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FIVE INTO THIRTEEN: LIEN AVOIDANCE IN CHAPTER 13

RALPH A. PEEPLES[†]

Section 103(a) of the Bankruptcy Code provides that Chapters 1, 3, and 5 of the Code apply in a case brought under Chapters 7, 11, or 13 of the Code. Nevertheless, application of some sections of Chapter 5 in a Chapter 13 case can lead to inequitable results. This has prompted a few bankruptcy courts to refuse to apply these sections in a Chapter 13 case despite the seemingly clear mandate of section 103(a). Professor Peeples examines the tension between Chapters 5 and 13, concluding that the unqualified availability of these sections of Chapter 5 to a Chapter 13 debtor leads to serious distortions of bankruptcy policy. Because correcting these problems would require a strained reading of the Code in its present form, however, Professor Peeples suggests that the ultimate solution is legislative revision of Chapter 13.

I. INTRODUCTION

On at least one point the returns from the bankruptcy courts are in agreement: Chapter 13¹ is a box office success with debtors.² That was not the case with its predecessor, Chapter XIII,³ which was used sporadically and unevenly around the country.⁴ Although greater use of Chapter 13 was a major goal of the draftsmen⁵ of the Bankruptcy Code⁶, its new-found popularity has led to

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1. 11 U.S.C. §§ 1301-1330 (Supp. V 1981).

2. The number of voluntary bankruptcy filings has increased every year since the Bankruptcy Reform Act became effective on October 1, 1979. Chapter 13 filings have accounted for a steadily increasing share of these filings. For the year ending June 30, 1979, 39,442 of the 225,549 voluntary filings were under old Chapter XIII (1898 Act) petitions (17.49%). DIRECTOR OF THE ADMIN. OFFICE OF THE U.S. COURTS, 1979 ANNUAL REPORT 573-74 table F-2 [hereinafter cited as (year) ANNUAL REPORT]. For the nine months ended June 30, 1980, 46,894 of the 209,414 voluntary filings were Chapter 13 petitions (22.39%) 1980 ANNUAL REPORT 550-57 table F2BC. For the year ended June 30, 1981, 86,788 of the 358,997 voluntary filings were Chapter 13 petitions (24.17%). 1981 ANNUAL REPORT 544-45 table F-2A. Chapter 13 has proved particularly popular with North Carolina debtors, although the use of old Chapter XIII was significantly above the national average as well. For the time periods defined above, Chapter XIII and Chapter 13 petitions consistently accounted for over 60% of all voluntary petitions filed in North Carolina. Compilation of statistics derived from 1979 ANNUAL REPORT 574, 1980 ANNUAL REPORT 552, 1981 ANNUAL REPORT 545.

3. 11 U.S.C. §§ 1001-1086 (1976) (repealed 1978).

4. H.R. REP. NO. 595, 95th Cong., 1st Sess. 117 (1977), reprinted in app. 2 W. COLLIER, COLLIER ON BANKRUPTCY II-1 (15th ed. 1979) [hereinafter cited as HOUSE REPORT]; S. REP. NO. 989, 95th Cong., 2d Sess. 12 (1978), reprinted in app. 3 W. COLLIER, COLLIER ON BANKRUPTCY V-1 (15th ed. 1979) [hereinafter cited as SENATE REPORT]; COMMISSION ON THE BANKRUPTCY LAWS OF THE UNITED STATES, REPORT, H.R. DOC. NO. 137, 93rd Cong., 1st Sess., pt. I, at 157 (1973), reprinted in app. 2 W. COLLIER, COLLIER ON BANKRUPTCY I-1 (15th ed. 1979) [hereinafter cited as COMMISSION REPORT].

5. HOUSE REPORT, *supra* note 4, at 117-8, 121; SENATE REPORT, *supra* note 4, at 13.

some rather sharp controversies about what a debtor may do in such a proceeding under the guise of "adjusting" his debts. Undoubtedly the most visible and the most heavily contested issue has been the confirmation of plans that provide for minimal or even zero payment to unsecured creditors.⁷ Resolution of that issue has most frequently turned on the construction of the requirement of section 1325(a)(3) that "the plan has been proposed in good faith."⁸ The lure of a more comprehensive discharge under Chapter 13 than is available under Chapter 7⁹ has exacerbated the minimal payment controversy, while sparking criticism in its own right.¹⁰ The question of what qualifies a person as an "individual with regular income" and therefore eligible for Chapter 13 relief has also been explored with considerable frequency.¹¹

There is another controversy, less pronounced than the dispute over minimal payment plans, which nonetheless is troubling a growing number of bankruptcy courts: the application of Chapter 5 of the Bankruptcy Code¹² to Chapter 13 proceedings. Similar to the debate over the meaning of the "good faith" standard in section 1325(a)(3), it poses a question of statutory construction that at first blush seems straightforward, but upon reflection becomes anything but clear cut. And like the "good faith" debate, it goes to the heart of the assumptions about, and aspirations held for, Chapter 13 by its draftsmen.

The question most often arises when a Chapter 13 debtor seeks to invoke the lien avoiding powers of section 522(f).¹³ It can also arise when a Chapter 13 debtor begins casting a wistful eye at sections 544, 545, 547, 548, and 553,¹⁴

6. 11 U.S.C. §§ 101 to 151326 (Supp. V 1981).

7. Compare the list of cases collected and catalogued in *In re Scher*, 12 Bankr. 258, 280-83 (Bankr. S.D.N.Y. 1981). The problem has been frequently noted by commentators. See, e.g., Cyr, *The Chapter 13 "Good Faith" Tempest: An Analysis and Proposal for Change*, 55 AM. BANKR. L.J. 271 (1981); Hughes, *Chapter 13's Potential for Abuse*, 58 N.C.L. REV. 831 (1980); Note, *Payments to Unsecured Creditors Under Chapter 13 of the Bankruptcy Reform Act*, 57 IND. L.J. 189 (1982); Note, *"Good Faith" and Confirmation of Chapter 13 Composition Plans: Analysis and a Proposal*, 65 MINN. L. REV. 659 (1981); Note, *Abusing Chapter 13 of the Bankruptcy Code: The Problem of Nonrepayment*, 55 N.Y.U. L. REV. 941 (1980).

8. Judicial treatment of minimal payment plans has been varied and inconsistent. The essential question is whether the requirement of 11 U.S.C. § 1325(a)(3) that the plan be proposed "in good faith" can support a court's refusal to confirm a plan that provides for payments substantially less than what the debtor apparently could pay. See, e.g., *In re Deans*, 692 F.2d 968 (Bankr. 4th Cir. 1982); *In re Goeb*, 675 F.2d 1386 (Bankr. 9th Cir. 1982); *In re Rimgale*, 669 F.2d 426 (Bankr. 7th Cir. 1982); *In re Terry*, 630 F.2d 634 (Bankr. 8th Cir. 1980); Cyr, *supra* note 7.

9. 11 U.S.C. §§ 701-766 (Supp. V 1981).

10. See, e.g., Hughes, *supra* note 7, at 842-43.

11. See, e.g., cases collected in Annot., 57 A.L.R. FED. 339 (1982).

12. 11 U.S.C. §§ 501-554 (Supp. V 1981).

13. Section 522(f) permits the debtor to avoid judicial liens on any exempt property, as well as nonpossessory, nonpurchase money security interests in specific types of exempt personal property, including household furnishings, household goods, wearing apparel, tools of trade, and professionally prescribed health aids, to the extent that such liens or security interests "impair an exemption to which the debtor would have been entitled." 11 U.S.C. § 522(f) (Supp. V 1981).

14. Sections 544, 545, 547, 548, and 553 are the principal statutory means of avoiding prepetition transfers of the debtor's property. Section 544(a) confers upon the bankruptcy trustee the status of judicial lien creditor, execution lien creditor, and bona fide purchaser of real property, thereby enhancing his avoidance powers. For example, possession of the rights of a judicial lien creditor enables the trustee to avoid transfers such as unperfected security interests. The status of a bona fide purchaser of real property enables the trustee to avoid unrecorded mortgages. Section 544(b) gives the trustee the power to avoid any transfer voidable under applicable state law by an

and the tantalizing possibilities they offer.

A majority of the bankruptcy courts that have faced the issue have concluded that Chapter 5, and section 522(f) in particular, apply without qualification in a Chapter 13 proceeding, almost invariably citing section 103(a) of the Code¹⁵ as authority.¹⁶ There is additional evidence to believe that a number of other bankruptcy courts (as well as trustees and lawyers) have simply assumed, without much reflection, that unrestricted use of section 522 is open to a Chapter 13 debtor.¹⁷ But the tone of the opinions that often announce the result with considerable reluctance, overt or implied,¹⁸ is instructive. The discomfort is obvious. In fact, the courts' discomfort has been so great that in spite of the apparently unambiguous language of section 103(a), several bankruptcy courts, most notably those in North Carolina, have denied to Chapter 13 debtors the avoiding powers of section 522(f).¹⁹

This article will explore the connections and tensions between Chapters 5 and 13. Examining the "fit" of those two chapters—and identifying flaws where alterations may be necessary—may become more significant in the not so distant future, as Congress considers encouraging even more forcefully the use of Chapter 13's rehabilitation scheme over Chapter 7's final relief program for individual debtors.²⁰

unsecured creditor of the debtor. Section 545 enables the trustee to avoid certain statutory liens. Section 547 empowers the trustee to avoid certain preferential transfers. Fraudulent transfers are recoverable under § 548. Section 553 makes certain setoffs against the debtor recoverable by the trustee.

15. 11 U.S.C. § 103(a) (Supp. V 1981) provides: "Except as provided in § 1161 of this title, chapters 1, 3, and 5 of this title apply in a case under chapter 7, 11 or 13 of this title." Chapter 1 consists of general provisions. Chapter 3 governs case administration. Chapter 5 deals with "creditors, the debtor, and the estate."

16. *In re Thurman*, 20 Bankr. 978 (Bankr. W.D. Tenn. 1982); *In re Mattson*, 20 Bankr. 382 (Bankr. W.D. Wis. 1982); *In re Barker*, 20 Bankr. 11 (Bankr. D.S.C. 1982); *In re Donato*, 17 Bankr. 708 (Bankr. E.D. Va. 1982); *In re Walls*, 17 Bankr. 701 (Bankr. D.W. Va. 1982); *In re Reeves*, 17 Bankr. 383 (Bankr. W.D. La. 1982); *In re Colandrea*, 17 Bankr. 568 (Bankr. D. Md. 1982); *In re Jones*, 20 Bankr. 258 (Bankr. W.D. Ky. 1981); *In re Canady*, 9 Bankr. 428 (Bankr. D. Conn. 1981); *In re Hagerman*, 9 Bankr. 412 (Bankr. W.D. Mo. 1981); *In re Young*, 10 Bankr. 17 (Bankr. S.D. Cal. 1980); *In re Primm*, 6 Bankr. 142 (Bankr. D. Kan. 1980); *In re Jordan*, 5 Bankr. 59 (Bankr. D.N.J. 1980); *In re Ohnstad*, 6 BANKR. CT. DEC. (CRR) 6 (Bankr. S.D. 1980).

The only reported federal district court case dealing with the application of Chapter 5 in a Chapter 13 case is *Baldwin v. Avco Fin. Serv.*, 22 Bankr. 507 (D. Del. 1982). The *Baldwin* court concluded that § 522(f) applies with full force in a Chapter 13 case.

17. *See, e.g., In re Antley*, 18 Bankr. 207 (Bankr., M.D. Ga. 1982); *In re Esser*, 20 Bankr. 178 (Bankr. E.D. Pa. 1982); *In re Marshall*, 15 Bankr. 738 (Bankr. W.D.N.C. 1981); *In re Graham*, 15 Bankr. 1010 (Bankr. E.D. Pa. 1981); *In re Cohen*, 13 Bankr. 350 (Bankr. E.D.N.Y. 1981); *In re Fluharty*, 7 Bankr. 677 (Bankr. N.D. Ohio 1980); *Rodrock v. Security Indus. Bank*, 3 Bankr. 629 (Bankr. D. Colo. 1980), *aff'd*, 642 F.2d 1193 (Bankr. 10th Cir. 1981), *aff'd sub. nom.* *United States v. Security Indus. Bank*, 103 S. Ct. 407 (1982).

18. *See, e.g., In re Coleman*, 21 Bankr. 832, 834 (Bankr. S.D. Tex. 1982); *In re Barker*, 20 Bankr. 11 (Bankr. D.S.C. 1982); *In re Drummond*, 17 Bankr. 494, 495 (Bankr. E.D. Ark. 1981); *In re Hagerman*, 9 Bankr. 412 (Bankr. W.D. Mo. 1981).

19. *In re Corden*, 19 Bankr. 552 (Bankr. M.D. Fla. 1982) (following *Sands*); *In re Morgan*, 18 Bankr. 17 (Bankr. D. Del. 1981); *In re Aycock*, 15 Bankr. 728 (Bankr. E.D.N.C. 1981); *In re Sands*, 15 Bankr. 563 (Bankr. M.D.N.C. 1981).

20. Presently pending before Congress is H.R. 4786 (S.2000), entitled the "Bankruptcy Improvements Act." H.R. 4786 would significantly amend the Bankruptcy Code's consumer debtor provisions. Section 2 of the bill amends § 109 of the Code to require individual debtors to demonstrate an inability to pay "a reasonable portion of debts out of anticipated future income" as a

II. CHAPTER 13—BACKGROUND

A Chapter 13 proceeding is essentially a court supervised composition. The debtor proposes a plan for repayment of his debts in full or in part over a period of up to five years.²¹ The plan must be confirmed by the bankruptcy court.²² Upon completion of the plan, the debtor receives a discharge of all debts covered by the plan.²³

The premise of Chapter 13 thus differs fundamentally from that of Chapter 7. Chapter 13 is based on the idea that the debtor's future income should be relevant in a bankruptcy proceeding.²⁴ Future income, after all, lies at the heart of the initial decision to extend consumer credit, in sharp contrast to the largely fictional reliance on "net worth" that underlies Chapter 7.²⁵ Use of a portion of future income to repay creditors under specified conditions, in specific amounts, and over a defined period of time should benefit both creditors and debtors. Creditors benefit because they receive a greater percentage of their debt; debtors benefit because they receive a more comprehensive discharge²⁶ while retaining most if not all of their property, exempt and nonexempt.²⁷ At least that was the assumption of the draftsmen of Chapter 13.²⁸ But Chapter 13 was not fashioned of entirely new cloth; innovative as it is, Chapter 13 was nonetheless derived in large part from the fabric of Chapter XIII of the Bankruptcy Act.²⁹

Criticism of Chapter XIII was never difficult to find. Its use varied considerably among the bankruptcy courts; its provisions were not generally understood, often impractical, and frequently impossible to decipher with certainty. Other shortcomings of Chapter XIII included its failure to allow individuals with regular income from sources other than wages to qualify for relief; the very restricted availability of a hardship discharge; the uncertain treatment of secured creditors; the leverage obtained on the debtor by proceeding against accommodation codebtors; and the unnecessary expense of formal creditor approval of the plan.³⁰ Of these defects, the uncertain treat-

condition to seeking relief under Chapter 7. The effect of such a requirement would certainly be increased use of Chapter 13. The standards for confirmation under § 1325(a) would also be made stricter by § 19 which would impose a "bona fide effort" requirement in addition to the existing "good faith" criterion.

21. 11 U.S.C. §§ 1321, 1322(c) (Supp. V 1981).

22. *Id.* §§ 1325, 1327.

23. *Id.* § 1328.

24. 5 W. COLLIER, *supra* note 4, ¶ 1300.0.

25. *Id.*

26. Section 523 lists nine types of debts that are not dischargeable in bankruptcy. Under § 1328(a), only debts "of the kind specified in § 523(a)(5)" (alimony and support payments and certain long-term obligations) are not dischargeable in a Chapter 13 case.

27. 11 U.S.C. §§ 1306(b), 1327(b), 1327(c) (Supp. V 1981).

28. HOUSE REPORT, *supra* note 4, at 118; SENATE REPORT, *supra* note 4, at 13.

29. The Bankruptcy Act of 1898, 11 U.S.C. §§ 1 to 1255 (1976) (repealed 1978) was repealed and replaced by the Bankruptcy Reform Act, Pub. L. No. 95-598, 92 Stat. 2549 (1978) (codified at 11 U.S.C. §§ 101 to 151326 (Supp. V. 1981)).

30. SENATE REPORT, *supra* note 4, at 13.

ment of secured creditors was perhaps the most serious.³¹ As the Senate Report noted, "[S]ecured creditors are dealt with erratically, tediously, and uncertainly, resulting from a hodgepodge of state and federal statutory provisions, bankruptcy and local rules, many conflicting reported cases and varied local customs."³² Three years after becoming law, the same criticism rings true for Chapter 13. One of the major reasons for the criticism stems from the unclear parameters of the avoiding powers of Chapter 5 in a Chapter 13 proceeding. This shortcoming has led to uncertainty over the validity and viability of many security interests in bankruptcy.

III. THE PROBLEM DEFINED

To what extent does Chapter 5 apply to Chapter 13? To what extent should it apply? On first inspection the answer is easy. Section 103(a) explicitly provides: "Except as provided in section 1161 of this title [dealing with railroad reorganization], chapters 1, 3 and 5 of this title apply in a case under chapter 7, 11 or 13 of this title."³³ The legislative history unambiguously supports the position that Congress both knew and meant what it said in section 103(a).³⁴ Certainly Congress was on notice; the bill drafted by the Bankruptcy Commission³⁵ took an approach quite similar to that of section 103(a).³⁶ Section 103(a) appeared in the enacted bill without change from the Senate³⁷ and House³⁸ versions. Indeed, numerous bankruptcy courts, in finding various provisions of Chapter 5 applicable to Chapter 13, have found it necessary only to cite section 103(a) to support their results.³⁹

Nonetheless, the application of Chapters 1, 3, and 5 to Chapter 13 has never been altogether straightforward. Qualifications and exceptions do exist. Most prominently, section 1328(a) severely restricts the kinds of nondischargeable debts that section 523, otherwise applicable by virtue of section 103(a), describes.⁴⁰ Section 1305 modifies the general rules regarding claims found in sections 501 to 510, section 502 in particular.⁴¹ Section 1306(a) expands sec-

31. COMMISSION REPORT, *supra* note 4, at 165.

32. SENATE REPORT, *supra* note 4, at 13.

33. 11 U.S.C. § 103(a) (Supp. V 1981).

34. HOUSE REPORT, *supra* note 4, at 6, 316; SENATE REPORT, *supra* note 3, at 28.

35. The Commission on the Bankruptcy Laws of the United States was established by Congress in 1970 to study the existing bankruptcy law (the Bankruptcy Act of 1898) and to make recommendations for revision. S.J. Res. 88, 84 Stat. 468 (1970). The Commission filed its final report on July 30, 1973. Part I of the report set out the Commission's findings and recommendations. Part II contained a proposed statute with explanatory notes.

36. COMMISSION REPORT, *supra* note 4, at 170.

37. S. 2266, 95th Cong., 2d Sess. § 103(a) (1978).

38. H.R. 8200, 95th Cong., 1st Sess. § 103(a) (1977).

39. See cases cited *supra* note 16.

40. 11 U.S.C. §§ 523, 1328(a) (Supp. V 1981). See *supra* note 26.

41. 11 U.S.C. §§ 501-510, 1305 (Supp. V 1981). Sections 501-510 comprise subchapter I of Chapter 5, entitled "Creditors and Claims." Subchapter I provides the basic Code rules for filing and allowance of claims. Section 502 sets forth the standards for allowance of claims. Section 1305 deals with claims that arise after a Chapter 13 petition has been filed. Section 1305(b) incorporates the standards of § 502, but provides that allowance will be determined as of the date the claim arises, rather than the date the petition was filed. Section 1327(c) provides for the disallow-

tion 541's definition of property of the estate,⁴² and section 1306(b) tacitly renders inapplicable section 521(3), which requires the debtor to "surrender to the trustee all property of the estate."⁴³ Section 1326 supplements the list of priority claims found in section 507.⁴⁴ Section 1301 expands the protection of the automatic stay provisions of section 362 to codebtors as well.⁴⁵ Sections 1303 and 1304 impose limits on the debtor's authority under section 363 to use, sell, or lease property of the estate.⁴⁶ In some of these instances, the qualification is something more than supplementation. For example, paired provisions that conflict directly include section 521(3) and section 1306(b), and section 363 and sections 1303 and 1304. To resolve such conflicts, the bankruptcy courts invariably invoke the principle of statutory construction that the specific provision overrides the general.⁴⁷

The suspicion that section 103(a) should be taken less than literally is heightened by the fact that the Bankruptcy Reform Act contained a number of formal errors, due in large part to the hurried circumstances surrounding its enactment. The various technical amendments considered by Congress since the Act's enactment are stark evidence of the existence of a considerable number of "scriveners' errors."⁴⁸

ance of postpetition claims for property or services necessary for the debtor's performance under the plan, if the claimant "knew or should have known that prior approval by the trustee . . . was practicable and was not obtained." See SENATE REPORT, *supra* note 4, at 140-1.

42. 11 U.S.C. §§ 541, 1306(a) (Supp. V 1981). The basic rule of § 541 is that the debtor's estate consists of "all legal or equitable interests of the debtor in property as of the commencement of the case." *Id.* § 541(a)(1). Section 1306(a) expands this definition to include as property of the estate property acquired or earnings received after commencement but before the case is closed, dismissed, or converted to a case under another Chapter of the Code. See SENATE REPORT, *supra* note 4, 140-1.

43. 11 U.S.C. §§ 521(3), 1306(b) (Supp. V 1981). Section 1306(b) provides: "Except as provided in a confirmed plan or order confirming a plan, the debtor shall remain in possession of all property of the estate." See SENATE REPORT, *supra* note 4, at 141.

44. 11 U.S.C. §§ 507, 1326(a) (Supp. V 1981). Section 1326(a) requires that the Chapter 13 trustee's fees be paid, along with administrative expenses under § 507(a)(1), before any payments are made to creditors under the plan. See SENATE REPORT, *supra* note 4, at 142.

45. 11 U.S.C. §§ 362, 1301 (Supp. V 1981). Section 362 stays virtually all collection efforts against the debtor. It becomes effective upon the filing of a bankruptcy petition.

46. 11 U.S.C. §§ 363, 1303, 1304 (Supp. V 1981). For example, under § 1303 the debtor lacks the trustee's power under § 363(h-j) to sell property held by the debtor and a co-owner as tenants in common or joint tenants, or held by the debtor and the debtor's spouse in the entirety. The debtor further lacks the trustee's power under § 363(n) to void sales authorized under § 363 if collusion among potential bidders is found.

47. See, e.g., *In re Mattson*, 20 Bankr. 382, 383 (Bankr. W.D. Wis. 1982); *In re Aycocock*, 15 Bankr. 728, 729-30 (Bankr. E.D.N.C. 1981); *In re Young*, 10 Bankr. 17, 18 (Bankr. S.D. Cal. 1980).

48. The Senate passed S. 658, 96th Cong., 2d Sess. on December 1, 1980. 126 CONG. REC. S15,176 (daily ed. Dec. 1, 1980). The House passed a modified version of S. 658 two days later. 126 CONG. REC. H11,740 (daily ed. Dec. 3, 1980). In April, 1981, a new technical amendments bill was introduced in the Senate, S. 863, 97th Cong., 1st Sess., entitled the "Bankruptcy Amendments Act of 1981." S. 863 passed the Senate in July, 1981, 127 CONG. REC. S7,907 (daily ed. July 17, 1981). The House did not act on the bill. All of the bills contained substantive changes to § 1325(a)'s standards for confirmation of the debtor's plan. For example, § 128(b) of the Bankruptcy Amendments Act adds the requirement to § 1325 that "such plan represents the debtor's bona fide effort." See *In re Goeb*, 675 F.2d 1386, 1389 (Bankr. 9th Cir. 1982); LoPucki, "Encouraging" Repayment Under Chapter 13 of the Bankruptcy Code, 18 HARV. J. ON LEGIS. 347, 361-63 (1981); Note, *Payments to Unsecured Creditors Under Chapter 13 of the Bankruptcy Reform Act of 1978*, 57 IND. L.J. 189, 204 (1982).

Such circumstances, however, are hardly enough to create a significant problem on their own. After all, the rule of section 103(a), even modified, is still clear: except where otherwise provided (explicitly or not, but at least by fair implication from a more specific section), Chapter 5 applies in a Chapter 13 case. The reported opinions, however, tell a different story. They disclose substantial uneasiness on the part of many bankruptcy courts in applying Chapter 5 to Chapter 13. Most of the reluctance has surfaced over the use of section 522(f) by a Chapter 13 debtor.⁴⁹ It has arisen as well over the use of the avoidance powers of Subchapter III.⁵⁰

IV. SECTION 522

Much of the allure of a Chapter 13 proceeding is the likelihood that a debtor will have to relinquish little, if any, of his or her existing property to obtain relief.⁵¹ This feature contrasts with the operation of Chapter 7, in which a debtor surrenders all nonexempt property to the trustee for liquidation and distribution to creditors in return for a prompt discharge. The ability of a debtor in a Chapter 13 case to retain substantially all of his property also points to a subtle but important link between that Chapter and section 522, the general exemptions provision of the Code. In states that have "opted out" of the federal exemptions, pursuant to section 522(b),⁵² while providing a set of state law exemptions that are less generous than those provided by section 522(d), the appeal of Chapter 13 becomes even stronger.⁵³ Thus, each state, if it chooses, has the power to encourage or discourage the use of Chapter 13 by manipulating its own exemption system. The potential distortion—uneven use of Chapter 13 nationwide—suggests a return to the pattern of old Chapter XIII, and consequently threatens one of the stated goals of the Code's drafters.⁵⁴ As the number of states that have "opted out" grows,⁵⁵ the use of Chap-

49. See, e.g., *In re Barker*, 20 Bankr. 11 (Bankr. D.S.C. 1982); *In re Drummond*, 17 Bankr. 494 (Bankr. E.D. Ark. 1981); *In re Hagerman*, 9 Bankr. 412 (Bankr. W.D. Mo. 1981).

50. See, e.g., *In re Coleman*, 21 Bankr. 832 (Bankr. S.D. Tex. 1982). Subchapter III of Chapter 5 ("The Estate") consists of §§ 541-554, which include the principal bankruptcy avoidance powers.

51. In addition to the opportunity to restructure and reduce existing indebtedness, the Chapter 13 debtor receives immediate relief from collection efforts by virtue of § 362, the automatic stay. Upon successful completion of the plan, the debtor is entitled to a more comprehensive discharge of remaining indebtedness under § 1328 than is available to a Chapter 7 debtor under § 523.

52. Section 522(b) permits a debtor to choose between the exemptions provided by applicable state law and the federal exemptions set forth in § 522(d). Any state, however, may expressly statutorily deny this choice to its residents.

53. Wickham, *Chapter 7 or Chapter 13: Guiding Consumer Debtor Choice Under the Bankruptcy Reform Act*, 58 N.C.L. REV. 815, 822-23 (1980). North Carolina provides a good example. In 1981 the General Assembly enacted a completely new exemptions law while denying the "federal option" to North Carolina debtors in bankruptcy. Act of June 2, 1981, 1981 Sess. Laws 751 (codified at N.C. GEN. STAT. §§ 1C-1601 to -1604), amended by Act of June 18, 1982, ch. 1224, H.B. 1453. The dollar values and types of exemptible property are significantly less generous than those provided in § 522(d) of the Bankruptcy Code.

54. See *supra* notes 4 & 6.

55. At least 35 states have enacted "opt out" legislation. See ALA. CODE § 6-10-11 (Cum. Supp. 1982); ALASKA STAT. § 09.38.055 (Cum. Supp. 1982); ARIZ. REV. STAT. ANN. § 33-1133 (Cum. Supp. 1981); ARK. STAT. ANN. § 36-210 (Cum. Supp. 1981); COLO. REV. STAT. § 13-54-107

ter 13 will likely increase.⁵⁶ The question of the proper application of Chapter 5, and section 522(f) in particular, will become more important as the use of Chapter 13 increases.

If the Chapter 13 debtor will not be required to part with his property, exempt or nonexempt, of what relevance is section 522 in a Chapter 13 case? The answer is that in many cases section 522 will have little practical significance. In fact, the only instance in which the section necessarily becomes important is at confirmation, when the court is required by section 1325(a)(4)⁵⁷ to find that the debtor's plan is in the best interest of unsecured creditors⁵⁸—that an amount not less in value than what would have been paid in a Chapter 7 proceeding will be distributed to unsecured creditors under the plan proposed by the debtor. To make this "best interest" comparison a computation of exempt property is necessary, since the debtor's exempt property in a Chapter 7 proceeding has the effect of reducing pro tanto the amount of assets available

(Cum. Supp. 1981); DEL. CODE ANN. tit. 10, § 4914 (Cum. Supp. 1982); FLA. STAT. ANN. § 222.20 (West Cum. Supp. 1982); GA. CODE ANN. § 51-1601 (Cum. Supp. 1982); IDAHO CODE § 11-609 (Cum. Supp. 1981); ILL. ANN. STAT. ch. 52, § 101 (Smith-Hurd Cum. Supp. 1982); IND. CODE ANN. § 34-2-28-0.5 (Burns Cum. Supp. 1982); IOWA CODE ANN. § 627.10 (West Cum. Supp. 1982); KAN. STAT. ANN. § 60-2312 (Cum. Supp. 1981); KY. REV. STAT. § 427.170 (Cum. Supp. 1982); LA. REV. STAT. ANN. § 13:3881(b) (West Cum. Supp. 1982); ME. REV. STAT. ANN. tit. 14 § 4426 (Cum. Supp. 1982); MD. [CTS. & JUD. PROC.] CODE ANN. § 11-504(g) (Cum. Supp. 1982); MO. ANN. STAT. § 513.427 (Cum. Supp. 1981); MONT. CODE ANN. § 31:2:106 (1981); NEB. REV. STAT. § 25-15, 105 (Cum. Supp. 1982); NEV. REV. STAT. § 21:090 (1981); N.H. REV. STAT. ANN. § 511:2-a (Cum. Supp. 1981); N.Y. DEBT. & CRED. LAW § 284 (McKinney Cum. Supp. 1982); N.C. GEN. STAT. § 1C-1601(f) (Cum. Supp. 1981); N.D. CENT. CODE § 28-22-17 (Supp. 1981); OHIO REV. CODE ANN. § 2329.662 (Page Supp. 1980); OKLA. STAT. ANN. tit. 31, § 1B (West Cum. Supp. 1981); OR. REV. STAT. § 23:305 (1981); S.C. CODE ANN. § 15-41-425 (Law. Co-op. Supp. 1982); S.D. CODIFIED LAWS ANN. § 43-45-13 (Supp. 1981); TENN. CODE ANN. § 26-2-112 (1980); UTAH CODE ANN. § 78-23-15 (Supp. 1981); VA. CODE § 34-3.1 (Cum. Supp. 1982); W. VA. CODE § 38-10-4 (Cum. Supp. 1982); WYO. STAT. § 1-20-109 (Cum. Supp. 1981).

56. Wickham, *supra* note 53, at 822-23.

57. 11 U.S.C. § 1325(a) (Supp. V 1981) provides:

The court shall confirm a plan if —

- (1) the plan complies with the provisions of this chapter and with other applicable provisions of this title;
- (2) any fee, charge, or amount required under chapter 123 of title 28, or by the plan, to be paid before confirmation, has been paid;
- (3) the plan has been proposed in good faith and not by any means forbidden by law;
- (4) the value, as of the effective date of the plan, of property to be distributed under the plan on account of each allowed unsecured claim is not less than the amount that would be paid on such claim if the estate of the debtor were liquidated under chapter 7 of this title on such date;
- (5) with respect to each allowed secured claim provided for by the plan—
 - (A) the holder of such claim has accepted the plan;
 - (B)(i) the plan provides that the holder of such claim retain the lien securing such claim; and
 - (ii) the value, as of the effective date of the plan, of property to be distributed under the plan on account of such claim is not less than the allowed amount of such claim; or
 - (C) the debtor surrenders the property securing such claim to such holder; and
- (6) the debtor will be able to make all payments under the plan and to comply with the plan.

58. 5 W. COLLIER, *supra* note 4 at ¶ 1325.01[2][D].

for liquidation and distribution to creditors in such a proceeding.⁵⁹ Section 522 is not, however, limited to a simple catalog of property that debtors are entitled to keep from creditors. It also empowers the debtor to enhance his position by avoiding various liens on and transfers of exempt property.⁶⁰

Section 522(f) is perhaps second only to minimal payment Chapter 13 plans as a source of bankruptcy litigation.⁶¹ Most of the litigation has centered on the retroactive application of section 522(f) to liens predating either the effective date or the enactment of the Bankruptcy Reform Act. It is a small irony that the very case which decided this question—*Rodrock v. Security Industrial Bank*⁶²—was itself a Chapter 13 case. The issue of Chapter 5's applicability was apparently not raised, and that is not surprising: most commentators and courts, relying on section 103(a), have simply assumed that section 522 applies in its entirety to Chapter 13.⁶³ The wisdom of that assumption has been less frequently considered.

Section 522(f) permits the debtor to avoid judicial liens on exempt property, and to avoid nonpossessory, nonpurchase money security interests in exempt personal property such as household goods and furnishings, appliances, clothing, and tools of the trade, to the extent that such judicial liens or security interests "impair an exemption to which the debtor would have been entitled." The effect of section 522(f) on creditor and debtor will vary according to the circumstances, and in a Chapter 13 case four possible situations can be identified: (1) none of the claims may be vulnerable under 522(f) (for example, the debtor's creditors may consist of a mortgagee, a few creditors holding purchase money security interests, and a number of unsecured claimants); (2) the debtor may propose a plan that provides for payment in full of all his creditors; (3) the debtor may propose a relatively high dividend to his unsecured creditors; and (4) the debtor may propose a relatively low dividend to his unsecured creditors.⁶⁴

In the first situation, the issue simply will not arise. In the second situation, allowing the debtor to avoid various liens may mean a modest interest

59. *Id.* ¶ 1325.01[2][D][b][iv].

60. In addition to § 522(f), § 522(g) allows the debtor to exempt property of the estate recovered by the trustee. Section 522(h) enables the debtor to use the avoiding powers of §§ 544, 545, 547, 548, 549, 1724(a) and the recovery power of § 553 to recover any exempt property, otherwise exemptible, which the trustee fails to attempt to recover. Section 522(e) makes waivers of exemptions in favor of particular unsecured creditors unenforceable.

61. *See, e.g.*, cases collected in Annot., 55 A.L.R. FED. 353 (1981); *see also In re Gifford*, 669 F.2d 468, 471 (Bankr. 7th Cir. 1982).

62. 3 Bankr. 29 (Bankr. D. Colo. 1980), *aff'd*, 642 F.2d 1193 (Bankr. 10th Cir. 1981), *aff'd sub nom.* United States v. Security Indus. Bank, 103 S. Ct. 407 (1982).

63. *See supra* note 16.

64. Full payment to holders of allowed secured claims is assumed in the third and fourth situations, due to the operation of § 1325(a)(5). Section 1325(a)(5) requires a condition to confirmation of the plan—that each holder of an allowed secured claim either (1) accept the plan; (2) retain the lien securing the claim, if the value of the property to be distributed to that creditor under the plan, as of the plan's effective date, is at least equal to the allowed amount of such claim; or (3) receive the property securing the claim from the debtor. By operation of § 506(a), a claim is an "allowed secured claim" only to the extent of the value of the property securing the claim. Therefore, a creditor holding an allowed secured claim will receive either the property securing the claim or payments equal in value to such property.

savings for him. Invoking section 506(b),⁶⁵ an oversecured creditor might insist on receiving both principal and interest payments as a condition to accepting the debtor's plan under section 1325(a)(5).⁶⁶ If, however, the debtor can avoid all or part of the lien, the once oversecured claim is bifurcated into a partially secured claim and a partially unsecured claim, to the extent that the lien impairs an exemption. On this newly fashioned unsecured claim, no unmatured interest will be allowable under section 502(b)(2).⁶⁷ Nonetheless, in this second situation the benefit to the debtor will be modest. The prejudice to the creditor will likewise be modest.

In the third situation, the debtor will do the secured creditor more harm by invoking section 522(f). It may be that the debtor has assumed that his secured creditor's claim can be transformed to at least a partially unsecured claim (and the level of his payments to that creditor thereby reduced), in calculating the amount he can pay to unsecured creditors generally. Or it may be that there is no such linkage at all, since nothing in the Code requires it. Thus, in this third situation the use of section 522(f) may or may not have the effect of benefiting unsecured creditors or the debtor. The prejudice to the secured creditor has, however, obviously increased.

It is in the fourth situation that the conflict becomes sharpest. If the debtor has proposed only a minimal payment of unsecured claims, and also proposes to use section 522(f), the prejudice to the secured creditor has been maximized, with little or no corresponding benefit to the unsecured creditors. The benefit to the debtor, however, may take several forms. It may be that by avoiding the lien he has spared himself some periodic payments, which can be diverted instead to fund the proposed payment to unsecured creditors. But there is no necessary connection. Nothing in Chapter 13 requires such a result.⁶⁸ Instead, it may be that the debtor is simply paying himself a bonus, in the form of reduced debt payments. It is thus entirely possible in this fourth situation—and to a lesser extent in the second and third situations—to use section 522(f) as a purely punitive weapon. This possibility is at the heart of the reluctance of the bankruptcy courts to apply section 522 in Chapter 13 proceedings.

The reluctance is understandable. If the debtor is in fact using section 522(f) for purely punitive reasons, then it is difficult to see how section 522

65. 11 U.S.C. § 506(b) (Supp. V 1981). Section 506(b) permits an oversecured creditor to recover interest and reasonable collection costs to the extent provided "under the agreement under which such claim arose."

66. Most courts and commentators have concluded that § 506(b) overrides § 502(b)(2), which disallows claims for unmatured interest. Thus, postpetition interest can be recovered by a sufficiently oversecured creditor. *See, e.g.*, 3 W. COLLIER, *supra* note 4, at ¶ 506.05; Fortgang & King, *The 1978 Bankruptcy Code: Some Wrong Policy Decisions*, 56 N.Y.U. L. REV. 1148, 1165 (1981).

67. One can assume that the debtor's plan will ordinarily provide for the secured claim. Kennedy, *Secured Creditors Under the Bankruptcy Reform Act*, 15 IND. L. REV. 477, 496 (1982). If, for example, the plan ignored the secured claim, the creditor would then have the power to enforce his lien, with potentially disastrous results for the debtor.

68. *See, e.g.*, 11 U.S.C. § 551 (Supp. V 1981), which provides that transfers avoided under § 522 are preserved for the benefit of the estate.

serves its avowed purpose of providing the debtor with a fresh start.⁶⁹ The debtor will retain the property regardless of the use of section 522(f). No benefit to him is received, except in the form of a gratuitous bonus; the secured creditor has been prejudiced, and not even the unsecured creditors have benefited as a result.

This potential use of section 522(f) leads to larger problems as well. The ability to avoid, for example, an offending security interest (the existence of which persuades the debtor outside of bankruptcy to remain current in installment payments) and thereby relieve oneself of the monthly payments poses quite a temptation. That temptation becomes even more inviting when one realizes that the costs associated with its use in Chapter 13 are much less than they would be in a Chapter 7 proceeding. No property will have to be surrendered. In short, this potential use of section 522(f), when coupled with the more liberal discharge of section 1328⁷⁰ and the relaxed restrictions on subsequent petitions,⁷¹ may make Chapter 13 too attractive an alternative, to the point of encouraging unnecessary petitions.

The use of section 522(f) in a Chapter 13 case thus can produce a difficult result, underscoring the distortions that the employment of minimal payment plans representing less than the debtor's best effort can produce. But is it a totally unjustifiable result? Providing honest debtors with a meaningful "fresh start" was undoubtedly one of the primary goals of the Code, and of section 522 in particular,⁷² but it was never the exclusive goal. The evidence is ample that from the start of the reform process—through the initial studies, the Committee hearings, and the Committee reports—section 522(f) and its forerunners had a second function: discouraging the practice of taking a blanket nonpurchase money security interest in the borrower's personal property.⁷³

The ability of a secured creditor under then-existing law to exert undue pressure on the debtor by threat of repossession provoked widespread criticism.⁷⁴ Since the collateral's resale value was usually quite low in relation to its replacement cost, however, the threat was often an empty one.⁷⁵ The threat

69. From the beginning of the bankruptcy reform process, the drafters of the Code recognized the critical role exemptions play in providing debtors a meaningful "fresh start." COMMISSION REPORT, *supra* note 4, at 169; HOUSE REPORT, *supra* note 4, at 117-18, 126, 176; SENATE REPORT, *supra* note 4, at 6.

70. See *supra* note 26. In addition, the grounds for denial of a discharge in a Chapter 7 case found in § 727 are inapplicable in a Chapter 13 case.

71. Under § 727(a)(8), a discharge in a Chapter 7 proceeding bars the debtor from receiving a subsequent Chapter 7 discharge for six years. No such restriction applies as a result of a Chapter 13 discharge, if pursuant to § 727(a)(9), the debtor paid 70% of the allowed unsecured claims and the plan was the debtor's best effort.

72. See *supra* note 69.

73. The Bankruptcy Commission's report recommended that nonpurchase money security interests be made unenforceable against various types of exempt property. Section 4-503(f) of the Commission's bill was the direct ancestor of § 522(f). COMMISSION REPORT, *supra* note 4, at 170. The House Report amplified the concerns expressed in the Commission's report. HOUSE REPORT, *supra* note 4, at 127-28, 163; HOUSE REPORT, *supra* note 4, app. 1, at 172 (statement of D.H. Williams, Attorney, Fed. Trade Comm'n). See also Note, *Constitutionality of Retroactive Lien Avoidance Under Bankruptcy Code § 522(f)*, 94 HARV. L. REV. 1616, 1618 (1981).

74. HOUSE REPORT, *supra* note 4, at 127, 163; COMMISSION REPORT, *supra* note 4, at 169.

75. "In fact, were the creditor to carry through on his threat and foreclose on the property, he

of repossession was instead frequently used to induce a reaffirmation agreement⁷⁶ under the old Act—a reaffirmation that could have the effect of undoing the benefits of the bankruptcy process for the debtor.⁷⁷ Nor was section 522(f)(2) the only place in the Code where Congress sought to redress what it perceived to be unfair lending practices. Section 722 permits a Chapter 7 debtor to redeem certain otherwise exemptible personal property encumbered by a security interest by tendering the fair market value of the collateral to the creditor.⁷⁸ Section 523(a)(2), as a condition to making a debt incurred through use of a false financial statement nondischargeable, requires that the creditor must have “reasonably relied” on such statement, and that the debtor prepared the statement with the intent to deceive the creditor.⁷⁹ Thus, there is a second, preventive function of section 522(f)(2), apart from the debtor’s “fresh start,” which serves a separate congressional purpose—the restriction of certain lending practices.⁸⁰

How effective is section 522(f)(2) at restricting such practices? On inspection, one notices a peculiar characteristic of this kind of restriction. The only sanction it carries is avoidance of the offending security interest in whole or in part. No penalties are assessed. The debt is not disallowed, fines are not imposed, citations are not issued. Not every debtor who signs a nonpurchase money security interest covering his or her household goods will end up in a bankruptcy proceeding. Of those debtors that do, not all of them will seek to avoid the otherwise vulnerable security interest. Those security interests will remain good and will be available to the holder for whatever collection use he wishes. In the event that such a security interest is avoided, it is only the security interest that is lost, nothing more. There is, therefore, no incentive not to demand the security interest and hope for the best.⁸¹ In short, the use of a blanket nonpurchase money security interest from a bankruptcy perspective represents a can’t-lose/could-win outcome for the creditor. Thus, although section 522(f)(2) can be shown to serve a policy that, unlike the fresh start policy, retains its logic in a Chapter 13 proceeding, it does so in a rather inefficient way. Nor can it be said that section 522(f)(2) insulates the Chapter 13 debtor from undue creditor pressure by removing the threat of repossession.

would receive little, for household goods have little resale value. They are far more valuable to the creditor in the debtor’s hands, for they provide a credible basis for the threat, because the replacement costs of the goods are generally high. Thus, creditors rarely repossess, and debtors, ignorant of the creditors’ true intentions, are coerced into payments they simply cannot afford to make.” HOUSE REPORT, *supra* note 4, at 127.

76. In a reaffirmation agreement, the debtor agrees to repay a debt discharged or dischargeable in bankruptcy.

77. HOUSE REPORT, *supra* note 4 at 163.

78. 11 U.S.C. § 722 (Supp. V 1981).

79. *Id.* § 523(a)(2).

80. Several courts have identified this second function of § 522(f) in a Chapter 13 setting. *Baldwin v. Avco Fin. Serv.*, 22 Bankr. 507 (D. Del. 1982); *In re Thurman*, 20 Bankr. 978 (Bankr. W.D. Tenn. 1982); *In re Mattson*, 20 Bankr. 382 (Bankr. W.D. Wis. 1982); *See also In re Gifford*, 669 F.2d 468, 472 (Bankr. 7th Cir. 1982); Note, *supra* note 73, at 1618.

81. The same criticism has been made of the “deterrent” function of § 547. *See McCoid, Bankruptcy, Preferences, and Efficiency: An Expression of Doubt*, 67 VA. L. REV. 249, 262-65 (1981).

A Chapter 13 debtor can retain property subject to a security interest, even over the objection of the secured creditor, if the creditor retains his lien and the value of property to be distributed to that creditor under the plan is equal to the allowed amount of the secured claim.⁸² Since the "allowed amount" is limited to the actual value of the collateral,⁸³ the danger of debtor coercion seems more illusory than real in this situation; after all, the debtor will have up to five years to pay the creditor the actual value of the collateral—which in most cases should not constitute a great burden.⁸⁴

Nevertheless, section 522(f)(2) does not represent all the avoidance possibilities contained in section 522. Section 522(f)(1) permits avoidance of judicial liens on *any* property to the extent that the lien "impairs an exemption." There is a fundamental difference between judicial liens and nonpurchase money security interests. A judicial lien, as defined by section 101(27) of the Code, means "lien obtained by judgment, levy, sequestration, or other legal or equitable process or proceeding,"⁸⁵ in contrast to the meaning of "security interest," defined by section 101(37) as a "lien created by an agreement."⁸⁶ There is no consensual aspect to a judicial lien, and that distinction alters the fairness equation of avoidance. A debtor does not "agree" to the imposition of a judgment lien in the sense that he "agrees" to give a lender a security interest in his personal property, since there is no element of contract. One might therefore conclude that judicial liens ought to be at least as vulnerable to avoidance as are nonpurchase money security interests. But the difference is hardly polar. One can reasonably wonder how much more "agreement" in practical terms is characteristic of a nonpurchase money security interest than a judgment lien.⁸⁷ Still, the absence of any consensual character at all in a judicial lien might make it an easier question on the equities: at least no express agreement is being repudiated.

There is, however, a further difference. A secondary justification of section 522(f)(2) is as a means of discouraging various lending practices, a function that section 522(f)(1) does not perform. Section 522(f)(1) perhaps serves a different goal. By permitting avoidance of what will usually be judgment liens or execution liens, to the extent that exemptions are impaired, the Code's basic goal of discouraging hasty creditor action by promoting equality of treatment might, at first blush, seem to be served. But what usually will be attacked are judgment liens obtained more than ninety days prior to bankruptcy. Execu-

82. 11 U.S.C. § 1325(a)(5)(B) (Supp. V 1981).

83. *Id.* § 506(a).

84. The "actual value" of the property would ordinarily be quite modest. See HOUSE REPORT, *supra* note 4, at 127; *supra* note 74 and accompanying text. See *Baldwin v. Avco Fin. Serv.*, 22 Bankr. 507, 509 (D. Del. 1982).

85. 11 U.S.C. § 101(27) (Supp. V 1981).

86. *Id.* § 101(37).

87. The distinction can at times become quite blurred. See, e.g., *In re Ashe*, 669 F.2d 105, 109 (Bankr. 3rd Cir. 1982) (finding a recorded confession of judgment to be a "judicial lien" for § 522(f)(1) purposes, but acknowledging that "[a]s a practical matter . . . the taking of a cognovit note in connection with a loan to an owner of real estate serves most of the same functions as a mortgage").

tion liens, unlike judgment liens, ordinarily are not capable of lengthy life; an execution lien older than ninety days would be rare.⁸⁸ An execution lien less than ninety days old would be vulnerable *in full* to attack as a preference, as would a judgment lien obtained within ninety days of bankruptcy.⁸⁹ Thus, section 522(f)(1) in effect allows the debtor to avoid judgment liens only on his or her residence, because in most states judgment liens reach only real property,⁹⁰ and under section 522, the only real property generally exemptible will be the debtor's residence.⁹¹

Thus, the remark in the House report that section 522(f)(1) "allows the debtor to undo the actions of creditors that bring legal action against the debtor shortly before bankruptcy"⁹² seems misinformed. More to the point is the Bankruptcy Commission's comment that by virtue of section 4-503(f), the forerunner provision to section 522(f)(1) and (2), "[e]xemptions under this section cannot be affected by judicial liens or agreement other than an indefeasible security agreement."⁹³ The purpose of section 522(f)(1) was, therefore, from the start less complex than section 522(f)(2): its sole function was to better assure the debtor of a minimum amount of property that would survive bankruptcy. Seen in this light section 522(f)(1) is more difficult to justify than section 522(f)(2) in a Chapter 13 proceeding. No predatory practice or race to the courthouse is discouraged; only judicial liens obtained well in advance of bankruptcy are subject to avoidance. Nonetheless, a modest role for section 522(f)(1) in Chapter 13 can be identified. Assuming that section 522(f)(1) is most frequently used to avoid a judgment lien on the debtor's residence,⁹⁴ it may be that the subsection makes some Chapter 13 plans feasible. Section 1325(a)(5)(B) provides that a nonconsenting holder of an allowed secured claim is entitled to retain his lien and receive, over the life of the plan, an amount equal to the "allowed amount" of his claim.⁹⁵ In the absence of section 522(f)(1), a judgment lien on the debtor's house would be an allowed secured claim to the extent of the debtor's equity; there is no dollar ceiling on how large the allowed secured claim could be, other than the overall limit of

88. D. EPSTEIN, *DEBTOR-CREDITOR LAW IN A NUTSHELL* 53-55 (1980); S. RIESENFELD, *CREDITORS' REMEDIES AND DEBTORS' PROTECTION* 172-73 (1979).

89. 11 U.S.C. § 547 (Supp. V 1981). Section 547(b) defines a preference as a transfer to or for the benefit of a creditor, for or on account of an antecedent debt, made while the debtor was insolvent and within 90 days of the commencement of the case, which enabled the creditor to receive a greater percentage of his claim than he would have received if the transfer had not been made. For certain insider transactions, the recapture period is expanded from 90 days to one year. The involuntariness of the transfer is irrelevant.

90. S. RIESENFELD, *supra* note 88, at 94-95.

91. The only real property expressly exemptible in § 522(d) is property used as a residence or as a burial plot. The "wild card" provision of § 522(d)(5) could, of course, be used to exempt any real property of the debtor's choosing, but is limited to a maximum of \$400, plus any unused portion of the \$7500 residence exemption. Most state exemption systems follow a similar pattern of restricting real property exemptions to "homesteads." *See, e.g.*, N.C. GEN. STAT. § 1C-1601(a)(Cum. Supp. 1981).

92. HOUSE REPORT, *supra* note 4, at 126.

93. COMMISSION REPORT, *supra* note 4, pt. 2, at 130.

94. *See supra* text accompanying notes 88-91.

95. 11 U.S.C. § 1325(a)(5)(B) (Supp. V. 1981).

\$350,000 of "secured debts" imposed by the Code.⁹⁶ Under section 1325(a)(5)(B) the plan must provide for paying off that amount, however large and in full, in three or at most five years. That requirement is enough to topple many a Chapter 13 plan in which a judgment lien of any significance exists, unless the debtor is willing to give up his or her residence. That option is simply not attractive to most debtors; in fact, Chapter 13 is often used for the express purpose of "hanging on" to the house.⁹⁷

Section 522(f)(1) provides some modest relief in the situation outlined above. In a state in which the federal option has not been foreclosed⁹⁸ it can be used to convert up to \$7900 of an otherwise allowable secured claim to unsecured status, thus making retention of the homestead at least a bit more feasible for the Chapter 13 debtor.⁹⁹ Among the states that have "opted out," its availability will be unquestioned but its practical value will be defined by the extent of the particular homestead exemption.¹⁰⁰

It comes down to this. In a Chapter 13 case, only when the debtor uses the "savings" from avoidance of a section 522(f)(2) security interest to enhance payment to unsecured creditors can the use of section 522(f)(2) be justified by reference to the bankruptcy goals of "fresh start" and equality of treatment. In all other cases, some other policy must be found, and that policy is the restriction of certain lending practices. But the way section 522(f)(2) restricts those practices is curious indeed, since it provides no incentive for a creditor to refrain from taking the offending security interest in the first place. The debtor, meanwhile, will not ordinarily face loss of the property in question in any event by virtue of sections 506(a) and 1325(a)(5)(B).¹⁰¹ On the other hand, prejudice to the secured creditor in every case is real, from the loss of post-petition interest in the 100% payment plan,¹⁰² to the potential loss of virtually the entire claim in the minimal payment plan.¹⁰³

An analogous situation exists with respect to section 522(f)(1). Like section 522(f)(2), it is a blunter instrument than necessary. In plans calling for full payment, it saves the debtor nothing, except perhaps interest on the judgment giving rise to the lien. In plans calling for minimal payment, it provides relief the debtor may want but not really need. In such a situation, the lien

96. *Id.* § 109(e).

97. Beck, *The Plight of the Defaulting Mortgagor*, 15 IND. L. REV. 561 (1982); see, e.g., *In re Young*, 22 Bankr. 620, 622 (Bankr. N.D. Ill. 1982) (mem.); *In re Thompson*, 17 Bankr. 748, 751 (Bankr. W.D. Mich. 1982); *In re Pearson*, 10 Bankr. 289, 193 (Bankr. W.D. Mich. 1982); *In re Pearson*, 10 Bankr. 189, 193 (Bankr. E.D.N.Y. 1981).

98. See *supra* notes 52 & 55.

99. See *supra* note 91.

100. The amount of the homestead exemption varies enormously among the states. Five states (Connecticut, Delaware, New Jersey, Pennsylvania and Rhode Island) provide no homestead exemption at all. North Dakota allows an exemption of up to \$80,000 in value, over and above all liens and encumbrances. N.D. CENT. CODE § 47-18-01 (Supp. 1981). Texas allows debtors to exempt up to 200 acres of rural property, with improvements, or one "town lot" valued at \$10,000 or less, exclusive of improvements. TEX. REV. CIV. STAT. ANN. art. 3833 (Vernon Supp. 1982).

101. See *supra* text accompanying notes 82-84.

102. See *supra* text accompanying notes 65-67.

103. See *supra* text accompanying note 68.

avoidance provided by section 522(f)(1) amounts to a gratuitous bonus. It may serve a useful function in some Chapter 13 cases, in a way that section 522(f)(2) does not, by making loss of the debtor's residence less likely. But it is difficult to credit section 522(f)(1) with serving any deterrent function, even of the sort performed by section 522(f)(2). Like section 522(f)(2), its appropriate use ultimately ties into the problem of minimal payment plans, best effort, and "good faith." Available in all Chapter 13 cases, section 522(f) makes sense only for some of them. The dividing line is the difference between "best effort" of the debtor and "best interest of creditors."

It is one thing to conclude that section 522(f) does not, after all, fit well into Chapter 13. It is quite another to refuse to apply it, when confronted with the roadblock of section 103(a).¹⁰⁴ Several courts have offered reasons for bypassing section 103(a). None are completely convincing. There is, first of all, the flat assertion made in *In re Morgan*¹⁰⁵ that "[s]ection 522 is inconsistent with the provisions of Chapter 13. Exemptions are not allowable within a Chapter 13 proceeding; therefore no part of that section is available to a Chapter 13 debtor."¹⁰⁶ But even the broad grant of equity powers to the bankruptcy courts is not enough to explain brushing aside section 103(a).¹⁰⁷ Further, section 522 is not "inconsistent" with Chapter 13; much of it may seem to be unnecessary, or even unwise, but it is not "inconsistent."

More detailed arguments for rejecting section 522(f) appear in two North Carolina cases, *In re Sands*¹⁰⁸ and *In re Aycock*.¹⁰⁹ For the court in *Sands*, little benefit for the debtor could be found in permitting the use of section 522(f) in his Chapter 13 proceeding, compared to the substantial prejudice to his secured creditor. This situation led to the conclusion that because in a Chapter 13 case the debtor keeps all his property, exempt or nonexempt, no exemption is "impaired" so as to invoke section 522(f).¹¹⁰ The force of this argument depends on the meaning of the word "impairs." If "impairs" can be read synonymously with "deprived of possession," then it is true that no exemptions are "impaired" in a Chapter 13 proceeding. But if "impairs" is given a broader reading, suggestive of other kinds of diminished interest, such as "encumbered," then the argument becomes less persuasive. For example, it does not seem so inaccurate for a debtor to think of his interest in his home as "impaired" if it is subject to a mortgage. His interest is "impaired," although not in immediate jeopardy, so long as there is no default.¹¹¹ Further, "im-

104. See *supra* text accompanying notes 15-17.

105. 18 Bankr. 17 (Bankr. D. Del. 1981).

106. *Id.* at 17.

107. At least one bankruptcy judge has considered and discussed the possible invocation of broad equity powers to control abuse of Chapter 13, in the face of hostile statutory language, but with little apparent enthusiasm for the tactic. Hughes, *supra* note 7, at 849. The essential problem is that although the language of Chapter 13 and § 103(a) may on occasion lead to consternation, it is rarely ambiguous.

108. 15 Bankr. 563 (Bankr. M.D.N.C. 1981) (mem.).

109. 15 Bankr. 728 (Bankr. E.D.N.C. 1981).

110. *Sands*, 15 Bankr. at 565.

111. Although the meaning of "impairs" in the context of § 522 may be ambiguous, it has received little, if any, construction by the courts. What construction has occurred has been over its

pairs" must be read in context. Section 522(f) speaks of *liens* impairing exemptions. Liens "impair" upon attachment and perfection, not upon enforcement. It is the danger of enforcement that "impairs," not the divestiture itself.

The *Sands* opinion raises another difficulty: What is to be done if a Chapter 13 debtor uses section 522(f) to avoid a lien and then, several years later, the case is dismissed prior to the plan's completion? As the court pointed out, the answer is found in section 349:¹¹² an otherwise avoided lien will be reinstated by operation of section 349(b)(1)(B). But of what use in practical terms is reinstatement "after 4½ years under a plan and 20% payment to unsecured creditors"?¹¹³ To be sure, the potential for prejudice is present, but there is more to section 349. That section allows the court, for cause shown, to permit something other than reinstatement.¹¹⁴ Presumably, relying on section 105, a bankruptcy court could, if it chose, impose a replacement lien on other property of the debtor for the benefit of the prejudiced creditor.¹¹⁵ It should be noted that section 349 is a problem only if there is no subsequent Chapter 7 proceeding; so long as the debtor is in bankruptcy, the secured creditor's lien will be avoided or avoidable.

The court in *In re Aycock* took a more direct approach to the problem, asserting that section 522(f) conflicts with section 1325(a)(5)(B), which provides that a creditor holding an allowed secured claim who does not accept the Chapter 13 plan must be allowed to retain his lien.¹¹⁶ Since the two sections conflict, the more specific provision governs, and hence section 522(f) is set aside.¹¹⁷ The problem with the court's analysis is simply that these two provisions do not conflict. For a Chapter 13 case to reach the confirmation stage—i.e., for section 1325(a)(5)(B) to enter the picture at all—all claims that the plan provides for must first be filtered through section 506, which requires a determination of secured status.¹¹⁸ So long as a party in interest is willing to raise the issue, a claim secured by an avoidable lien cannot become an "allowed secured claim." If there is no allowed secured claim, there is no section 1325(a)(5)(B) conflict.¹¹⁹

meaning in §§ 1123, 1124, and 1126 of Chapter 11. See, e.g., *In re Barrington Oaks Gen. Partnership*, 15 Bankr. 952, 956 (Bankr. D. Utah 1981) (mem.); *In re Antilles Yachting*, 4 Bankr. 470, 474 (Bankr. D.V.I. 1980). The legislative history, though hardly definitive, suggests that "impairs an exemption" means something less drastic than "deprived of possession," approximating instead "encumbered." HOUSE REPORT, *supra* note 4, at 362; SENATE REPORT, *supra* note 4, at 76.

112. 11 U.S.C. § 349 (Supp. V 1981).

113. *Sands*, 15 Bankr. at 565.

114. Section 349(b) (emphasis added) provides: "Unless the court, for cause, orders otherwise, a dismissal of a case other than under § 742 of this title—(1) reinstates . . . (C) any lien voided under § 506(d) of this title."

115. Section 105(a) provides: "The bankruptcy court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title."

116. 11 U.S.C. § 1325(a)(5)(B) (Supp. V 1981).

117. *Aycock*, 15 Bankr. at 730.

118. 11 U.S.C. § 506(a) (Supp. V 1981).

119. *Baldwin v. Avco Fin. Serv.*, 22 Bankr. 507, 509 (D. Del. 1982); *In re Mattson*, 20 Bankr. 382 (Bankr. W.D. Wis. 1982); *In re Hagerman*, 9 Bankr. 412, 414 (Bankr. W.D. Mo. 1981) (mem.); see 5 W. COLLIER, *supra* note 4, at ¶ 1325.01[2]-[E][1][a].

But if none of the rationales articulated by the courts for denying section 522(f) to Chapter 13 debtors is convincing, neither is the perfunctory citation to section 103(a) wholly satisfying. The fact remains that if section 522(f) were to be in conflict with some provision of Chapter 13, it could plausibly be bypassed.

There is a conflict, but not of the order suggested by *Aycock*. It is a conflict that becomes apparent only when one identifies the various contexts in which section 522(f) can be invoked in a Chapter 13 case. An examination of these contexts leads to the conclusion that the primary shortcoming of section 522(f) in a Chapter 13 case is that it is over-inclusive. It reaches too many types of debtors and too many types of plans. In its most extreme application, when the debtor proposes a minimal payment plan representing less than a realistic effort on his part, section 522(f)(2) makes sense only if one believes that it plays a significant role in discouraging the use of blanket nonpurchase money security interests. Section 522(f)(1) makes sense only if one believes that the ability to remove in whole or in part a judgment lien on the debtor's residence enables a significant number of debtors to propose viable plans. To make sense, in both cases, one must believe that the stated policy objective is sufficiently advanced to justify substantial injury to secured creditors without any corresponding benefit to unsecured creditors. Thus, there is a conflict, not of sections but of policies: the Chapter 13 policy favoring substantial repayment of debts (consistent with the debtor's ability to pay) versus the policy discouraging the use of "blanket" nonpurchase money security interests and the policy encouraging the use of Chapter 13. Although none of these policies has ever been as well described or as clearly articulated as the "fresh start" policy, the legislative history contains evidence of them all.¹²⁰

In light of these competing policies, what authority can be invoked to curtail the use of section 522(f) in Chapter 13? One might first consider pointing to the lack of meaning and purpose of section 522(f) in many Chapter 13 cases and then invoking the traditional equity powers of the bankruptcy courts¹²¹ as a basis for refusing to allow the use of section 522(f) in appropriate cases. But such an ambitious approach seems less than inviting. Section 103(a), after all, remains part of the Bankruptcy Code; the damage done to the Code's integrity by such a frontal assault would be considerable.

Reliance on section 105(a), which enables the bankruptcy court to issue "any order, process or judgment that is necessary or appropriate to carry out

120. Both committee reports saw Chapter 13 as a way of encouraging debtors to "save face" by substantially repaying their debts whenever possible. HOUSE REPORT, *supra* note 4, at 118; SENATE REPORT, *supra* note 4, at 13. Evidence of congressional disapproval of the use of blanket nonpurchase money security interests is collected *supra* notes 73-77 and accompanying text. Expanded use of Chapter 13 is discussed in both committee reports. HOUSE REPORT, *supra* note 4, at 118-19, 121, 319-20; SENATE REPORT, *supra* note 4, at 13.

121. 28 U.S.C. § 1481 (Supp. V 1981) provides: "A bankruptcy court shall have all the powers of a court of equity, law and admiralty . . ." The Supreme Court has recognized the role that equity plays in bankruptcy: "There is an overriding consideration that equitable principles govern the exercise of bankruptcy jurisdiction." *Bank of Marin v. England*, 385 U.S. 99, 103 (1966).

the provisions of this title,"¹²² likewise seems unduly optimistic as well as a bit strained. Use of section 105(a) would require a finding that section 103(a) must be ignored in order to bypass section 522(f), and that such a bypass is "necessary or appropriate" to "carry out the provisions of this title." The trouble is that the statute says "provisions," not "intent," or "purpose." The difference is sufficiently restrictive to make successful use of section 105(a) unlikely.

Finally, one can attack the problem indirectly by transmuted the issue into a "good faith" question: no creditor is receiving much, and the debtor presumably has the ability to pay more; he has simply dealt himself a bonus by relieving himself of a regular installment payment obligation while retaining the collateral. In short, due to the lack of substantial repayment, lien avoidance is doing no one but the debtor much good.

Encouraging substantial repayment under the present statutory array has required some quick footwork by the courts; it goes to the heart of the "good faith" debate discussed earlier.¹²³ As several bankruptcy courts have concluded (albeit reluctantly),¹²⁴ that footwork—reliance on section 1325(a)(3)¹²⁵—is disingenuous. The fault is with the statute. No reading of it can squarely support the ambitious definition of "good faith" for which so many bankruptcy courts, as well as the Eighth Circuit Court of Appeals,¹²⁶ have strived. Indeed, subsequent decisions by the Fourth,¹²⁷ Seventh,¹²⁸ Ninth,¹²⁹ and District of Columbia Circuit Courts of Appeals¹³⁰ indicate a growing reluctance to read "good faith" expansively and require "substantial repayment."¹³¹ Imposing additional stress on that overworked section, as a way of keeping section 522(f) out of Chapter 13, might therefore seem ill-advised. Nonetheless, the additional stress would make a finding of lack of good faith an easier result. As the Ninth Circuit's opinion in *In Re Goeb* suggests, the proper inquiry in assessing "good faith" for section 1325(a)(3) purposes is whether the debtor acted equitably in proposing the plan.¹³² Specific indications of inequitable conduct would include such things as misrepresen-

122. 11 U.S.C. § 105(a) (Supp. V 1981).

123. See *supra* text accompanying notes 7 & 8.

124. See, e.g., *In re Scher*, 12 Bankr. 258, 269, 272-73 (Bankr. S.D.N.Y. 1981); Cyr, *supra* note 7, at 273.

125. Section 1325(a)(3) provides: "The court shall confirm a plan if . . . the plan has been proposed in good faith and not by any means forbidden by law"

126. *In re Terry*, 630 F.2d 634 (Bankr. 8th Cir. 1980).

127. *In re Deans*, 692 F.2d 968 (Bankr. 4th Cir. 1982).

128. *In re Ringale*, 669 F.2d 426 (Bankr. 7th Cir. 1982).

129. *In re Goeb*, 675 F.2d 1386 (Bankr. 9th Cir. 1982). The *Goeb* decision in particular highlights the difficulties associated with a generous construction of "good faith." "The presence of an explicit statutory standard [§ 1325(a)(4)'s best interest of creditors test] strongly suggests that Congress did not intend to substitute a more rigorous standard when it imposed a general good faith requirement." *Id.* at 1388. The court also noted that S. 863, 97 Cong., 1st Sess. § 128(b) (1981), passed by the Senate and at the time pending House action, would have amended § 1325(a)(3) to require that a Chapter 13 plan represent "the debtor's bona fide effort." *Id.* at 1389.

130. *Barnes v. Whelan*, 689 F.2d 193 (D.C. Cir. 1982).

131. 692 F.2d at 970; 689 F.2d at 198-200; 675 F.2d at 1388; 669 F.2d at 431.

132. 675 F.2d at 1390.

tation of facts, proposal of a plan in an inequitable manner, and unfair manipulation of the Code.¹³³ For the Ninth Circuit, nominal repayment was "one piece of evidence that the debtor is unfairly manipulating Chapter 13 and therefore acting in bad faith."¹³⁴ The proposed use of section 522(f) in a minimal repayment plan indicates further, compounded "unfair manipulation." Thus, a finding of lack of good faith becomes easier when the debtor invokes section 522(f).

Such an approach, however, is at best a patchwork solution. Statutory revision is instead in order. This revision might take the form of a more detailed Chapter 13, one that distinguishes between plans which represent the debtor's best efforts and those which do not. While permitting both sorts of plans, the statute could make incentives available for "best effort" plans, such as access to section 522(f). Such a distinction would make the use of section 522(f) possible in only those cases in which it will benefit someone other than the debtor. There would be a further benefit in making such a distinction: the discrimination against "best effort" plans now implicitly contained in the Code would be removed.¹³⁵

V. USE OF SUBCHAPTER III: SECTIONS 544, 545, 547, 548 AND 553

May the Chapter 13 trustee use the avoiding powers of subchapter III of Chapter 5? May the Chapter 13 debtor? Although far fewer cases address these questions, their resolution is important in defining with precision the rights of secured creditors in a Chapter 13 proceeding.

A. *Use of Subchapter III by the Trustee*

There is no uniform and exclusive statement of a bankruptcy trustee's functions to be found in Chapters 3 or 5, so as to invoke automatically the magic of section 103(a) in a Chapter 13 case. Section 323, for example, simply

133. *Id.*

134. *Id.* at 1391. The Fourth Circuit's position is similar. The basic inquiry should be "whether or not under the circumstances of the case there has been an abuse of the provisions, purpose, or spirit of [the Chapter] in the proposal or plan." *In re Deans*, 692 F.2d at 972 (quoting 9 W. COLLIER, COLLIER ON BANKRUPTCY ¶ 920 (14th ed. 1978)). "Manipulation" of Chapter 13's provisions is subsequently suggested as grounds for denying confirmation. *Id.* The Court of Appeals for the District of Columbia, on the other hand, has provided less guidance, holding that "good faith" is to be given the traditional meaning of "honesty of intention." *Barnes v. Whelan*, 689 F.2d at 200.

135. A Chapter 13 discharge ordinarily requires successful completion of the plan. 11 U.S.C. § 1328(a) (Supp. V 1981). The actual amount repaid is irrelevant. "Best effort" plans require a higher level of payments than minimal payment plans, and thus run a greater risk of not being completed successfully.

One court has suggested that denial of the § 522(f) avoiding powers in a Chapter 13 case would "significantly affect the desirability to file under Chapter 13," thereby leading to more Chapter 7 consumer cases, "a much less desirable alternative from the creditors' point of view." *Baldwin v. Avco Fin. Serv.*, 22 Bankr. 507, 510 (D.Del. 1982). Although greater use of Chapter 7 by consumer debtors might well be less desirable for unsecured creditors, the same is not at all true for secured creditors. Further, denying use of § 522(f) in a Chapter 13 case while retaining it in a Chapter 7 case would still provide Chapter 13 debtors with a useful bargaining chip when negotiating with recalcitrant secured creditors, since a Chapter 13 debtor has the option, under § 1307(a), of converting his case to Chapter 7.

makes the trustee the representative of the estate, and gives the trustee the power to sue or be sued.¹³⁶ To determine the trustee's functions, one must refer to the relief chapters themselves for guidance. For a Chapter 13 case, the starting point is section 1302.¹³⁷ Section 1302(b)(1) provides that the trustee shall perform the duties of a liquidation trustee specified in section 704,¹³⁸ with the exclusion of sections 704(1) and 704(7). Therein lies the problem, because section 704(1) requires the trustee to "collect and reduce to money the property of the estate for which such trustee serves, and close up such estate as expeditiously as is compatible with the best interests of parties in interest."¹³⁹

The exclusion certainly makes at least partial sense. A Chapter 13 trustee does not "reduce to money the property of the estate," nor can he "close up such estate expeditiously." But a Chapter 13 trustee could, consistent with Chapter 13 "collect the property of the estate," in the sense of avoiding and recovering various prepetition transfers. This power is denied the trustee, however, by the expressly enumerated exclusion in section 1302(b)(1). Nonetheless, the exclusion is not dispositive of the question.¹⁴⁰ First, a Chapter XIII trustee had the power to avoid various prepetition transfers under the old Act.¹⁴¹ If Congress actually intended to remove that power, it is curious indeed that the legislative history makes no reference to such a change. In addition, the trustee has the responsibility to "investigate the financial affairs of the debtor," pursuant to sections 1302(b)(1) and 704(2), as well as the power under section 323(b) to sue and be sued. Withholding the power to act on the results of this investigation would render much of section 704(2) pointless.

The power can be argued by implication from section 546(a), which provides a statute of limitations for use of the avoiding powers of subchapter III. Such an action must be brought within two years after the trustee's appointment "under section 702, 1104, 1163 or 1302 of this title" or before the case is closed or dismissed, whichever event comes first.¹⁴² If a Chapter 13 trustee has no avoiding powers under Chapter 5, there would be no need to make reference to section 1302 in section 546(a).

By design a Chapter 13 case differs significantly from a Chapter 7 case. The mere fact that future income supplants existing or recoverable property as the source for payment of claims does not, however, mean that recovery of voidable transfers never serves any purpose in a Chapter 13 case. In any proceeding, the goal of equality of distribution, linked to discouraging hasty, uni-

136. 11 U.S.C. § 323 (Supp. V 1981).

137. *Id.* § 1302.

138. *Id.* § 704.

139. *Id.* § 704(1).

140. No reported case has squarely denied the Chapter 13 trustee access to subchapter III. The court in *In re Carter*, 2 Bankr. 321 (Bankr. D. Colo. 1980), flirted with this result, by pointing to §§ 704 and 1302, but backed away from holding that the trustee could not use subchapter III, § 544 in particular.

141. See *In re Carter*, 2 Bankr. 321 (Bankr. D. Colo. 1980); *City Nat'l. Bank & Trust Co. v. Oliver*, 230 F.2d 686 (10th Cir. 1956).

142. 11 U.S.C. § 546(a) (Supp. V 1981).

lateral creditor action, ought to be served.¹⁴³ If a preference¹⁴⁴ is objectionable in a liquidation case, so too is it objectionable in a rehabilitation case. Uniformity of result, chapter to chapter, makes sense if one is interested in discouraging such behavior. In fact, uniformity of result may be essential to avoid the possibility of collusion between debtor and preferred creditor,¹⁴⁵ when, for example, a debtor might be induced by such a creditor to file a Chapter 13 petition rather than a Chapter 7 petition to circumvent the trustee's avoiding powers. The converse situation also presents risks. Unpreferred creditors might attempt to coerce the debtor into filing a Chapter 7 proceeding, or such creditors might feel compelled to ensure such a result by filing an involuntary petition against the debtor.

Finally, a straightforward application of section 103(a), coupled with a plain reading of the various avoiding powers of subchapter III, suggests that the power does exist, unless some specific provision of Chapter 13 conflicts with it. The only candidate for such a conflict is section 1302(b)(1), but it is difficult to characterize the discrepancy between that section and section 704 as a "conflict." The fit is not precise, but the provisions can plausibly be read together, while concluding that the exclusion of section 704(1) does not preclude the Chapter 13 trustee from using subchapter III to challenge various prepetition transfers.¹⁴⁶

Although there is no reason why property recovered by the trustee cannot be liquidated and its proceeds distributed to creditors, it is nonetheless possible in a Chapter 13 case for property to be recovered without necessarily benefiting creditors. Following successful recovery of the avoided transfer, there is no requirement in Chapter 13 that the recovery be made available to creditors. The recovered transfer becomes property of the estate under section 541, and property of the estate is vested in the debtor when the plan is confirmed, unless the plan or the order of confirmation provides otherwise.¹⁴⁷ Ordinarily the contents of the plan are determined by the debtor, with the court retaining power to modify only by virtue of its ability to deny confirmation. The ability to deny confirmation is limited by section 1325, which requires the court to

143. Discouraging precipitous, unilateral action by a creditor or creditors of the debtor and ensuring equality of treatment for similarly situated claims are basic bankruptcy objectives. See HOUSE REPORT, *supra* note 4, at 177-79; 4 W. COLLIER, *supra* note 4, ¶ 547.03.

144. Preferential transfers are recoverable by the trustee by virtue of sections 547 and 550(a). Section 547(b) defines a preference as a transfer to or for the benefit of a creditor, for or on account of an antecedent debt, made while the debtor was insolvent and within 90 days of the commencement of the case, which enabled the creditor to receive a greater percentage of his claim than he would have received if the transfer had not been made. For certain insider transactions, the recapture period is expanded from 90 days to one year.

145. A preferred creditor is, simply enough, a creditor who receives a preference. For example, a creditor holding a \$15,000 unsecured claim who persuades or induces the debtor to pay him in full has been "preferred," if there are at the time other unsecured creditors whose claims remain unpaid. If a bankruptcy case is commenced within 90 days of such payment, the transfer to the preferred creditor may be avoided as a preference. See *supra* note 144.

146. See, e.g., *In re Walls*, 17 Bankr. 701 (Bankr. S.D. W. Va. 1982); *In re Colandrea*, 17 Bankr. 568 (Bankr. D. Md. 1982); *In re Reeves*, 17 Bankr. 383 (Bankr. W.D. La. 1982), 5 W. COLLIER, *supra* note 4, ¶ 1300.93.

147. 11 U.S.C. § 1327(b) (Supp. V 1981).

confirm a plan that complies with the conditions set forth in subsection 1325(a).¹⁴⁸

Two possibilities exist for establishing a connection between recovery and benefit to creditors. First, if recovered nonexempt property is to be retained by the debtor, the ordinarily routine "best interest of creditors" computation of section 1325(a)(4) may become significant. In a Chapter 7 proceeding, recovered nonexempt property would be made available to creditors. The value of such property therefore becomes the minimum amount that the Chapter 13 debtor's proposed payments on unsecured claims must exceed. But if the debtor's plan satisfies the requirement of section 1325(a)(4), the recovered transfer notwithstanding, then the only remaining possibility is the "good faith" requirement of section 1325(a)(3).

The situation thus resembles that which arises from the interplay of section 522(f) and Chapter 13: a recovery of a voidable transfer of property in a Chapter 13 case does not necessarily benefit unsecured creditors. Is it nonetheless possible to justify use of the avoiding powers in a Chapter 13 case? The answer requires a closer look at the individual avoiding powers found in subchapter III.

1. Section 544(a)

Section 544(a) gives the trustee the status of three kinds of claimants who generally receive special treatment under state collection law: a judicial lien creditor, a creditor holding an unsatisfied writ of execution, and a bona fide purchaser of real property.¹⁴⁹

The evil that section 544(a) addresses is failure by a creditor to provide fair notice to others of an interest acquired in the debtor's property. The status

148. *Id.* § 1325(a) provides:

- (a) The court shall confirm a plan if—
- (1) the plan complies with the provisions of this chapter and with other applicable provisions of this title;
 - (2) any fee, charge, or amount required under chapter 123 of title 28, or by the plan, to be paid before confirmation, has been paid;
 - (3) the plan has been proposed in good faith and not by any means forbidden by law;
 - (4) the value, as of the effective date of the plan, of property to be distributed under the plan on account of each allowed unsecured claim is not less than the amount that would be paid on such claim if the estate of the debtor were liquidated under chapter 7 of this title on such date;
 - (5) with respect to each allowed secured claim provided for by the plan—
 - (A) the holder of such claim has accepted the plan;
 - (B) (i) the plan provides that the holder of such claim retain the lien securing such claim; and
 - (ii) the value, as of the effective date of the plan, of property to be distributed under the plan on account of such claim is not less than the allowed amount of such claim; or
 - (C) the debtor surrenders the property securing such claim to such holder; and
 - (6) the debtor will be able to make all payments under the plan and to comply with the plan.

149. *Id.* § 544(a).

of a judicial lien creditor enables the trustee to avoid unperfected security interests;¹⁵⁰ the status of a bona fide purchaser of real property enables the trustee to avoid unrecorded conveyances and encumbrances.¹⁵¹

Perfection and recordation are, of course, common commercial techniques that function to prevent other creditors and purchasers from being misled. In short, they are to be encouraged, and the way the Bankruptcy Code does so is to make any unperfected transfer vulnerable to avoidance.¹⁵² Because perfection and recordation are usually cheap and routine acts, the incentive works. The cost of compliance is low, while the risk of noncompliance is significant.

Section 544(a) therefore serves a useful commercial purpose independent of any direct benefit to the debtor or his unsecured creditors. Viewed in this light, there is little reason to deny its use to the Chapter 13 trustee. Denial would simply lead to uncertainty, since the status of an unperfected security interest in bankruptcy would depend on what sort of petition was filed.

2. Section 545

Section 545 allows the trustee to avoid various kinds of statutory liens:¹⁵³ statutory liens that are unperfected as against a bona fide purchaser as of the date of the petition; statutory liens that "first become effective against the debtor" when a bankruptcy petition is filed, or when other common insolvency-related events occur; and landlords' liens. The situation is thus much like that with section 544(a). Section 545 can be understood simply as an expression of congressional disfavor for these types of liens. That policy, particularly in regard to unperfected claims of lien,¹⁵⁴ is served by avoidance, whether in a Chapter 7 or a Chapter 13 proceeding.

3. Sections 544(b) and 548

Sections 544(b)¹⁵⁵ and 548¹⁵⁶ present more troublesome questions. To

150. Under § 9-301(1)(b) of the Uniform Commercial Code, an unperfected security interest is subordinate to a judicial lien.

151. 4 AMERICAN LAW OF PROPERTY § 17.10, at 556 (A. Casner ed. 1952); D. EPSTEIN, *supra* note 88, at 209.

152. In addition to 11 U.S.C. § 544(a) (Supp. V 1981), 11 U.S.C. §§ 547(e), 548(d) (Supp. V 1981) also provide grounds for avoiding transfers not timely recorded. *See infra* notes 159, 163 & 167.

153. 11 U.S.C. § 545 (Supp. V 1981).

154. "Unperfected" in the context of § 545 will generally mean "unfiled," as in the case of a typical construction lien. A possessory statutory lien ordinarily arises and is perfected by possession of the property by the creditor.

Nonetheless, the rule of § 545(2) must be qualified. The legislative history suggests that if, after a petition is filed, a creditor succeeds in perfecting his claim of lien, and applicable law recognizes the concept of "relation back," then by virtue of § 546(a), the lien is deemed "perfected." HOUSE REPORT, *supra* note 4, at 371.

155. 11 U.S.C. § 544(b) (Supp. V 1981). Section 544(b) gives the trustee the power to avoid any transfer voidable under applicable state law by an unsecured creditor of the debtor.

156. *Id.* § 548. Section 548 gives the trustee the power to avoid fraudulent transfers. It is derived in large part from the Uniform Fraudulent Conveyances Act.

the extent that it incorporates applicable state law regarding fraudulent conveyances and bulk transfers,¹⁵⁷ section 544(b) supplements section 548, which addresses fraudulent transfers directly. In practical terms, use of section 544(b) may permit the trustee to avoid transfers beyond the reach of section 548, due to the latter section's one year statute of limitations.¹⁵⁸ Nonetheless, justification for the use of section 544(b) in a Chapter 13 case is tied to section 548. The evils addressed in both sections are transfers that are intended to be or that have the effect of being fraudulent to creditors. How effective the simple sanction of avoidance is in deterring such conduct is problematic, but beside the point. The critical consideration is simply that fraudulent transfers are "wrong" and should not go unpunished,¹⁵⁹ even though there will be no necessary benefit to creditors as a result of avoidance. But if the debtor was a knowing party to the fraud,¹⁶⁰ the idea of "punishment" by simply forcing a reconveyance to one of the "guilty" parties is unappealing. In short, automatic use of section 544(b) and section 548 in a Chapter 13 case can cause serious distortions of policy.

4. Section 547

Section 547 enables the trustee to recover preferential transfers made within ninety days of bankruptcy.¹⁶¹ The legislative history makes it clear that the purposes of section 547 are to discourage the creditor "race of diligence" and to promote equality of distribution among similarly situated creditors.¹⁶² The first purpose serves the second; the goal of equality of distribution is the dominant objective.¹⁶³

Equality of treatment is served by section 547 in two ways: first, by permitting the recovery and redistribution of preferential transfers, and second, by deterring creditors from seeking them.¹⁶⁴ The second means, deterrence, is of doubtful utility, because the worst that can happen to the preferred creditor

157. Transfers voidable under applicable state law by actual unsecured creditors are avoidable by the trustee in full under § 544(b). Fraudulent transfers and bulk sales conducted in violation of Article 6 of the Uniform Commercial Code are typical examples of such transfers. HOUSE REPORT, *supra* note 4, at 370; 4 W. COLLIER, *supra* note 4, ¶ 544.03.

158. Under § 544(b) the applicable state statute of limitations for attacking fraudulent conveyances would control. Section 548(a) imposes a one year statute of limitations for the recovery of fraudulent transfers.

159. Not all fraudulent transfers within the reach of § 548 are "wrong" in the sense of being morally offensive, of course. For example, by operation of § 548(d), transfers not timely perfected may become "fraudulent." For such transfers in the context of a Chapter 13 case, an analysis similar to that developed for § 544(a) obtains. See *supra* text accompanying notes 149-52.

160. A transfer under § 548(a)(2), for example, can be avoided without any requirement of knowledge or intent on the part of the debtor.

161. 11 U.S.C. § 547(b)(4) (Supp. V 1981). See *supra* notes 89 & 144-45.

162. HOUSE REPORT, *supra* note 4, at 177-78, 179.

163. HOUSE REPORT, *supra* note 4, at 178; 4 W. COLLIER, *supra* note 4, ¶ 547.03; McCoid, *supra* note 81, at 260. One other function of § 547 merits attention. Section 547(e) can be used to recover transfers not timely perfected, in a way similar to § 544(a). For example, a security interest created four months prior to bankruptcy, but perfected one week before the petition, would be deemed a transfer made on the date of perfection, thereby making the transfer subject to attack as a preference.

164. McCoid, *supra* note 81, at 262.

is that the property received will have to be returned.¹⁶⁵ Further, the creditor may not be aware of the debtor's financial distress, nor will he necessarily know that within ninety days of the transfer his debtor will be in bankruptcy. In short, "frequently the sensible course is to accept the preference and to hope for success."¹⁶⁶

In a liquidation case the goal of equality of distribution is still served by the first function, that of recovery and redistribution of preferential transfers. But even that function breaks down in a Chapter 13 case when minimal payment to unsecured creditors is proposed, since there may be a recovery without any redistribution. Equality of distribution is being served, but only in a limited, negative sense: no creditor will emerge from the debtor's bankruptcy unscathed. All will suffer. For most creditors, that is likely to be small comfort indeed. Compounding the problem is the possibility that the property will be returned after it had been freely and voluntarily transferred by the debtor. In short, the use of section 547 does not necessarily serve any valid bankruptcy objective in a Chapter 13 case.¹⁶⁷ Instead, it has the potential for undermining the integrity of the proceeding itself.

5. Section 553

Section 553 has the principal effect of legalizing one particular kind of preferential transfer: setoffs.¹⁶⁸ Recovery of amounts setoff by, for example, a bank against a debtor-depositor are limited to the extent to which the bank improved its position during the period immediately preceding bankruptcy. Setoffs are restricted in section 553(b) for the same reason that preferential transfers are made avoidable by section 547: they are inimical to the idea of equality of treatment among similarly situated creditors. The means to this end are the same as in section 547: recovery and redistribution, and deterrence. The effectiveness of these means are subject to the same criticisms leveled at section 547. The deterrence function is undermined by the absence of any sanction greater than a return to the status quo. The recovery and redistribution function is undercut by the lack of any link between recovery and redistribution in a Chapter 13 case.

165. *See id.* at 264. No penalties other than return of the property are imposed by § 547.

166. McCoid, *supra* note 81, at 262-65.

167. Section 547(e) operates as a limited exception to this conclusion, to the extent that, like §§ 544(a) and 548(d), it serves to encourage prompt perfection. *See supra* note 163.

168. 11 U.S.C. § 553 (Supp. V 1981). A setoff is one particular type of preference; it occurs when a creditor applies a debt owed by him to the debtor against the debt owed to him by the debtor. The most common example is that of a bank-lender and depositor-borrower; a setoff occurs when the bank applies the existing checking account balance of its depositor against the outstanding amount due on a loan made by the bank to the depositor. Special treatment is accorded setoffs by § 553. Under § 553(b), for example, a setoff is recoverable in bankruptcy only to the extent the off-setting creditor improved his position within the 90 days preceding the commencement of the case.

6. A Restatement

The trustee's use of the avoiding powers of sections 544(a), 545, 547(e)¹⁶⁹ and 548(d)¹⁷⁰ will always make sense in a Chapter 13 case, since the basic policies of these statutes are advanced equally as well in a Chapter 13 as in a Chapter 7 case. Use of section 544(b), 547, 548, and 553 may or may not make sense in a given Chapter 13 case, depending on the circumstances.¹⁷¹

The solution is not to differentiate between "best efforts" and "best interest" plans. Uniformity of result, chapter to chapter, regarding a given transfer would be endangered by any such discrimination. Uniformity of result is important to prevent collusion between a creditor and the debtor. For example, a creditor should not have the option of retaining his preferential payment by persuading the debtor to seek Chapter 13 relief and propose a "minimal payment" plan.

Under the Code as it now exists, the better approach would be to rely on the trustee's judgment to identify potential avoidable transfers and to decide whether to pursue them.¹⁷² Use of sections 544(a), 545, 547(e), and 548(d) will usually make sense. The appropriate use of sections 544(b), 547, 548, and 553 will depend on the debtor's intended purpose in recovering the transferred property and the circumstances surrounding the transfer.

Such an approach is not without problems. Reliance on the trustee's discretion would have the effect of making even more uncertain the treatment of various prepetition transfers. Nor is there much incentive, under existing law, for a Chapter 13 trustee vigorously to ferret out and attack avoidable prepetition transfers.¹⁷³

Statutory revision thus appears to be the only attractive solution. Such a revision might require that all recovered nonexempt property be used for the benefit of creditors, either in the sense of enabling the debtor to propose a feasible plan, or by increasing proportionately the dividend to general creditors.

B. Use of Subchapter III by the Debtor

The debtor can always propose avoidance of various transfers in his plan. But if the trustee refuses to prosecute, may the debtor proceed? There is little

169. See *supra* notes 163 & 167.

170. See *supra* notes 152 & 159.

171. The critical point here is the lack of any necessary connection in the form of redistribution between recovery of the transfer and benefit to creditors. See *supra* text accompanying notes 155-68.

172. See, e.g., *In re Walls*, 17 Bankr. 701, 704 (Bankr. S.D. W. Va. 1982) ("Where the use of the avoiding powers will achieve a more equitable distribution among creditors or where it will aid in a more appropriate classification of claims, the trustee likely should proceed with such action at the relation of the debtor.").

173. The trustee's fees are generally limited under § 326(b) to a maximum of five percent of all payments under the plan. Because recovery of avoidable prepetition transfers has no necessary link to amounts paid under the plan, there is little financial incentive for the trustee to pursue such transfers. See Moller, *It Isn't Only for Wage Earners Anymore: The Individual in Business and Chapter 13 of the Bankruptcy Code*, 17 HOUS. L. REV. 331, 336-37 (1980).

reason or authority to permit a debtor to avoid transfers of nonexempt property. The several courts that have addressed the question have uniformly concluded that the debtor lacks this power.¹⁷⁴ Only obliquely is there secondary authority to suggest otherwise, most notably the remark in the final floor statements by Representative Edwards and Senator DeConcini that "section 1303 [giving the debtor some of the trustee's section 363 powers regarding use and sale of estate property] does not imply that the debtor does not possess other powers concurrently with the trustee."¹⁷⁵ This statement, of course, can be explained easily enough in the context of sections 522(g) and (h), which are discussed later in this article.¹⁷⁶ In short, there is no reason, and no statutory basis, for permitting a Chapter 13 debtor to do what a Chapter 7 debtor cannot do—avoid a transfer of nonexempt property on his own motion.¹⁷⁷

The use of sections 544, 545, 547, 548, and 553 by the debtor does become possible when the transferred property in question is exemptible by the debtor. By operation of section 522(g), the debtor may exempt what the trustee recovers.¹⁷⁸ By operation of section 522(h) the debtor may recover and exempt what the trustee fails to recover, so long as the transfer itself was not voluntarily made and the debtor did not conceal such property.¹⁷⁹ The use of sections 544, 545, 547, 548, and 553 for the purpose of securing the debtor's exemptions, therefore, turns on the application of section 522(g) and (h) to a Chapter 13 case. Section 522(g) is of limited relevance in a Chapter 13 case. The trustee does not have the power to avoid, recover and *retain* transfers, because section 1327(b) provides that "except as otherwise provided in the plan . . . confirmation of a plan vests all of the property of the estate in the debtor." Thus, it is unlikely that a Chapter 13 trustee would ordinarily pursue most prepetition transfers with much enthusiasm.¹⁸⁰ Section 522(h) is therefore the more relevant section in a Chapter 13 case.

The key to determining what transfers are actually described by section 522(h) depends upon what constitutes a "voluntary transfer," since only property that was neither voluntarily transferred nor concealed can be recov-

174. *In re Coleman*, 21 Bankr. 832, 835 (Bankr. S.D. Tex. 1982); *In re Walls*, 17 Bankr. 701 (Bankr. S.D. W. Va. 1982); *In re Colandrea*, 17 Bankr. 568, 583 (Bankr. D. Md. 1982); *In re Saberman*, 3 Bankr. 316, 320 (Bankr. N.D. Ill. 1980); *In re Carter*, 2 Bankr. 321 (Bankr. D. Colo. 1980).

175. 124 CONG. REC. H11,106 (daily ed. Sept. 28, 1978), reprinted in app. 3 W. COLLIER, *supra* note 4, at IX-121; 124 CONG. REC. S17,423 (daily ed. Oct. 6, 1978), reprinted in app. 3 W. COLLIER, *supra* note 4, at 3, X-47.

176. See *infra* text accompanying notes 178-92. But see Moller, *supra* note 173, at 336.

177. The distinction between § 1107, which defines the rights, powers, and duties of a Chapter 11 debtor in possession, and § 1303, which defines the rights and powers of a Chapter 13 debtor, is often cited by the courts as a basis for denying the Chapter 13 debtor the use of the avoiding powers. Section 1107 is a broader grant of authority than is § 1303. See, e.g., *In re Coleman*, 21 Bankr. 832 (Bankr. S.D. Tex. 1982).

178. 11 U.S.C. § 522(g) (Supp. V 1981). Section 522(g) gives the debtor a limited right to claim exemptions in property recovered by the trustee under §§ 510(c)(2), 542, 543, 550, 551, or 553. Section 550(a) implements the avoiding powers of §§ 544, 545, 547, 548, 549, and 724(a). It authorizes the trustee to recover from the transferee the property, or the value of the property, that was the subject of the avoided transfer.

179. 11 U.S.C. § 522(h) (Supp. V 1981).

180. See *supra* note 173.

ered.¹⁸¹ Presumably payment in full (in cash or in kind) to an unsecured creditor two days before bankruptcy would be a "voluntary transfer," as would the transfer of a security interest or a mortgage. Presumably the fixing of a judgment lien would be an "involuntary transfer." Foreclosure of a mortgage or repossession of property subject to a security interest present closer questions. In the absence of a bankruptcy definition of involuntary transfers, reliance on state law may yield inconsistent results.¹⁸² Although neither foreclosure nor repossession ordinarily would be vulnerable to section 547 attack,¹⁸³ the question is not unimportant. For example, both the sale of foreclosed real property and the sale of repossessed personal property could be vulnerable under section 548(a)(2)¹⁸⁴ as transfers made within a year of bankruptcy for less than "reasonably equivalent value" while the debtor was insolvent.¹⁸⁵

The reported cases provide some clues concerning the types of transfers sections 522(g) and (h) can reach in a Chapter 13 case. In *In re Donato* the Chapter 13 debtor was permitted to use section 553(b) to attack a bank setoff, by virtue of section 522(h).¹⁸⁶ In *In re Saberman* the court indicated that the Chapter 13 debtor could use section 544(a) to avoid a mechanic's lien filed after the petition.¹⁸⁷ In *Marshall v. Spindale Savings & Loan Association*¹⁸⁸ and *In re Coleman*¹⁸⁹ the Chapter 13 debtors succeeded in avoiding the completed foreclosure sale of their residences by using section 548. Thus, setoffs, statutory liens, and mortgage foreclosures have all been found sufficiently "involuntary" to be vulnerable to a Chapter 13 debtor's assault. Presumably, judicial liens would be vulnerable as well.

181. Section 522(h) permits the debtor to avoid and recover transfers only "to the extent that the debtor could have exempted such property under subsection (g)(1) of this section." Section 522 (g)(1) permits the debtor to exempt property recovered by the trustee only if "(A) such transfer was not a voluntary transfer of such property by the debtor; and (B) the debtor did not conceal such property."

182. The question is hardly settled law. See, e.g., *National Bank & Trust Co. v. Rickard*, 57 A.D.2d 156, 393 N.Y.S.2d 801 (App. Div. 1977); *In re Foreclosure of Deed of Trust*, 303 N.C. 514, 279 S.E.2d 566 (1981). At least one bankruptcy court has attempted to construe "voluntary transfer" as used in § 522(g)(1)(A). *In re Tackett*, 21 Bankr. 107 (Bankr. D.N.M. 1982).

183. A secured creditor who simply resorts to his security does not "improve his position" and thus the final element of preference, § 547 (b)(5), is not met.

184. Section 548(a)(2) is derived from section 4 of the Uniform Fraudulent Conveyance Act. It enables the trustee to avoid transfers made within one year of bankruptcy if the debtor received less than a "reasonably equivalent value" in exchange, and was insolvent when the transfer was made or was rendered insolvent as a result thereof. No proof of fraudulent intent is necessary under section 548(a)(2) to make the transfer avoidable.

185. See, e.g., *In re Coleman*, 21 Bankr. 832 (Bankr. S.D. Tex. 1982); *Marshall v. Spindale Sav. & Loan Ass'n*, 15 Bankr. 738 (Bankr. W.D.N.C. 1981).

186. 17 Bankr. 708 (Bankr. E.D. Va. 1982).

187. 3 Bankr. 316 (Bankr. N.D. Ill. 1980).

188. 15 Bankr. 738 (Bankr. W.D.N.C. 1981). *Marshall* is in several ways a difficult case. At no point did the trustee appear. Instead, the matter was prosecuted by the debtor through her attorney. The basis for using § 548 is unclear from the opinion. Assuming that the debtor's use of § 548 stems from the authority of § 522(h), problems arise because, under North Carolina law, foreclosure of a mortgage is not deemed an "involuntary transfer." *In re Foreclosure of Deed of Trust*, 303 N.C. 514, 279 S.E.2d 566 (1981). In any event, *Marshall* should make the certification of land titles, when a foreclosure sale is involved, a bit more interesting.

189. 21 Bankr. 832 (Bankr. S.D. Tex. 1982).

The kinds of transfers vulnerable as a practical matter under section 522(h) can be delineated with more certainty. Seemingly only judicial liens that attach within ninety days of the petition are susceptible to avoidance under section 522(h), since section 547 is the only enumerated section in section 522(h)(1) that could successfully be used to avoid a judicial lien.¹⁹⁰ This limitation, however, is rendered meaningless by section 522(f)(1),¹⁹¹ which can be used by the debtor independently of section 522(h). Involuntary transfers of exempt property for less than reasonably equivalent value can also be reached by section 522(h). The critical inquiry is "voluntariness." Sale of repossessed personal property otherwise exemptible and the foreclosure sale of the debtor's residence, if not deemed to be "voluntary" and if they occur within one year of bankruptcy, are vulnerable as fraudulent transfers.¹⁹² Few other transfers, otherwise fraudulent, would likely qualify as involuntary—certainly not under section 548(a)(1), which requires a degree of voluntary behavior on the part of the debtor, and probably not under section 544(b) either.¹⁹³

Section 544(a) should seldom enter the picture. Because it is primarily directed at consensual transfers, such as unperfected security interests and unrecorded mortgages,¹⁹⁴ it would be a rare case in which the involuntariness of the transfer could nonetheless be established.

Section 545 concerns two additional types of transfers: landlord's liens and unperfected liens for the improvement of real property. Artisans' liens, ordinarily perfected by possession, are not vulnerable. Involuntariness should not be a problem; the only limitation will be the exempt nature of the property.

That leaves section 547 and section 553(b). The involuntariness requirement severely restricts the types of transfers subject to avoidance under section 547. In the absence of fraud or duress, it is difficult to conceive of any preferential transfer as involuntary, other than judicial liens, which, as noted earlier, are covered adequately by section 522(f)(1).¹⁹⁵

In states that have not "opted out,"¹⁹⁶ or in states that nonetheless permit

190. A judicial lien that attached within 90 days of the commencement of the case might well satisfy the requirements of § 547(b), and thus constitute a preference. Treating a judicial lien as a fraudulent transfer under § 548 would be more difficult. Section 548(a)(2) reaches transfers made within one year of bankruptcy, while the debtor was insolvent and for which the debtor "received less than a reasonably equivalent value" in exchange. The definition of "value" in § 548, however, includes the securing of an antecedent debt. Because judicial liens necessarily secure antecedent debts (the debt originally sued on), "reasonably equivalent value" can usually be demonstrated by the transferee, sufficient to defeat a § 548(a)(2) challenge.

191. Section 522 (f)(1) permits the debtor to avoid judicial liens to the extent that such liens "impair an exemption to which the debtor would have been entitled." See *supra* text accompanying notes 85-91.

192. 11 U.S.C. § 548(a)(2). See *supra* note 190.

193. Whether applicable state fraudulent conveyance law incorporated by § 544(b) is based on 13 Eliz., ch. 5 (1570), or on the Uniform Fraudulent Conveyance Act, some minimal level of debtor-transferor complicity will need to be shown to render the conveyance voidable.

194. See *supra* text accompanying notes 149-52.

195. See *supra* text accompanying notes 190-92.

196. See *supra* notes 52 & 55 and accompanying text.

the debtor to exempt an amount of cash, bank and employer setoffs will be susceptible to section 522(h) attack.¹⁹⁷ Nonetheless, setoffs are not always truly involuntary; the use of section 553(b) by means of section 522(h) should by no means be automatic.¹⁹⁸

Thus, the types of transfers actually covered by section 522(h) include foreclosure and repossession sales, certain statutory liens, and involuntary setoffs. In a Chapter 13 case, does the avoidance of such transfers serve any valid purpose? The fundamental problem, as before, is the possibility of a recovery without a corresponding benefit, since there is no requirement in Chapter 13 that at least some of the benefit of the recovery be passed through to unsecured creditors. The deterrence function may be served effectively by avoiding unperfected statutory liens on the debtor's residence, but no such efficacy can be claimed for setoffs, since there is little reason for a creditor not to attempt a setoff.¹⁹⁹ The deterrent effect is more difficult to assess for foreclosure and repossession sales. To the extent that section 548 and section 522(h) operate to encourage higher bidding at such sales to avoid the "less than reasonably equivalent value" snare of section 548(a)(2), a legitimate policy is furthered, since prices that approach fair value benefit all the parties concerned.

A further justification exists for the use of section 522(h) in a Chapter 13 case. Section 522(h) makes Chapter 13 viable for at least some debtors by extending the carrot (retention of property) to debtors already divested of substantial and critical items of property, such as a bank account, essential personal property, and the debtor's residence. On the other hand, the cost of this benefit is not insignificant. The practical result is to place the validity of virtually all repossession and foreclosure sales of property that could be exempted in bankruptcy in limbo for at least one year after the sale.²⁰⁰ It is, after all, one thing to watch the Chapter 7 trustee use section 548 to avoid a completed foreclosure sale, if the property is to be resold at a presumably higher price. The "extra" proceeds will ultimately benefit the debtor's creditors. It is quite another to watch the Chapter 13 debtor use section 548 to avoid the transfer when there will be no new sale at all. From that perspective, the viability of Chapter 13 for the debtor is important only if more will be paid to creditors as a result. It is, in short, a difficult result to accept.

Again, the only plausible solution is revision of the statute. In this last area, the policy choices are not easy. The fault once again is overinclusion. Section 522(h) covers too many dissimilar situations. Its proper use in Chapter 13 requires additional statutory distinctions to ensure that it will be invoked

197. See, e.g., *In re Gierhart*, 22 Bankr. 20 (Bankr. N.D. Ga. 1982); *In re Donato*, 17 Bankr. 708 (Bankr. E.D. Va. 1982).

198. See, e.g., *Katz v. First Nat'l Bank*, 568 F.2d 964 (2d Cir.), cert. denied, 434 U.S. 1069 (1977); *In re Gierhart*, 22 Bankr. 20 (Bankr. N.D. Ga. 1982).

199. As with §§ 522(f) and 547, at worst the creditor who benefits from such a transfer will be forced to return the transferred property.

200. Under § 548(a) there is a recapture period for fraudulent transfers of one year preceding the filing of a petition.

only when it will benefit someone other than the debtor. Left alone, the potential for mischief in section 522(h) is troubling.

VI. CONCLUSION

The fit between Chapter 5 and Chapter 13 is less than ideal. The unqualified availability of the avoiding powers of sections 522, 544, 545, 547, 548, and 553 leads to serious distortions of bankruptcy policy. In a Chapter 13 case in which the debtor proposes payments to unsecured creditors of an amount less than the debtor is able to pay, use of the avoidance powers serves neither the fresh start policy nor the goal of equality of treatment for creditors. Instead, the avoidance powers can be used for purely punitive purposes. At its most extreme, the availability of the avoiding powers may provide a powerful incentive to file a Chapter 13 petition, thereby encouraging unnecessary bankruptcies.

Unrestricted use of Chapter 5 exacerbates the dilemma posed by "minimal payment" plans by making the injury done to creditors more widespread and more severe. By virtue of sections 522(f), 547, and 548, secured creditors become unsecured creditors. By virtue of sections 547 and 553, unsecured creditors who by their own diligence or the favor of their debtor have seen their risk lessened are relegated to the same status as other, less fortunate unsecured creditors.

To justify these results, one can point to the prophylactic function of sections 522(f), 544, 545, 547, 548, and 553. But any harm prevented is accomplished inefficiently by sections 522(f), 547, and 553, since no penalty other than rescission is imposed for taking a nonpurchase money security interest, a preference, or a setoff. Sections 544(b) and 548 function somewhat more efficiently, although their use can create an anomalous result in a Chapter 13 case—return of the fraudulently transferred property to the transferor. Only sections 544(a), 545(2), 547(e) and 548(d) serve the objective of discouraging certain types of behavior—nonperfection of security interests and construction liens—reasonably well.

Correcting these problems would require a strained reading of the Code in its present form. The "good faith" requirement of section 1325(a)(3), long overworked, seems incapable of bearing more interpretive tension, although it may be that the additional stress that proposed use of the avoiding powers places on confirmation may make a finding of lack of "good faith" easier.

Similarly, the successful use of section 105 seems unlikely because the Code as it now exists requires considerable reliance on the judgment and discretion of the Chapter 13 trustee. The ultimate solution is revision of Chapter 13. Greater differentiation among the various types of plans that may be proposed is necessary. Treatment of these plans should vary according to their terms. In this manner, the basic bankruptcy goals of a fresh start and equality of treatment would be better served.