcy exemption law, an argument seemingly approved by *Sturges*,²⁹² then that law

282. 680 F.2d at 1136.

283. See *id.* at 1134, 1136. Similar to the decision in *Moses*, which did not discuss the differences between the 1867 Act and the 1898 Act, the Seventh Circuit did not analyze the difference between the 1898 Act and the 1978 Act in reaching its conclusion. For example, in the old law, a finding that property was exempt was a finding that the bankruptcy court had no jurisdiction over the property; while under the 1978 Act, the trustee is initially vested with title, possession, and control over all property, and upon allowance of exemptions to the debtor, the trustee re-vests title, possession, and control of the exempt property to the debtor.

284. 14 Bankr. 629 (M.D. Tenn. 1981), *rev'd sub nom.* *Rhodes v. Stewart*, 705 F.2d 159 (6th Cir.), *cert. denied*, 104 S. Ct. 427 (1983). After the *In re Sullivan* decision, *Rhodes* was reversed, following *Sullivan's* approval of the *Moses* doctrine that uniformity is geographical rather than personal.

285. 656 F.2d 60 (4th Cir. 1981).

286. 680 F.2d at 1136.

287. *Id.* at 1136-37. See *supra* text accompanying notes 244-55.

288. *Id.* at 1137. The Seventh Circuit also dismissed the improper delegation of power argument by relying on *Sturges v. Crowninshield*, 17 U.S. (4 Wheat) 122 (1819) (state law can not conflict with federal law).

289. This same argument was misapplied in *Rhodes*. See *Rhodes v. Stewart*, 705 F.2d 159 (6th Cir. 1983).

290. See 680 F.2d at 1134-35.

291. See Brief for Petitioner, at 15, *Sullivan v. United States*, No. 82-5229 (U.S. filed in Oct., 1982).

292. See *Sturges v. Crowninshield*, 17 U.S. (4 Wheat) 122, 195-96 (1819).

It is fundamental that the state and federal legislatures share concurrent authority to promulgate bankruptcy laws, *Sturges v. Crowninshield* [sic], 17 U.S. (4 Wheat.) 119 [sic], 4 L.Ed. 529 (1819), and that the Supremacy Clause and the doctrine of preemption will serve to invalidate state promulgations to the extent that they are inconsistent

should be made by a specific federal pre-emptive power much the same way that states may "opt-out" of the Truth in Lending Act.²⁹³ Therefore, Illinois' exemption statute, should not be decreed "uniform" because it is not a proper exercise of Congress' delegation power and because the statute frustrates Congress' purpose in passing a federal bankruptcy exemption law.²⁹⁴

5. The Bankruptcy Reform Act is Not Uniform

In fairness to the country, the Supreme Court should either overrule *Moyes* or limit its authority to section 6 of the 1898 Bankruptcy Act. *Moyes* was decided at a time when most of the United States' population lived on subsistence farms and in small towns. The degree of personal mobility in 1901 was far less than that of today's urban wage earners and salaried help. In a static rural society, it might have been reasonable to allow the states to set up federal bankruptcy exemptions which offered no incentive to state domiciliaries to file bankruptcy petitions when pressed by creditors. Since the turn of the century, however, Americans have increasingly become citizens of the United States first and citizens of their state only secondarily.²⁹⁵ Individual state exemption laws do not take into account that debtors are apt to have property located in several states, or have obligations to support families living in another state.²⁹⁶ Ignoring for a moment the question of the adequacy of state-created exemption laws as mechanisms for a "fresh start", too many debtors have assets in too many different states with vastly different exemption laws to make a state-by-state bankruptcy exemption system appropriate.

Congress is required to make uniform laws on the subject of bankruptcy exemptions,²⁹⁷ and as such Congress should be held to the requirement that its bankruptcy exemptions are national in scope as well as in origin. The principle of "geographic uniformity" is a subterfuge by which the courts may ignore the bankruptcy clause of the Constitution. The process is not uniform when a debtor in bankruptcy, depending on his domicile, can claim a \$60,000 homestead exemption in Massachusetts²⁹⁸ or none if he is in Penn-

with or contrary to federal laws. *Perez v. Campbell*, 402 U.S. 637, 91 S. Ct. 1704, 29 L.Ed. 2d 233 (1971). It is equally axiomatic, however, that Congress has not pre-empted an area wherein it has legislated when it expressly and concurrently authorizes the state legislatures to disregard or opt-out of such federal legislative area.

Rhodes v. Stewart, 705 F.2d 159, 163 (6th Cir. 1983).

293. See 15 U.S.C. § 1601 *et seq.* (1982) (states can adopt statutes that are parallel and more stringent than the federal statutes). The Sixth Circuit presumed that the source of the legal power to enact exemption legislation was not an act of Congress, but a pre-constitutional residue of general police power regulation.

294. Brief for Petitioner, *supra* note 292, at 23-27. Purpose refers to the notion of providing a fresh start. See 680 F.2d at 1136.

295. Since 1890, the percent of Americans who resided in the state census tracts in which they were born has steadily declined from 90.7% of all Americans in 1900 to 79.4% as of 1970. *Historical Statistics of the United States, Colonial Times to 1970* (U.S. Dept. of Commerce: Bureau of the Census 1975) Series C-1-14 at 89.

296. For a description of what little is known empirically about the assets of debtors, see Schuchman, *Little Bankruptcies in New England*, 56 B.U. L. REV. 685 (1976) (debtors in bankruptcy are less stable than the rest of the community, tending to move more often, and to collect their property in more than one community).

297. See U.S. CONST. art. I, § 8 cl. 4.

298. MASS. GEN. LAWS ANN. ch. 188 § 1 (Supp. 1984).

sylvania.²⁹⁹ If the state has no opt-out law, as is the case in Pennsylvania, he may elect the section 522 exemption scheme.

C. "Opting-Out" and Lien Avoidance

One of the hidden problems created by "opting-out" of section 522(d) is the language of section 522(f)³⁰⁰, allowing avoidance of judicial liens against exempt property and non-purchase money security interest in household goods, tools of trade or professional prescribed health aids. Section 522(f) permits avoidance "to the extent that such lien impairs an exemption to which the debtor would have been entitled under subsection (b) of this section."³⁰¹

A serious internal conflict exists in section 522. For instance, Ohio has opted-out of section 522(b) and prescribes in its state-created exemption laws that a lien can impair exempt property.³⁰² The issue of whether Ohio can enforce liens on exempt property despite section 522(f) has gone both ways.³⁰³ There appears to be no clear trend among the states on the relationship of the opt-out provision and other parts of section 522 such as section 522(f).³⁰⁴

1. In re *McManus*

Consider *In re McManus*³⁰⁵ involving Louisiana's "opt-out" provision³⁰⁶ and whether a debtor can avoid a nonpurchase money security interest in household goods. Relying on the opt-out provision, the bankruptcy court had denied the avoidance of the lien because Louisiana's exemption laws precluded any exemption in encumbered household goods.³⁰⁷ In *Gipson*, the companion case to *In re McManus*, the bankruptcy judge had allowed the debtor to avoid a non-purchase money security interest in household goods.³⁰⁸ The Fifth Circuit affirmed *McManus* and reversed *Gipson*.³⁰⁹

299. Pennsylvania, as of the date of this article, has no homestead exemption law.

300. 11 U.S.C. § 522(f). See *supra* note 211.

301. *Id.*

302. OHIO REV. CODE ANN. § 2329.661(C) (1981) reads as follows: "Section 2329.66 of the Revised Code does not affect or invalidate any sale, contract of sale, conditional sale, security interest, or pledge of any personal property, or any lien created thereby."

303. See, e.g., *Foster v. City Loan & Sav. Co.*, 16 Bankr. 467 (N.D. Ohio 1981) (holding household goods can be encumbered because Congress intended states to enact whatever exemption statutes they wished); *Curry v. Associates Fin. Serv.*, 11 Bankr. 716 (N.D. Ohio 1981) (holding liens on household goods can be avoided because the Ohio statute directly conflicts with section 522(f)).

304. See generally *supra* notes 210-16 and accompanying text (discussing the effect of labeling a motor vehicle as a tool of trade on section 522(f)). See also *In re Giles*, 18 Bankr. 708 (E.D. Tenn. 1982) (applying Georgia's opt-out clause did not prevent the avoidance of a lien on household goods); *In re Frederickson*, 12 Bankr. 506 (D. S.D. 1981) (can avoid a non-purchase money agreement in household goods under section 522(f) even though South Dakota opted out of section 522(d)).

305. 681 F.2d 353 (5th Cir. 1982).

306. See LA. REV. STAT. ANN. § 13:3881B (West Supp. 1984).

307. 681 F.2d at 354. See LA. REV. STAT. ANN. § 13:3885 (West Supp. 1984) (household goods subject to a mortgage are not exempt).

308. 681 F.2d at 354.

309. *Id.* at 357.

The court began its analysis by noting that all assets are vested with the trustee as part of the debtor's estate, whereupon any exempt property is re-vested in the debtor.³¹⁰ Then the Fifth Circuit applied a logical three-step approach to its holding that Louisiana can hinder exempt property that is subject to an encumbrance.³¹¹ First, the court found section 522(f) is not a separate statute and is dependent upon the exemption provisions of section 522(b).³¹² Second, the court examined section 522(b), noting it provided two exemption schemes: the federal list or the state-created list. Recognizing section 522(b) does not limit what a state can enact for exemptions,³¹³ the Fifth Circuit considered Louisiana's statutes in its third step. Because Louisiana explicitly provides any encumbered household goods will not be exempt in bankruptcy, section 522(f) does not apply under the authority of section 522(b).³¹⁴

Judge Dyer dissented.³¹⁵ He considered the execution of a nonpurchase money lien on household goods as a waiver of exemptions, "subject to the avoiding power found in § 522(f)."³¹⁶

If the majority opinion correctly states the law, any state can by statute preclude a debtor from availing himself of the lien avoidance provisions found in 522(f). . . . There is no provision of the Bankruptcy Code which grants the states authority to pre-empt any subsection of § 522(f) other than subsection (b), Congress intended that even if a state opts out of the federal exemptions, the debtor's lien avoidance power under subsection (f) is not thereby affected.³¹⁷

According to Judge Dyer, the majority ignored the conflict between Louisiana's exemption laws and federal policy expressed in section 522(f), which "must be constitutionally resolved in favor of federal law."³¹⁸

If the *McManus* decision stands, then a state can lawfully "opt-out" not only from section 522(d), but from sections 522(f), 522(g), and 522(m) as well.³¹⁹ Arguments about congressional intent relative to "opting-out" are

310. *Id.* at 354, citing section 541 of the Bankruptcy Act, 11 U.S.C. § 541. This is one administrative provision that both the Commission and the Judges' agreed upon. See *supra* text accompanying notes 162 & 174.

311. *Id.* at 357.

312. *Id.* at 355.

313. *Id.* at 355-56.

Significantly, the section does not mandate that debtors be guaranteed a right to exempt particular types of property. The unambiguous language of section 522(b) implicitly indicates a state may exempt the same property included in the federal laundry list, more property than that included in the federal laundry list, or less property than that included in the federal laundry list. The states also may prescribe their own requirements for exemptions, which may either circumscribe or enlarge the list of exempt property.

Id. (footnote omitted).

314. *Id.* at 357. The Fifth Circuit noted hypothetically that if Louisiana had not specifically defined mortgaged household goods and furnishings a different result would have been granted: section 522(f) would have been available to avoid liens encumbering exempt property. See *id.*

315. *Id.* at 357 (Dyer, J., dissenting).

316. *Id.* at 358.

317. *Id.*

318. *Id.*

319. These sections of 11 U.S.C. § 522 and others form a single system of exemption rights

essentially meaningless, as Congress' intent can be found only by reading section 522(b)(1). The drastic lack of uniformity, either actual or geographical, produced by the congressional authorization to state legislatures to mangle the bankruptcy exemption laws, simply underscores the unconstitutionality of section 522(b)(1). Sections 522(f), (g), and (m) may apply to some states but not others. In Louisiana³²⁰ and in Ohio,³²¹ a debtor may have no right to assert a claim to avoid a nonpurchase money security interest in household goods, but in another state such as Illinois,³²² which has also "opted-out", such a denial would be unconstitutional and void.

The unsupported conclusion in *Moses* that Congress has the power to delegate to the states the duty to pass bankruptcy exemption laws is as unfounded as the holding in *Moses* that adopting those state bankruptcy exemptions is "uniform".³²³ In the past, Congress has delegated authority to federal agencies to make rules having the force of law. Almost all of these delegations have been sustained against similar attacks of unconstitutional delegation based on the "necessary & proper" clause.³²⁴ Occasionally Congress has delegated authority to "drop out" of a nationwide federal regulatory scheme, such as the Truth in Lending Simplification and Reform Act.³²⁵

No delegation challenge directed at the bankruptcy statutes has been sustained³²⁶ because of its special article I status.³²⁷ Congress may delegate regulation of commerce to the states, but it may not delegate the passage of "uniform laws on the subject of bankruptcy" to the states, as it has attempted to do in section 522(b)(1). *Moses* is the only Supreme Court case suggesting that Congress has the power to delegate its bankruptcy clause powers to the states. No jurisprudential history of Supreme Court cases supports such a delegation. Any reliance on *Sturges v. Crowninshield*³²⁸ as an implicit authorization for Congress to hand out its bankruptcy jurisdiction to the states is misplaced.³²⁹ The issue of delegation of authority was neither

under federal bankruptcy law, all of which depends on section 522(b). For instance, an "opting out" act in a state that wished to deny debtors any of the federal rights in section 522 under the *McManus* doctrine could contain clauses stating: that exemptions under state law may be waived by the debtor; that any voidable preference, or fraudulent transfer, or property under a lien avoidable under section 724 cannot be held exempt; that any assets of the debtor turned over to the estate may not be taken as exempt; and, that no citizen of the state may take any exemption in any property incumbered by a judicial lien or by a non-purchase money security agreement.

320. See *supra* text accompanying note 305.

321. See *supra* notes 301-02.

322. See *supra* text accompanying notes 272-88.

323. See *supra* notes 108-13 and accompanying text.

324. U.S. CONST. art. I, § 8, cl. 18. See generally K. DAVIS, ADMINISTRATIVE LAW TREATISE 149, §§ 3:1-3:7 (2d ed. 1978 & Supp. 1983). Cf. *Carter v. Carter Coal Co.*, 298 U.S. 238 (1936) (delegation of power to coal producers and workers unconstitutional).

325. See, 15 U.S.C. § 1610(b) (1982) (state laws not affected unless inconsistent with the federal chapter).

326. See, e.g., *In re Lausch*, 16 Bankr. 162, 165 (M.D. Fla. 1981) (it is not an unconstitutional delegation but a recognition of concurrent power).

327. *Sturges v. Crowninshield*, 17 U.S. (4 Wheat.) 122, 196-97 (1819).

328. 17 U.S. (4 Wheat.) 122 (1819).

329. See *supra* note 291.

contended for by either party nor addressed in Justice Marshall's opinion.³³⁰

Congressional delegation of a federal power to non-federal entities should be narrowly circumscribed and carefully limited to those few cases in which vital, concurrent interests of both the state and federal governments coincide.³³¹ Bankruptcy law is not such an aggregation of vital, concurrent interests. But, if it is viewed as such a matter on which both state and federal legislatures have a mutual interest, the delegation of federal authority must be limited and precise—not a broadly worded escape hatch. The force of the argument presented in *Cheeseman v. Nachman*, cancelling state acts which conflict with general federal bankruptcy policies,³³² makes good sense. Congress did not delegate, as alleged in *McManus*,³³³ its authority to the states only to have it exercised helter-skelter. If the courts are willing to hold the principle of delegation constitutional, the type of delegation done in section 522(b)(1) must be judicially confined to statutes which are similar in all essential respects to sections 522(a) through (m). Deviation, such as that countenanced by *McManus*, in enacting exemptions would be not uniform and too broad an exercise of delegated federal power.

V. A REAPPRAISAL OF EXEMPTION THEORY AND LAW IS REQUIRED

A. Exemption Theory

The current theory behind the exemptions of section 522 of the Bankruptcy Code is that of the "fresh start."³³⁴ Although various commentators have suggested exemption schemes that should be sufficient for a "fresh start",³³⁵ the words are ephemeral and do not point toward anything definite that courts are able to follow in dealing with bankruptcy exemptions. The concept of "fresh start" originated with the National Bankruptcy Com-

330. The primary issue of concern was whether a New York insolvency law impaired the constitutional right to contract and that such contracts may not be impaired. See 17 U.S. (4 Wheat.) at 197-208. In this setting Justice Marshall wrote:

It has been said, that Congress has exercised this power [to enact uniform laws on bankruptcy]; and, by doing so, has extinguished the power of the States, which cannot be revived by repealing the law of Congress.

We do not think so. If the right of the states to pass a bankrupt law is not taken away by the mere grant of that power to Congress, it cannot be extinguished; it can only be suspended, by the enactment of a general bankrupt law.

Id. at 196. See *In re Sullivan*, 680 F.2d at 1137 (relied on *Sturges* for delegating to states the power to pass exemption laws).

331. See generally K. DAVIS, *supra* note 322, at 206-16, § 3:15 (suggesting that the courts should look at whether the congressional delegation of legislative authority should be limited by safeguards supplied by the object of delegated authority; and, if not, the court should intervene to prevent arbitrary exercise of delegated authority).

The Supreme Court has stated that:

the presence or absence of standards is the key to the validity of legislative delegation that has never been the law and it cannot be, because the behavior of any responsible officer will be the same whether the statute states no standard or whether it says "just and equitable" or "in the public interest."

K. DAVIS, ADMINISTRATIVE LAW TREATISE SUPPLEMENT 21, § 2.00 (1976).

332. See *supra* text accompanying notes 245-53. See also *Rhodes*, 705 F.2d 159.

333. See *supra* text accompanying notes 317-22.

334. See HOUSE REPORT *supra* note 9 at 6087 (defining "fresh start").

335. See, e.g., STANLEY & GIRTH, *supra* note 149 at 206. This treatise details bankruptcy exemptions that are "designed to permit the bankrupt to continue his occupation and to maintain a standard of living reasonably consistent with his occupation and previous history." *Id.*

mission's report on the 1973 Bankruptcy Reform Act.³³⁶ It was hypothesized in that report that bankruptcy, which affects larger numbers of wage earners and salaried persons than it does business entities, should allow the debtor enough to get by on after bankruptcy has done its work.³³⁷ It was not considered that the debtor would be a functional economic unit after bankruptcy, save through the mandatory rehabilitation processes of wage earner plans. Consequently, the property saved from distribution to creditors is essentially the equivalent of a welfare stipend, designed to tide the debtor over until the wage earner plan took hold.

This theoretical basis is consistent with the theory behind the homestead exemption, the life insurance exemption and other state-created exemptions from execution and attachment.³³⁸ According to section 522, a debtor in bankruptcy should, like Dickens' paupers, be left with the clothes on his or her back, a pile of furniture or other lumber, and a roof over his or her head, and little else.³³⁹ This theoretical approach to exemptions had reached its zenith in the 1840's and has little relevance to American economic life in the twentieth century.

Essentially, an individual debtor is a conduit for recycling the money supply. The debtor's sources of money must be either whatever the debtor earns as wages or salary, or whatever he can borrow.³⁴⁰ By discharging the debtor from debt and future garnishments, bankruptcy shields one primary source of funding—earnings. As has been well documented, bankruptcy is no bar to further forays into indebtedness by bankrupt debtors.³⁴¹ What individual wage-earning and salaried debtors have needed over the years is protected from their own follies. When Congress rejected the federal bankruptcy administration and mandatory debtor's workouts as proposed by the Bankruptcy Commission,³⁴² it rejected a true reform of the bankruptcy process for wage earners and, instead adopted a scheme which benefits only those who have an interest in maintaining the traditional control of bankruptcy process.

The current bankruptcy exemptions are intended to mesh with

336. See COMMISSION REPORT, *supra* note 154, Part I, at 75, 78.

337. A third allocative standard relates the goal of fair and equitable treatment with the goal of a fresh start for the debtor. It imposes the burden of a debt on the party better able to bear it. This determination should be made on two bases. The first is the external social policy respecting responsibility indicated by the debt. The second is an internal policy that looks to the ability of the creditor to pass on risk of loss. The bankruptcy process affects different creditors to different degrees. . . . [A corollary goal is the] preservation of the debtor's property necessary in his household. A uniform exemption law should set apart such property from that available generally to creditors. The debtor should be able to retain, in both immediate discharge and payment-plan cases, essential goods that are collateral securing payment of the purchase price.

Id. Part I, at 78-80.

338. See *supra* text accompanying notes 57-88 (discussing these exemptions in relation to the 1898 Act).

339. See *supra* text accompanying notes 20-30 (discussing the origin of this notion of "Dickens' paupers").

340. P. NADLER, *COMMERCIAL BANKING IN THE ECONOMY* 3-6 (3d ed. 1979). See also J. COCHRAN, *MONEY, BANKING AND THE ECONOMY* table 11-19, 194 (1979).

341. STANLEY & GIRTH, *supra* note 149, at 62-65.

342. See COMMISSION REPORT, *supra* note 154, Part I, at 7-8.

mandatory debtor work-outs and counseling conducted by a federal agency: the objective of which is to protect debtors from themselves. Because such a system never got off the drawing boards, the law of bankruptcy permits debtors in failing circumstances to turn over their assets once every seven years to the bankruptcy courts in return for discharge from their previous credit mistakes. While such a system preserves the freedom of individuals to obtain credit and also enshrines the right of individuals to resort to no-asset liquidations when creditors begin to press them, it does little else for debtors. The current exemptions are welfare payments to debtors made at the expense of unsecured, and some secured, creditors. This system of indirect welfare payments in the form of homestead and other exemptions does spread the risk of a wage-earner's economic failure over a class larger than the wage earner and his dependents, but it also theoretically spreads the loss of no-asset cases much further. Because creditors accrue bad debt reserves based on the frequency of bankruptcies among debtors, as well as other economic failures causing losses, the cost of the present system is directly allocated to all persons borrowing money from any creditor. Since 1980, that cost has been increasing at great rates, due to the pressure of hard times and an accessible bankruptcy process.³⁴³

Exemptions based on the economic and moral theories of 1840, will not meet the problems of contemporary economic failure. The bankruptcy system can, and should provide a cure for debtors in failing circumstances. The constitutional infirmities of "opting out" statutes designed to placate those whose vision cannot go beyond the antiquated laws of their state, should demonstrate the fallacy of leaving it to the states to deal with exemptions as social policy. The serious problems caused by lien avoidance, and the unduly complicated and conflicting management problems produced by the categorical exemption system, a relic of the nineteenth century's approach to exemption, makes a new direction in bankruptcy exemptions necessary.

B. *A New Direction in Exemptions*

Bankruptcy exemptions should be considered as a means of restoring debtors to functional economic units with income and capital. The traditional exemption policies give only indirect welfare payments. The bankruptcy exemptions should be an incentive to wage-earning debtors with a proven bad track record as installment credit buyers and borrowers to protect themselves from disaster. If that would be the goal of the exemption process, then what the debtor needs is a flexible cash allowance out of his assets, which, like the ancient English acts,³⁴⁴ gives a premium to debtors who made some substantial effort to give their unsecured creditors a dividend. Under our scheme of things, this means an exemption system encouraging debtors to file bankruptcy plans with serious thought to repayment in mind. The debtor's preservation as an economic unit is the goal, and to

343. According to the U.S. Administrative Office of the Courts, 331,088 personal bankruptcy petitions were filed in 1980, 363,847 petitions in 1981, counting joint petitions filed by husband and wife as one filing.

344. See *supra* text accompanying notes 17-21.

achieve this goal the exemption system should provide for aggregation of the debtor's assets in liquid form for investment purposes. Many consumer-debtors have not developed a habit of thrift and have not accumulated a cash reserve. Thus, rehabilitation for them would be a program of court-supervised thrift.

Debtors should be shielded by an exemption that provides for some immediate welfare substitute and for a long-term accumulation of capital. To design such a program, Congress would have to reject the preference it has shown for states' rights and pleasing everyone with every aspect of exemptions. The most feasible program design for such a rehabilitation program would be an exemption trust fund, which would allow debtors to place liquidated cash exemptions in trust, supervised by a bankruptcy court. The purpose of the exemption trust fund would be to rehabilitate debtors as economic units, and to encourage debtors to take viable work-out programs, in lieu of no-asset straight bankruptcies.

Administratively, the trust fund would be administered by a special trustee under the supervision of the bankruptcy judge. The trust fund would pay compensation to the trustee out of earnings. Because trust account practices would require annual reports to the court and investments in a prudent manner, having regard for the principal as well as earnings, the trust fund would be restricted to the purchase of United States Government securities. Congress could in fact authorize the Treasury Department to issue special obligations that would retire the principal of the national debt, paying a fixed non-taxable rate for sale only to the nation's Exemption Trust Funds. The funds held in trust should be free from taxation in the hands of the trustees and free from taxation in the debtor's hands as dividends.

The assets of debtors in the Exemption Trust Fund would be free from all claims of creditors, present and post-bankruptcy, whether dischargeable or not dischargeable, so long as not withdrawn by the debtor. Involuntary transfer of a debtor's interest as a result of death would not change the exempt status of the fund. Assets in the fund could not be paid over to the debtor during the year following the debtor's discharge or confirmation of the debtor's plan. After the one year moratorium, the debtor could withdraw up to twenty-five percent of the principal and accrued income credited to his or her account during each of the next four years, or withdraw the outstanding balance at the end of the fifth year. After the initial accumulation period, Chapter 11³⁴⁵ and 13³⁴⁶ debtors could also allocate up to ten percent of the principal and accrued income in their account for payments to creditors under their plan. Provisions for future payments from the trust fund accounts could, therefore, be included as part of the order confirming the plan in chapter 11 and 13 rehabilitation proceedings.

To encourage debtors to make use of the trust fund for their own benefit, chapter 11 and 13 debtors would be permitted to deposit post-bankruptcy earnings in their fund account for up to five years after confirmation.

345. 11 U.S.C. § 1101 (Reorganization Chapter).

346. 11 U.S.C. § 1301 (Adjustment of Debts of an Individual with Regular Income Chapter).

Thus, a confirmation order could require that a certain percent of post-petition earnings be deposited in the Exemption Trust Fund. Upon conversion of a chapter 11 or 13 case to a chapter 7³⁴⁷ case, the funds deposited in the Exemption Trust Fund could continue as exempt. Post-conversion deposits or withdrawals by debtors from the fund would not be part of the dividend to creditors.

Mechanically, exemptions for chapter 7 debtors would be simple. A chapter 7 debtor would be entitled to exempt \$10,000 in fair market value of his assets reported on the schedules of his petition for bankruptcy, to the extent that such assets are unencumbered by enforceable security interests or liens. This would be the welfare exemption. No categorical limitations would be placed on the debtor's choice. In addition to the \$10,000 exemption, equities in encumbered assets could be elected. These equities could be taken as cash allowances by the debtor, as well as a "set-off" of the encumbered exempt property to the debtor by the bankruptcy court. These exemptions would be subject to the claims of non-dischargeable debt-holding creditors.

If the debtor's estate was an asset estate, as opposed to the typical no-asset case, then the debtor would be allowed an additional exemption of a fixed percent of the estate as defined by section 541 in the 1978 Bankruptcy Reform Act.³⁴⁸ Section 541 would be redefined to make the beneficial interest of spendthrift trust funds³⁴⁹ and the debtor's interest in entireties property assets of the estate.³⁵⁰

Chapter 11 and Chapter 13 debtors filing petitions for rehabilitation would be able to claim the same welfare exemption as chapter 7 debtors. In addition, each would be given, as part of the confirmation order and plan, the opportunity to contribute a portion of post-petition funds to the Exemption Trust Fund as part of the plan. If the debtor's work-out produced a dividend of ten to thirty percent to creditors, the debtor would receive an additional exemption of four percent of the net dividend. If the debtor produced thirty-one to fifty percent dividends to creditors, then the debtor would be entitled to take an exemption of eight percent of the dividend amount. A dividend of fifty-one to seventy-five percent would merit a twelve percent exemption payment, and a dividend of seventy-six to one hundred percent would provide an exemption payment of fifteen percent of the net payment to creditors, taken from the assets of the debtor used to meet the plan. This final exemption would be payable at discharge time, and would be a bonus to the debtor who made a good faith effort to pay his obligations through a court-supervised work-out program.

There are three main objections to a trust fund of this type and exemptions geared to making debtors viable after bankruptcy: 1) such an enforced

347. 11 U.S.C. § 701 (Liquidation Chapter).

348. 11 U.S.C. § 541 (estate includes all property that a debtor has legal or equitable interest in, including community property, proceeds, bequests, and others).

349. See *supra* text accompanying notes 88-90 (history of the treatment of spendthrift trusts in bankruptcy).

350. See 11 U.S.C. § 541 (tenancy by the entirety property included in the bankrupt's estate).

savings mechanism has never been a part of the bankruptcy law before, and may not be permissible under the Constitution, 2) it makes no allowance for state created exemptions which are more, or less, generous to debtors than this program, and 3) the freedom of the debtor is abridged. The answer to the first objection is the standing trustee for chapter 13 cases is, in form, similar to this system and has not been challenged as an unconstitutional measure.³⁵¹ The second objection is granted. No preference is given state exemptions because they serve no federal purpose, unless favoritism of special interest groups is a legitimate federal purpose. The third objection is also granted. Debtors are not free to commit financial suicide after bankruptcy.

Were the trust fund adopted as the federal bankruptcy scheme, all the constitutional challenges to the crazy quilt exemption pattern of section 522 would be terminated. The "opt-out" statute with its importation of made by state bankruptcy laws into the federal bankruptcy courts would be eliminated. The unworkable administration of the categorical exemptions in bankruptcy would not have to be dealt with each day. An incentive to wage earning and salaried debtors to pay substantial portions of their debts would be provided. This would, of course, be at the expense of the debtor's freedom to commit financial suicide via chapter 7. It would also provide a means to retire a portion of the national debt and encourage thrift as a part of the chapter 11 and 13 plans.

351. See 11 U.S.C. § 1302, § 1326 (defining the duties of a standing trustee and the percentage fee for the trustee).