

Exemptions, Opting Out, and Bankruptcy Reform

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I. INTRODUCTION

Exemptions in bankruptcy occupied a center stage in the reform process leading to enactment of the Bankruptcy Reform Act.¹ Viewing exemptions as central to the individual debtor's fresh start following bankruptcy, reformers developed as part of the reform legislation a comprehensive set of exemptions to be specifically available to debtors in bankruptcy.² It came as a disappointment to many,³ therefore, that in enacting the Bankruptcy Reform Act, Congress gave to individual states the opportunity to control this component considered so important in the reform process.

The new law provided that a state may enact specific legislation depriving its debtors of the choice of using the exemptions found in the Bankruptcy Reform Act⁴ and thereby confining those debtors to the use of exemptions found in "State or local law applicable on the date of the filing of the petition in the debtor's domicile."⁵ Most of the thirty-two states that have chosen to opt out⁶ have done only that and simply stated within their generally applicable debtor's exemption legislation that their debtors are not authorized to utilize the exemption provisions contained in the Bankruptcy Code.⁷ The apparent intent is that the state's general debtors' exemption provisions are to be used both outside bankruptcy and in bankruptcy as well.

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1. Bankruptcy Reform Act of 1978, 11 U.S.C. §§ 101–1330 (1980) (hereinafter referred to as the Code or the Reform Act).

2. *Id.* § 522(d). Exemptions are available only to "individual debtors," *id.* § 522(b), whose bankruptcy petitions constitute the vast bulk of total bankruptcy filings. See *infra* note 42.

3. See, e.g., Hertz, *Bankruptcy Code Exemptions: Notes on the Effect of State Law*, 54 AM. BANKR. L.J. 339, 354 (1980); Vukowich, *Debtors' Exemption Rights Under the Bankruptcy Reform Act*, 58 N.C.L. REV. 769, 801 (1980).

4. 11 U.S.C. § 522(b) (1980).

5. *Id.* § 522(b)(2).

6. The term "opt out" has been used in this context by courts and commentators to denote a state's exercise of the option given it by Congress to confine its debtors to exemptions in bankruptcy formulated by the state legislature. See, e.g., *Cheeseman v. Nachman*, 656 F.2d 60, 64 n.11 (4th Cir. 1981); Peoples, *New Rules for an Old Game, North Carolina's New Exemption Act*, 17 WAKE FOREST L. REV. 865 (1981). For a summary of the pertinent state legislation, see *infra* text accompanying notes 66–87.

7. Indiana's provision is typical. It reads:

In accordance with section 522(b) of the Bankruptcy Code of 1978 (11 U.S.C. 522(b)), in any bankruptcy proceeding, an individual debtor domiciled in Indiana:

(1) is not entitled to the federal exemptions as provided by section 522(d) of the Bankruptcy Code of 1978 (11 U.S.C. 522(d)); and (2) may exempt from the property of the estate only that property specified by Indiana law.

IND. CODE § 34-2-28-0.5 (Supp. 1980). Ohio and Georgia are among the seven states that have not followed this pattern. See *infra* text accompanying notes 215–29.

Because opting out may be accomplished by a one sentence provision, there is danger that the full policy implications of the result may be ignored or unseen in the state legislative process. Moreover, it seems that this prevalent approach to opting out may proceed from an attempt to return the law to what it was prior to enactment of the Bankruptcy Reform Act, a sense that individuals in and out of bankruptcy should be treated the same, and a belief that different exemption provisions for the two situations will supply debtors—or creditors—with an incentive to file bankruptcy petitions. While these ideas are appropriately considered within the legislative process, there is a danger that they overwhelm the process and divert attention from the question whether, from the standpoint of sound policy, a state's exemption provisions should be used in the bankruptcy setting. Because the two debtor situations (in and out of bankruptcy) have become so different,⁸ there is the possibility that state exemptions, perhaps well suited for the nonbankruptcy situation, will be ill-suited for use in bankruptcy. And because exemptions now play such a critical role in bankruptcy, poorly designed exemptions within that system might undercut much of the good the remedy is designed to provide.

The purpose of this Article is to examine the opting-out process and to identify some of the problems that the opting-out process has generated. This examination suggests that many legislatures have not fully realized the implications of opting out and that their opt-out legislation has produced problems that impose unnecessary costs on debtors and creditors alike.⁹ More importantly, an examination of current opt-out legislation suggests that most states are unduly rigid in attempting to recreate a pre-Reform Act status quo and thereby miss an opportunity to tailor federal policy to local needs in the best traditions of federalism.¹⁰ Rather than suggest specifics—clearly inappropriate for a system designed to recognize different needs and traditions—the approach here will be to suggest an analytical framework within which the state political process might approach the question of bankruptcy exemptions appropriate for its debtors.

II. DEBTORS' EXEMPTIONS AND BANKRUPTCY EXEMPTIONS: THE BACKGROUND

Introduction

The exemption concept has been with us for a long time. The idea is that there should be a certain quantum of property owned by an individual that, for various policy reasons, should not be reachable by most creditors seeking satisfaction of their debts. Outside bankruptcy the exemption claim is generally raised by the debtor to defend against levy and execution on specific

8. As will be developed in the text, procedure, substantive rules, policy emphasis, and perhaps even judicial temperament differ in the two systems.

9. See *infra* text accompanying notes 72–132.

10. See *infra* text accompanying notes 132–92.

property by the sheriff. If the debtor is successful, that property may not be taken. In bankruptcy the exemption claim is made within the bankruptcy proceedings. Property found exempt is retained by the debtor while everything else of value¹¹ owned by the debtor is liquidated and distributed among creditors.

While the general idea of allowing the debtor some quantity of property free from the claims of creditors has existed in both bankruptcy and non-bankruptcy situations for centuries, the reasons thought to justify exemptions have changed over time. It is, of course, those reasons that ultimately produce much of the content of specific exemption provisions. The changing notions of the purposes of exemptions should be examined in both situations because such a study both helps explain content and makes it easier to understand current attitudes toward those provisions.

A. *History—Toward Unity*

Statutes exempting some quantity of a debtor's property from the reach of execution creditors are, in this country, largely rooted in early nineteenth century economics and politics.¹² Most debtors' exemption statutes were initially based on the eighteenth century Spanish Civil Code,¹³ which, in turn, was based on Roman law having the very practical purpose of maintaining an adequate tax flow.¹⁴ The public interest was thought to be served by those early exemptions because destitute persons were unlikely to pay taxes or produce wealth that could be taxed. But while the earliest purpose of debtors' exemptions may have been an economic one of keeping people productive, by the early nineteenth century multiple objectives were reflected in the provisions. Family protection and maintenance,¹⁵ as well as family promotion,¹⁶ had, for example, become important justifications for exempt property. The goal of keeping the debtor productive continued to be reflected in exemptions for tools of the trade and, perhaps, working homesteads such as farms and ranches. But the dominant articulated conceptual basis for the nineteenth century state debtors' exemption laws had become the basically humanitarian

11. Property of "inconsequential value to the estate" is subject to abandonment by the trustee. 11 U.S.C. § 554 (1980).

12. Note, *Bankruptcy Exemptions: Critique and Suggestions*, 68 YALE L.J. 1459, 1463 (1959).

13. Rombauer, *Debtors' Exemption Statutes—Revision Ideas*, 36 WASH. L. REV. 484, 485 (1961).

14. *Id.* See also Comment, *Personal Property Exemptions and the Uniform Exemptions Act*, 1978 B.Y.U. L. REV. 462, 468 (1978).

15. Rombauer, *Debtors' Exemption Statutes—Revision Ideas*, 36 WASH. L. REV. 484, 485 (1961); Vukowich, *Debtors' Exemption Rights*, 62 GEO. L.J. 779, 784-86 (1974).

16. See R. WAPLES, *HOMESTEAD AND EXEMPTION* 3-4 (1893):

The conservation of family homes is the purpose of homestead legislation. The policy of the state is to foster families as the factors of society, and thus promote the general welfare.

.....

Families are the units of society, indispensable factors of civilization, the bases of the commonwealth. Upon their permanency, in any community, depends the success of schools, churches, public libraries, and good institutions of every kind. The sentiments of patriotism and independence, the spirit of free citizenship, the feeling of interest in public affairs, are cultivated and fostered more readily when the citizen lives permanently in his own castle with a sense of its protection and durability.

one of protecting the overextended debtor and his family from penury.¹⁷ In statutes exempting the debtor's furniture or provisions one finds the humanitarian idea that there was a minimal level of debtor existence or maintenance that, as a matter of social conscience, was more important to preserve than was the creditor's ability to collect debts rightfully due.¹⁸ Debtors' exemption laws, conceived in this early nineteenth century atmosphere of humanitarian reform, for the most part remained unchanged in content and purpose until the middle of the twentieth century.¹⁹

Exemptions within the law of bankruptcy reflect comparable and contemporaneous conceptual development. Bankruptcy began in this country as a mechanism for creditor relief, the focus of which was the orderly liquidation and distribution of a debtor's assets to his creditors.²⁰ The limited exemptions found in early acts were created by necessity and historical inertia.

Congress patterned our first Bankruptcy Act,²¹ passed in 1800, after its English counterpart²² and excepted from distribution to creditors necessary apparel and bedding.²³ The Act also provided a premium of three to ten percent of the estate to the complying debtor up to a maximum of eight hundred dollars, and the percentage exempted rose with the percentage that creditors were paid on their claims.²⁴ This cash exemption, like the bankruptcy discharge,²⁵ appears originally designed as an incentive for the debtor to gather for creditors the largest estate possible. The mechanism made creditor returns the focal point in determining the amount exempted.

Before long, the humanitarian ideas reflected in nineteenth century debtors' exemptions found their way into bankruptcy exemptions. The exemption provisions of the 1841 Bankruptcy Act²⁶ manifest a shift in purpose from generating a larger estate for creditors to providing the debtor with minimal maintenance; that shift, in turn, parallels the shift in bankruptcy from a creditor to a debtor orientation over the same period of time.²⁷ The 1841 Act "excepted" from distribution family apparel, household and kitchen furniture, and "necessaries" up to three hundred dollars in value.²⁸ This shifted

17. Kennedy, *Limitations of Exemptions in Bankruptcy*, 45 IOWA L. REV. 445, 447-48 (1960); Note, *Bankruptcy Exemptions: A Full Circle Back to the Act of 1800?*, 53 CORNELL L. REV. 663, 665 (1968).

18. Cf. 8 W. HOLDSWORTH, A HISTORY OF ENGLISH LAW 100 (1926) (on the prohibition of usury, considered to be both a sin and a crime in earliest times).

19. See Joslin, *Debtors' Exemption Laws: Time for Modernization*, 34 IND. L.J. 355, 356 (1959).

20. Rendleman, *The Bankruptcy Discharge: Toward a Fresher Start*, 58 N.C.L. REV. 723, 724 (1980).

21. Bankruptcy Act of 1800, ch. 19, § 5, 2 Stat. 19, 23 (1800). Copies of the texts of all American bankruptcy acts from *Statutes at Large* are conveniently located at the Supplemental Appendix, Part I, of *Bankruptcy Act Revision: Hearings on H.R. 31 and H.R. 32 Before the Subcomm. on Civil and Constitutional Rights of the Comm. on the Judiciary*, 94th Cong., 1st & 2d Sess. (1975-76) [hereinafter cited as *House Hearings*].

22. For a history of early bankruptcy laws in England, see 8 W. HOLDSWORTH, A HISTORY OF ENGLISH LAW 229 (1926).

23. Bankruptcy Act of 1800, ch. 19, § 5, 2 Stat. 19, 23 (1800).

24. *Id.* §§ 34, 35, 2 Stat. 30, 31. The larger the percentage that creditors were paid on their claims, the larger the exempted percentage became. *Id.*

25. See J. MACLACHLAN, BANKRUPTCY § 100, at 88 (1956).

26. Bankruptcy Act of 1841, ch. 9, 5 Stat. 440 (1841).

27. See generally C. WARREN, BANKRUPTCY IN UNITED STATES HISTORY chs. I & II (1935).

28. Bankruptcy Act of 1841, ch. 9, § 3, 5 Stat. 440, 443 (1841).

focus to “necessaries” suggests that the requirements of the debtor and his family had supplanted creditor returns as a central inquiry in determining how much property was exempt. The shift in focus from the creditors to the debtor suggests a parallel shift in the perceived role of exemptions in bankruptcy—a shift from their role as an incentive to a role similar to that served by contemporaneous state debtors’ exemptions.

The debtor, his family, and their needs were again the focus of the exemption provisions of the 1867 Bankruptcy Act.²⁹ That Act, for the first time, incorporated state exemption provisions into its operation. The statute exempted household furniture and “necessaries” up to five hundred dollars, family apparel, military arms, uniforms and equipment, and “any such other property . . . as is excepted from levy and sale upon execution or other process . . . by the laws of the state in which the bankrupt has domicile at the time of the commencement of the proceedings in bankruptcy”³⁰ The effect was a federal minimum amount of property left to the bankrupt; the maximum was left to state legislation. Incorporation of state exemptions into bankruptcy was natural and understandable in view of the similarity in purpose of exemption provisions in the two systems.

The 1898 Bankruptcy Act³¹ produced complete identity of exemptions in and out of bankruptcy. Section 6 of that Act looked entirely to state law and federal law apart from the Act to determine that property which would be left to the bankrupt after bankruptcy proceedings were concluded.³² Because similar humanitarian purposes—debtor and family maintenance and protection from destitution—were behind exemption provisions both in and out of bankruptcy, it was inoffensive from a policy standpoint that the provisions be the same and be determined locally. Moreover, because the 1898 Act used state law to decide a variety of related questions,³³ a certain symmetry resulted from the use of debtors’ exemptions in bankruptcy: with minor exceptions, debtors and creditors theoretically got the same shares of the pie whether the debtor was in bankruptcy or not. In retrospect it appears that the legislative union of exemptions in and out of bankruptcy through the 1898 Act, while sensible at the time, tended to obscure recognition that the purposes of exemptions in and out of bankruptcy might change over time. That union may thereby have hindered any independent development of exemptions in response to changing needs or purposes of bankruptcy law.

B. History—Growing Disparity

Several twentieth century developments subjected the 1898 Bankruptcy Act’s exemption scheme to increasing stress. The first was the relative growth

29. Bankruptcy Act of 1867, ch. 176, 14 Stat. 517 (1867).

30. *Id.* § 14, 14 Stat. 522–23.

31. Bankruptcy Act of 1898, ch. 541, 30 Stat. 544 (1898).

32. *Id.* § 6, 30 Stat. 548.

33. See *infra* text accompanying notes 136–43.

and crystallization of the fresh start for the debtor as a central consideration in bankruptcy, and the use of that notion in judicial decisionmaking. The perception that bankruptcy liquidation might serve as a debtor relief mechanism and might, through the fresh start, restore a debtor's productive energies was gradual in its development.

Giving the debtor relief from debt was initially an incidental benefit of the discharge, originally designed to induce the debtor to gather honestly all assets.³⁴ But even as early as 1799, a conceptual association between the bankruptcy process and the restoration of the productive energies of debtors was being made in Congress.³⁵ The recognition of debtor rehabilitation as one objective of bankruptcy appears in judicial decisions in the latter part of the nineteenth century,³⁶ but as late as 1910 the "primary object" continued to be perceived as distribution of the debtor's property, the discharge and fresh start being "incidental and subordinate."³⁷

It is, of course, impossible to determine when the fresh start idea actually began influencing decision makers with any regularity. It appears that the influence of the idea was well underway by the time of the 1934 Supreme Court decision in *Local Loan Co. v. Hunt*³⁸ in which the Court explicitly recognized the fresh start as "one of the primary purposes of the Bankruptcy Act."³⁹ The idea's comparatively recent ascendancy as a central purpose of bankruptcy has signalled a further movement of bankruptcy from its early nineteenth century creditor relief origins to its late twentieth century conception as a mechanism for debtor relief and revitalization.⁴⁰

Exempt property, being the bulk of the property with which the debtor emerged from bankruptcy, formed part of the foundation on which the debtor could begin a new financial life. But while the perceived importance of the fresh start was growing, state exemption provisions that were applicable in bankruptcy and that might have accommodated that growth were not changing. Bridging the widening gap between perceived policy goals and applicable legislation, a number of courts understandably enhanced the debtor's grub-

34. J. MACLACHLAN, *BANKRUPTCY* § 100, at 88 (1956).

35. C. WARREN, *BANKRUPTCY IN UNITED STATES HISTORY 16-17* (1935).

36. *E.g.*, *In re Muller*, 17 F. Cas. 974-75 (D. Or. 1869) (No. 9912); *Silverman's Case*, 22 F. Cas. 134 (D. Or. 1870) (No. 12,855).

37. *In re Swoffard Bros. Dry Goods Co.*, 180 F. 549, 556 (W.D. Mo. 1910). *See also* *Burlingham v. Crouse*, 228 U.S. 459, 473 (1913); *In re Mumford*, 255 F. 108, 117 (E.D. N.C. 1919).

38. 292 U.S. 234 (1934).

39. *Id.* at 244. *Cf.* *Gilbert v. Shouse*, 61 F.2d 398, 399 (5th Cir. 1932) ("The purpose of the Bankruptcy Act is twofold, i.e., to permit an honest debtor to start afresh, relieved from his burden of indebtedness, and to distribute his assets equitably among his creditors. The act must be reasonably construed to effect both objects." (citations omitted)).

40. *See* Rendleman, *The Bankruptcy Discharge: Toward a Fresher Start*, 58 N.C.L. REV. 723, 724 (1980). The use of "revitalization" instead of the more common "rehabilitation" is for purposes of clarity. The theoretical underpinnings of the fresh start include the rekindling of the debtor's productive energy following the removing of oppressive debt. *See* J. MACLACHLAN, *BANKRUPTCY* § 100 (1956). "Rehabilitation" often is used to express that process, but it also is used to express the distinct process of assisting the debtor to repay debts due and owing, most commonly through chapter 13 of the Code. Confusion can result from mixing these different uses of "rehabilitation." *Cf.* Schuchman, *An Attempt at a "Philosophy of Bankruptcy"*, 21 U.C.L.A. L. REV. 403, 417 (1973). Use of "revitalization" here will avoid that confusion.

stake not by finding property exempt under state law, but rather, by manipulating the more fluid property of the estate concept in a way to achieve the same goal.⁴¹

A related factor that placed the 1898 Act's exemption provisions under stress was the large increase in consumer debt and in consumer bankruptcies following World War II.⁴² This development focused increased attention on the problems of consumer bankruptcies, and with that came further attention to the fresh start. Only after World War II did property left to an individual following bankruptcy become generally discussed as a vital consideration in advancing a fresh start policy.⁴³ This increased attention brought into view the obsolescence and irrelevance of some state debtors' exemption laws, many of which had not been revised for over a century.⁴⁴ The obsolescence of some state exemption statutes⁴⁵ and the extreme diversity in the fresh starts obtainable in, for example, Maryland and Texas⁴⁶ under the 1898 Act produced a current in the bankruptcy reform movement for uniform, federal exemptions to be provided within the Bankruptcy Act itself.⁴⁷

State exemptions, suitable for advancing the humanitarian goals of exemptions in and out of bankruptcy in 1898, had thus become potentially unsuited to advancing the fresh start goals of modern bankruptcy. The perceived reasons behind exemptions in bankruptcy had changed while the provisions themselves, largely unchanged state exemptions designed to advance goals different from the bankruptcy fresh start, had not. With the addition of a

41. The fresh start objective motivated several courts to constrict the Act's definition of "property" to exclude—and thereby preserve for the debtor—things of value such as rights to accrued vacation pay, which otherwise would have been distributed to creditors. See *Lee, Leading Case Commentary*, 45 AM. BANKR. L.J. 115, 118-19 (1971); Comment, *Protection of a Debtor's "Fresh Start" Under the New Bankruptcy Code*, 29 CATH. U.L. REV. 843, 849-50 (1980).

42. In 1946, 10,196 bankruptcy cases were filed; in 1967, 208,329 cases were filed, and in between, filings increased almost continuously. D. STANLEY & M. GIRTH, *BANKRUPTCY: PROBLEM, PROCESS, REFORM* 18 (1971). The increase is due largely to the increase in consumer filings, five in six in 1946, more than eleven in twelve by 1971. *Id.* at 20. See also H.R. REP. NO. 595, 95th Cong., 2d Sess. 116-17, reprinted in 1978 U.S. CODE CONG. & AD. NEWS 5963, 6076-77 [hereinafter cited as HOUSE REPORT]; REPORT OF THE COMMISSION ON THE BANKRUPTCY LAWS OF THE UNITED STATES, H.R. DOC. NO. 137, 93d Cong., 1st Sess., pt. I, at 2-3 (1973) [hereinafter cited as COMMISSION REPORT].

43. See Countryman, *For a New Exemption Policy in Bankruptcy*, 14 RUTGERS L. REV. 678, 684 (1960); Note, *supra* note 12, at 1462. The Court in *Burlingham v. Crouse*, 228 U.S. 459, 473 (1913), appeared to recognize exemptions as a component of the fresh start.

44. See Countryman, *supra* note 43, at 681-84; Joslin, *Debtors' Exemption Laws: Time for Modernization*, 34 IND. L.J. 355, 355-56 (1955); Note, *supra* note 12, at 1465-68.

45. Specific examples included spinning wheels, horses, and mules, as well as unrealistic limits on value such as Indiana's \$700 homestead exemption. Joslin, *Debtors' Exemption Laws: Time for Modernization*, 34 IND. L.J. 355, 356, 364 (1959).

Virginia, an opt-out state that presumably has reviewed its exemption legislation recently, currently includes in its list of exemptions 25 bushels of rye or buckwheat, two hoes, one barrel of flour, two basins, one pot, and "one pair of cards." VA. CODE § 34-26(5) (Supp. 1982).

46. In 1960 Maryland's exemption provisions were said to be worth about \$300 to a debtor, while those of Texas, if cleverly used, could net a debtor in excess of \$100,000. Countryman, *supra* note 43, at 681-82.

47. *Id.* at 746; D. STANLEY & M. GIRTH, *BANKRUPTCY: PROBLEM, PROCESS, REFORM* 81-82 (1971); Note, *Bankruptcy Exemptions: A Full Circle Back to the Act of 1800?*, 53 CORNELL L. REV. 663, 666-68 (1968); Note, *supra* note 12, at 1508. But see Kennedy, *supra* note 17, at 446.

rising number of consumer bankruptcies, for which the fresh start was most important, the time was ripe for reform.

C. *Bankruptcy Reform—Recognized Disparity*

In 1970 Congress created the Commission on the Bankruptcy Laws of the United States,⁴⁸ whose mission it was to study and recommend changes in the bankruptcy law. The rise in consumer bankruptcies and the development of the fresh start idea had proceeded sufficiently that by 1970 the fresh start for and revitalization of consumer debtors appeared as a major theme.⁴⁹ The fresh start had developed into perhaps the dominant purpose for bankruptcy,⁵⁰ and exemptions in bankruptcy were now recognized by the Commission⁵¹ and reformers⁵² as central to the revitalization process that the fresh start idea represented. The Commission's approach was a set of uniform, federal exemptions in bankruptcy⁵³ "to eliminate diversity, reduce the amount of litigation having no direct relationship to the policy underlying exemptions, and because state exemption laws seem generally archaic and unduly generous in some states and exceedingly niggardly, particularly as to urban residents in others."⁵⁴

As one commentator⁵⁵ recognized early, however, any attempt to make uniform a body of law so diverse as debtors' exemptions would meet with substantial opposition from both sides of any proposed compromise. Moreover, the 1898 Act's incorporation of state debtors' exemptions in bankruptcy had produced a perceived general uniformity within a given state of the property that could be held free of creditor claims whether in bankruptcy or out.⁵⁶ This fueled another argument unavailable under previous bankruptcy statutes: increasing the exemptions in bankruptcy over those available in a given state, it was said, would induce debtors to elect bankruptcy to keep more property; decreasing them under a state's counterparts would induce creditors to file involuntary petitions so they might get more property.⁵⁷ In short, any disparity in exemptions in and out of bankruptcy would create in someone an incentive to file bankruptcy petitions.

The Senate was apparently unpersuaded by the arguments voiced by the Commission and others against the old system. Its final bill,⁵⁸ to be reconciled

48. Act of July 24, 1970, Pub. L. No. 91-354, § 1, 84 Stat. 468 (1970).

49. See, e.g., COMMISSION REPORT, *supra* note 42, pt. I, at 71.

50. House Hearings, *supra* note 21, at 180.

51. COMMISSION REPORT, *supra* note 42, pt. I, at 169-70.

52. See, e.g., House Hearings, *supra* note 21, at 369 (statement of Marjorie Girth and David Stanley); Countryman, *supra* note 43, at 684; Comment, *Bankruptcy Exemptions: State Law or Federal Policy?*, 35 U. PITT. L. REV. 630, 630 (1974); Note, *supra* note 12, at 1503.

53. COMMISSION REPORT, *supra* note 42, pt. II, § 4-503, at 125-27.

54. *Id.* at 127.

55. Kennedy, *supra* note 17, at 452.

56. This perception was not accurate in all respects. See *infra* text accompanying notes 136-43.

57. Kennedy, *supra* note 17, at 452. The fresh start idea was so important and the incentive argument so persuasive that one solution proposed (but not adopted) was federally legislated exemptions for use outside bankruptcy also. See House Hearings, *supra* note 21, at 193 (remarks of Professor Kennedy).

58. S. 2266, 95th Cong., 2d Sess. § 522 (1977).

with the House version,⁵⁹ like the 1898 Act gave the debtor the exemptions provided by the state of his domicile along with other exemptions to which the debtor would be entitled under federal law outside the bankruptcy law. The House version also did not adopt the Commission's recommendation that exemptions in bankruptcy be set entirely by the bankruptcy legislation. Instead, in an apparent compromise directed at the states with "unduly generous" exemptions, the House bill established a set of federal exemptions for use in bankruptcy, but permitted a debtor to choose the exemptions of the state of his or her domicile if desired.⁶⁰ Like the 1867 bankruptcy legislation, the effect of the House bill was to establish a federal minimum of exempted property for debtors to retain after bankruptcy and to let the individual states control the maximum.⁶¹

The opt-out provision⁶² permitting states to deprive debtors in their states of the choice among exemption provisions that the House bill had provided was the vehicle that reconciled these fundamental differences in the House and Senate versions of the Bankruptcy Code's basic exemption provision.⁶³ By including that provision, Congress permitted individual states to determine by suitable legislation a vital component of the fresh start with which domiciled debtors would emerge from bankruptcy.⁶⁴ It is not surpris-

59. H.R. 8200, 95th Cong., 1st Sess. (1977).

60. *Id.* § 522. See HOUSE REPORT, *supra* note 42, at 126-27, 360-63. The effect, of course, would be that debtors in "unduly generous" states could have the benefit of their states' generosity.

61. The House legislation was different from the 1867 Act in that under the House bill, a debtor got either the listed exemptions or whatever his state provided, but not both. The 1867 Act permitted a debtor to take both federal bankruptcy and state law exemptions. Bankruptcy Act of 1867, § 14, 14 Stat. 522-23 (1867).

62. 11 U.S.C. § 522(b) (1980). It reads in full as follows:

(b) Notwithstanding section 541 of this title, an individual debtor may exempt from property of the estate either—

(1) property that is specified under subsection (d) of this section, unless the State law that is applicable to the debtor under paragraph (2)(A) of this subsection specifically does not so authorize; or, in the alternative,

(2)(A) any property that is exempt under Federal law, other than subsection (d) of this section, or State or local law that is applicable on the date of the filing of the petition at the place in which the debtor's domicile has been located for the 180 days immediately preceding the date of the filing of the petition, or for a longer portion of such 180-day period than in any other place; and

(B) any interest in property in which the debtor had, immediately before the commencement of the case, an interest as a tenant by the entirety or joint tenant to the extent that such interest as a tenant by the entirety or joint tenant is exempt from process under applicable nonbankruptcy law.

63. 124 CONG. REC. 32,398 (statement by Congressman Don Edwards), *reprinted in* 1978 U.S. CODE CONG. & AD. NEWS 6452-53; 124 CONG. REC. 33,998 (statement by Sen. DeConcini), *reprinted in* 1978 U.S. CODE CONG. & AD. NEWS 6521.

64. In *In re Sullivan*, No. 81-1921 (7th Cir. May 19, 1982), the Court of Appeals for the Seventh Circuit upheld the constitutionality of the Code's opt-out provision based primarily on its conclusions about the congressional intent behind the opt-out compromise. In controversy was the Illinois opt-out, which provided nonhomeowners nothing comparable to the homestead exemption supplied to homeowners under Illinois exemption law and to everyone under the federal bankruptcy exemptions.

The court correctly observed that the opt-out provision was a compromise to resolve differences between a Senate bill that, without apparent limitation, incorporated state exemptions as the 1898 Act had done and a House version that set federal minimum exemptions for all states to ensure a fresh start. The court stated:

We find from this history that the intention of providing a "fresh start" can be attributed only to the House. A resolve to let states determine the applicable exemptions must be attributed to the Senate. Congress did not resolve this difference. It settled on a "compromise" which in some cases may thwart the underlying purpose of the House. This court cannot seize upon the motivation of the House as

ing, therefore, that the compromise has been condemned as undercutting a basic reform thrust—uniformity—of the Bankruptcy Code.⁶⁵

D. State Legislative Responses

The bankruptcy reform movement and the opt-out provision have sparked an interest in exemptions at the state level that is unprecedented in this century. Thirty-two states thus far have enacted legislation depriving debtors in their states of the choice of exemptions provided in the Bankruptcy Code.⁶⁶ Most states simply confined debtors in bankruptcy to the exemptions available to other debtors under state law.⁶⁷

Nearly all states that have opted out have, however, made changes in their debtors' exemption laws.⁶⁸ Some extensively rewrote their law of debt-

representative of the entire Congress when the enacted legislation clearly warrants a contrary conclusion.

Id., slip op. at 10.

The court's statement of legislative intent is unfortunate. While it is reasonably clear that the Senate did not favor a federally defined fresh start through mandatory federal bankruptcy exemptions, it clearly did recognize the fresh start role exemptions play in bankruptcy. Its report on S. 2266 discussed exemptions as follows:

Current law is retained in the area of exempt property which is property that the debtor may retain after bankruptcy for a fresh start. For this purpose, current law adopts the exemption law of the state in which the debtor is a resident. . . . The Committee feels that the policy of the bankruptcy law is to provide a fresh start but not instant affluence, as would be possible under the provisions of H.R. 8200. Moreover, current law has allowed the several state legislatures flexibility to meet the needs and fresh-start requirements of the debtors of their particular states.

S. REP. NO. 989, 95th Cong., 2d Sess. 6 (1977), reprinted in 1978 U.S. CODE CONG. & AD. NEWS 5787, 5792. Like the House, the Senate intended to provide a fresh start to debtors and recognized the role exemptions played in the fresh start. The major difference from the House approach concerned who would decide the exemptions necessary for a fresh start. In contrast with the House approach, the Senate initially chose to defer entirely to state legislatures to determine the exemption provisions that would provide a fresh start.

65. See, e.g., Vukowich, *Debtors' Exemption Rights Under the Bankruptcy Reform Act*, 58 N.C.L. REV. 769, 801-04 (1980); Comment, *Protection of a Debtor's "Fresh Start" Under the New Bankruptcy Code*, 29 CATH. U. L. REV. 843, 864-66 (1980). Cf. authorities cited *supra* notes 15-34.

66. See ALA. CODE § 6-10-11 (Supp. 1981); ARIZ. REV. STAT. ANN. § 33-1133 (Supp. 1981); ARK. STAT. ANN. § 36-210 (Supp. 1981); COLO. REV. STAT. § 13-54-107 (Supp. 1981); DEL. CODE ANN. tit. 10, § 4914 (Supp. 1981); FLA. STAT. ANN. § 222.20 (West Supp. 1982); GA. CODE ANN. § 51-1601 (Supp. 1981); IDAHO CODE § 11-609 (Supp. 1982); ILL. ANN. STAT. ch. 52, § 101 (Smith-Hurd Supp. 1981); IND. CODE ANN. § 34-2-28-0.5 (Burns Supp. 1982); IOWA CODE ANN. § 627.10 (West 1981); KAN. STAT. ANN. § 60-2312 (Supp. 1981); KY. REV. STAT. § 427.170 (Supp. 1980); LA. REV. STAT. ANN. § 13:3881(B) (West Supp. 1982); ME. REV. STAT. ANN. tit. 14, § 4425 (Supp. 1981); MD. CTS. & JUD. PROC. CODE ANN. § 11-504(g) (Supp. 1981); MONT. CODE ANN. § 31-2-106 (1981); NEB. REV. STAT. §§ 25-15,-105 (Supp. 1981); NEV. REV. STAT. § 21.090(3) (1982); N.H. REV. STAT. ANN. § 511:2-a (Supp. 1981); Act of June 2, 1981, ch. 490, § 1, 1981 N.C. Adv. Legis. Serv. No. 6 at 20 (to be codified at N.C. GEN. STAT. § 1C-1601(f)); N.D. CENT. CODE § 28-22-17 (Supp. 1981); OHIO REV. CODE ANN. § 2329.662 (Page 1981); OKLA. STAT. ANN. tit. 31, § 1(B) (West Supp. 1981); OR. REV. STAT. § 23.305 (1981); S.C. CODE ANN. § 15-41-425 (Law. Co-op. Supp. 1981); S.D. COMP. LAWS ANN. § 43-45-13 (Supp. 1981); TENN. CODE ANN. § 26-2-112 (Supp. 1980); UTAH CODE ANN. § 78-23-15 (Supp. 1981); VA. CODE § 34-3.1 (Supp. 1982); W. VA. CODE § 38-10-4 (Supp. 1982); WYO. STAT. § 1-20-109 (Supp. 1982). In addition, California has used its opt-out authority to restrict California debtors to the same exemption provisions (either state or federal) in a joint case. CAL. CIV. PROC. CODE § 690(b) (West Supp. 1981). It is unclear whether opt-out authority can be used in this way. Cf. 11 U.S.C. § 522(m) (1980).

Illinois and Tennessee have since had their opt-out statutes invalidated as in conflict with § 522 of the Code and therefore void under the supremacy clause of the Constitution. *Bradshaw v. Beneficial Fin. Co.* (*In re Balgemann*), 16 Bankr. 780 (Bankr. N.D. Ill. 1982); *Rhodes v. Stewart* (*In re Rhodes*), 14 Bankr. 629 (Bankr. M.D. Tenn. 1981). Illinois' opt-out was subsequently resurrected by the Seventh Circuit in *In re Sullivan*, No. 81-1921 (7th Cir. May 19, 1982). These cases are discussed *infra* in the text accompanying notes 237-44.

67. Notable exceptions include Arkansas, Georgia, Kentucky, North Dakota, Iowa, Ohio, and West Virginia. See *infra* text accompanying notes 193-229.

68. The focal point here is on personal property exemptions.

Wage garnishment, which diverts part of a debtor's income to creditors as it accrues, is restricted by the Consumer Credit Protection Act, 15 U.S.C. § 1671, and by a number of states as well, e.g., 42 PA. CONS. STAT.

ors' exemptions.⁶⁹ Others increased dollar limits within their present exemption statutes.⁷⁰ Most legislatures continued their old format⁷¹ in twentieth century terms and appear to have traded an updated set of exemptions for opting out of the Bankruptcy Code. While no distinct substantive trend emerges from the exemption legislation now applicable to debtors in opt-out states, the pattern suggests a prevalent legislative attempt to restrict debtors in bankruptcy to the exemption provisions available to all other debtors outside bankruptcy. The pattern of opting out and the legislation designed to effect an opt-out suggest generally inadequate legislative sensitivity to changes in the functioning of and policy behind exemptions for use in bankruptcy under the Bankruptcy Reform Act. We will consider first some specifics of the state opt-out legislation that may be troublesome and then consider broader questions that might be addressed in considering or reconsidering opt-out legislation.

III. OPT-OUTS: STATE EXEMPTIONS WITHIN THE BANKRUPTCY CODE

Section 522 of the Bankruptcy Reform Act gives the debtor a choice of exempting property specified within that section or of exempting property protected by federal nonbankruptcy law or state or local law "unless the State law that is applicable to the debtor . . . specifically does not so authorize."⁷² While the Code thus calls for specific state legislation to effect an opt-out, a simple, one sentence statement of intent to preclude state debtors from using the Code's federal bankruptcy exemptions suffices.⁷³ This insignificant legislative effort can produce far reaching effects. The result of that state legislation is an opt-out that not only deprives a debtor of the federal provisions, but replaces the Code's exemptions with whatever state exemptions the state happens to have. All opt-out states have made clear their intent to deprive domiciled debtors of the federal bankruptcy exemptions. As will be discussed, much of the state legislation has, however, failed to take into account

ANN. § 8127 (Purdon 1981). These are among the most important forms of exemptions for consumer debtors outside bankruptcy. See generally S. RIESENFELD, CREDITORS' REMEDIES AND DEBTORS' PROTECTION 341-43 (3d ed. 1979). Such statutes are, however, of little importance as exemptions in bankruptcy because the bankruptcy discharge ends the liability for which future wages might be diverted. Accordingly, our discussion of the use of state exemptions in bankruptcy will focus primarily on exemptions that extend to types of personal property currently considered as subject to current valuation, liquidation, and distribution to creditors in satisfaction of debt.

69. E.g., ARIZ. REV. STAT. ANN. § 33-1123 (Supp. 1981); IOWA CODE ANN. §§ 561.16, 627.6 (West Supp. 1982); OHIO REV. CODE ANN. § 2329.66 (Page Supp. 1980); OKLA. STAT. ANN. tit. 31, §§ 1, 2 (West Supp. 1981); TENN. CODE ANN. § 26-2-102 (1980).

70. E.g., ALA. CODE § 6-10-1 (Supp. 1981); GA. CODE ANN. § 51-101 (1979); ILL. ANN. STAT. ch. 52, §§ 1, 13 (Smith-Hurd Supp. 1981); IND. CODE § 34-2-28-1 (Supp. 1982); NEB. REV. STAT. §§ 25-1552, 40-101 (Supp. 1980); N.H. REV. STAT. ANN. § 511:2 (Supp. 1981); S.D. COMP. LAWS ANN. § 43-45-3(2) (Supp. 1981); VA. CODE §§ 34-4, 34-26 (Supp. 1982). At least one state imposed dollar limitations when none existed earlier. NEB. REV. STAT. § 44-371 (Supp. 1981).

71. There are three general formats within which most debtor exemption legislation can be described: the crystallized format in which specific items are enumerated within the legislation, the open designation format in which categories are specified such as "necessary farm implements," and what might be called a value format in which the legislature specifies the amount and the debtor selects those items of importance to him. See generally Joslin, *Debtors' Exemptions Laws: Time for Modernization*, 34 IND. L.J. 355, 356-60 (1955).

72. 11 U.S.C. § 522(b)(1) (1980). See *supra* note 62 for the full text of Code section 522(b).

73. See, e.g., the state statute quoted *infra* in note 75.

basic changes the Code made in the way state exemptions operate in bankruptcy. Much of the blame lies with Congress for failing to consider and deal with difficult questions of the interaction of state and federal law in the exemption provisions,⁷⁴ or for making it so easy to opt out that the legislative process does not itself require a state legislature to consider the implications. On the other hand, opt-out state legislatures might have eliminated many of these problems. Most have failed to do so.

The operative state opt-out provisions fall roughly into two formats. The denial format is found in those states that have simply said that debtors in bankruptcy in their states may not use the exemption provisions of Code section 522(d).⁷⁵ The replacement format goes a small step further by denying debtors the federal provisions and granting those exemptions as permitted by "the laws" of the opt-out state.⁷⁶ A variation of the replacement format combines the denial of the federal provisions with the specification that bankrupt debtors are to enjoy only those exemptions found in the state's statutes or constitution.⁷⁷

The apparent intent in most states under all three rubrics is that debtors who elect bankruptcy are to retain the same property as those hypothetical state debtors⁷⁸ who refrain from filing a bankruptcy petition, sit on their exemptions, and are subjected to an exhaustive creditor collection process instead.⁷⁹ While there may be questions about the wisdom of seeking parity of exemptions in and out of bankruptcy,⁸⁰ the state legislation as written may

74. On problems with the interaction of state and federal law in the exemption area, see Stern, *State Exemption Law in Bankruptcy: The Excepted Creditor as a Medium for Appraising Aspects of Bankruptcy Reform*, 33 RUTGERS L. REV. 70 (1980); Hertz, *Bankruptcy Code Exemptions: Notes on the Effect of State Law*, 54 AM. BANKR. L.J. 339, 354 (1980). See also *infra* text accompanying notes 81-160.

75. The Kansas provision is typical in providing that "[n]o person, as an individual debtor under the federal bankruptcy reform act of 1978 [sic] (11 U.S.C.A. § 101 et seq.), may elect exemptions pursuant to subsection (b)(1) of section 522 of such federal act." KAN. STAT. ANN. § 60-2312 (Supp. 1981). Other states in this category include Maryland (MD. CTS. & JUD. PROC. CODE ANN. § 11-509(g) (Supp. 1981)) and Wyoming (WYO. STAT. § 1-20-109 (Supp. 1982)). Compare Maine's approach, which permits debtors in bankruptcy only those exemptions permitted under Bankruptcy Code § 522(b)(2)(A)-(B). ME. REV. STAT. ANN. tit. 14, § 4425 (Supp. 1981).

76. Illinois is an example of a state following this approach. Its provision reads:

In accordance with the provision of Section 522(b) of the Bankruptcy Code of 1978 (11 U.S.C. 522(b)) residents of this state shall be prohibited from using the federal exemptions provided in Section 522(d) of the Bankruptcy Code (11 U.S.C. 522(d)) except as may otherwise be permitted under the laws of Illinois.

ILL. ANN. STAT. ch. 52, § 101 (Smith-Hurd Supp. 1981). Other states with this approach include Alabama (ALA. CODE § 6-10-11 (Supp. 1981)), Indiana (IND. CODE § 34-2-28-0.5 (Burns Supp. 1982)), and Louisiana (LA. REV. STAT. ANN. § 13:3881(B) (West Supp. 1982)).

77. Legislation in this category includes that of Florida (FLA. STAT. § 222.20 (Supp. 1982)), Nebraska (NEB. REV. STAT. §§ 25-15,-105 (Supp. 1981)), New Hampshire (N.H. REV. STAT. ANN. § 511:2-a (Supp. 1981)), Oklahoma (OKLA. STAT. ANN. tit. 31, § 1(B) (West Supp. 1981)), South Dakota (S.D. COMP. LAWS ANN. § 43-45-13 (Supp. 1981)), Tennessee (TENN. CODE ANN. § 26-2-112 (Supp. 1980)), and Virginia (VA. CODE § 34-3.1 (Supp. 1982)).

78. Because of the high costs of the coercive collection system on the one hand (see Leff, *Injury, Ignorance, and Spite—The Dynamics of Coercive Collection*, 80 YALE L.J. 1, 1 (1970)), and waiver of exemptions through the recognition of security interests in exempt property on the other (see Haines, *Security Interests in Exempt Personalty: Toward Safeguarding Basic Exempt Necessities*, 57 NOTRE DAME LAW. 215, 215-34 (1981)), the hypothetical debtors described in the text may be extremely rare.

79. This is not the intent in those states giving debtors in bankruptcy special state law treatment. See *infra* text accompanying notes 215-29.

80. See *infra* text accompanying notes 199-214.

result in a serious disparity in the property retained by some debtors following bankruptcy. At a minimum, the legislation presents interpretation problems that might easily be avoided by recognizing basic changes effected by the Code in the interaction of state and federal law in the exemption area.

A. *The Failure of State Legislative Expression*

The potential disparity in treatment of debtors in and out of bankruptcy despite identical exemptions arises out of the immunity from creditor process that most states grant to certain interests of debtors that are not specified in exemption statutes nor thought of as exempt property. Common examples of these interests include the tenancy by the entirety,⁸¹ the right to a pension,⁸² the right to alimony and child support,⁸³ the spendthrift trust,⁸⁴ and the cause of action for personal injury.⁸⁵ Because such interests were "not property,"⁸⁶ or "not transferable,"⁸⁷ common-law courts generally protected such debtor interests from the reaches of creditors.

The 1898 Bankruptcy Act, which looked entirely to state law for the content of exemptions in bankruptcy,⁸⁸ also recognized those de facto exemptions through its definition of "property of the estate." That Act defined "property of the estate" in terms of its transferability or leviability under state law.⁸⁹ Most de facto exemptions,⁹⁰ therefore, operated in bankruptcy as they did outside bankruptcy under state law—property that was not transferable or leivable never passed to the trustee and was thereby reserved to the debtor.

De facto exemptions no longer play the same role now that they did under the 1898 Act. This is because property of the estate under the current Code is no longer defined by the tests of common-law transferability and leviability used under the 1898 Act.⁹¹ Now, with narrow exceptions,⁹² all "legal or

81. See generally S. RIESENFELD, CREDITORS' REMEDIES AND DEBTORS' PROTECTION 310 (3d ed. 1979).

82. See, e.g., *In re Goodwin*, 57 F.2d 31 (6th Cir. 1932) (Ohio).

83. See, e.g., *In re Le Claire*, 124 F. 654, 656-58 (N.D. Iowa 1903).

84. See, e.g., *First N.W. Trust Co. v. IRS*, 622 F.2d 387 (8th Cir. 1980).

85. See, e.g., *Cesner v. Schmelzer (In re Schmelzer)*, 480 F.2d 1074 (6th Cir. 1973) (Ohio); *In re Anderson*, 345 F. Supp. 840 (E.D. Tenn. 1972). See S. RIESENFELD, CREDITORS' REMEDIES AND DEBTORS' PROTECTION 229 (3d ed. 1979); Plumb, *The Recommendations of the Commission on the Bankruptcy Laws—Exempt and Immune Property*, 61 VA. L. REV. 1, 43-47 (1975); Annot., 66 A.L.R. 2D 1217 (1959).

86. See Note, *supra* note 12, at 1478.

87. See, e.g., *Voltz v. Goodwin (In re Goodwin)*, 57 F.2d 31 (6th Cir. 1932); *In re Le Claire*, 124 F. 654, 656-58 (N.D. Iowa 1903); *Haines v. Public Fin. Corp.*, 7 Ohio App. 2d 89, 218 N.E.2d 727 (1966) (right of action for invasion of privacy).

88. Bankruptcy Act of 1898, ch. 541, § 6, 30 Stat. 544, 548 (1898) (repealed Oct. 1, 1979, Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, § 401(a), 92 Stat. 2549, 2682 (1979)).

89. Bankruptcy Act of 1898, ch. 541, § 70(a)(5), 30 Stat. 544, 566 (1898) (repealed Oct. 1, 1979, Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, § 401(a), 92 Stat. 2549, 2682 (1979)).

90. Not all de facto exemptions operated in bankruptcy under the 1898 Act, however. Since § 70(a)(5) defined property of the estate to include interests that were either leivable or transferable under state law, certain interests that were transferable but that could not be reached by creditors (nonleivable) came into the estate. Examples included memberships on stock exchanges and the equity of redemption. See generally Note, *supra* note 12, at 1478-79.

91. 11 U.S.C. § 541(a)(1) (1980). See generally 4 COLLIER ON BANKRUPTCY § 541.02 (L. King ed. 15th ed. 1981).

92. The major exception is the spendthrift trust. 11 U.S.C. § 541(c)(2) (1980).

equitable interests of the debtor in property” become part of the estate and, while neither “interest” nor “property” is defined in the Code, the congressional intent was clearly to bring into the estate anything of value the debtor had.⁹³ The federal exemptions contained in section 522(d) give some indication of the breadth of the new property of the estate concept. In that section are provisions exempting from property of the estate limited interests in alimony, support and separate maintenance,⁹⁴ the right to pension benefits,⁹⁵ the right to receive compensation on account of personal injury,⁹⁶ and others.⁹⁷

The new Code format thus frees the question of what comes into the estate from the vagaries and variations of state law and, instead, utilizes a very broad federal standard to include in the estate both exempt and non-exempt property as well as property necessary for a fresh start formerly reserved to the debtor by judicial decision under the old law.⁹⁸ The impact of the change is, in part, that courts may be much more restricted in their ability to use state property law or bankruptcy notions of fresh start to immunize property for the debtor on a case by case basis.⁹⁹ By restricting courts’ use of these vague and inherently flexible concepts, Congress arguably has injected more certainty into the delineation of exempt property because it has moved considerable responsibility for that delineation from the judicial to the legislative branch. An implication of decreased judicial flexibility is that legislative policymaking and drafting in the exemption area is much more important than it was under the 1898 Act—courts no longer have the judicial tools they once had to fill legislative gaps in the law.¹⁰⁰

Problems are to be expected concerning those interests now included in bankruptcy’s “property of the estate” for which state law has created common-law immunities. Because state common law immunized those interests from creditor process, it was superfluous in the past for a state legislature to include provisions protecting such interests in its exemption statutes. Trustees, of course, will use the expanded property of the estate definition in a creatively expansive way to attempt to reach interests in property not generally

93. HOUSE REPORT, *supra* note 42, at 175-76.

94. 11 U.S.C. § 522(d)(10)(D) (1980).

95. *Id.* § 522(d)(10)(E).

96. *Id.* § 522(d)(11)(D)-(E).

97. *E.g.*, the right to a disability, illness, or unemployment benefit (*id.* § 522(d)(10)(C)), and the right to an award under a crime victim’s reparation law (*id.* § 522(d)(11)(A)).

98. S. REP. NO. 989, 95th Cong., 2d Sess. 82, *reprinted in* 1978 U.S. CODE CONG. & AD. NEWS 5787, 5868.

99. *See supra* text accompanying notes 40-41.

100. It has been suggested that, given the last-minute nature of the opt-out compromise in Congress and the incompatibility of some state exemption provisions with the expanded definition of property of the estate, courts should continue to have the flexibility they had under the Act to exclude various interests in property from the bankruptcy estate. Eisenberg, *Bankruptcy Law in Perspective*, 28 U.C.L.A. L. REV. 953, 972 n.60 (1981). While the approach is plausible for reconciling many of the problems produced by the opt-out compromise, it seems dubious, given the present volume of case law and commentary on the expansive nature of § 541, that the section will be narrowed judicially to permit this flexibility. Moreover, the lack of bankruptcy jurisdiction over such exempt property could set the stage for a resurfacing of the *Lockwood v. Exchange Bank* doctrine, which the Code was structured to avoid. *See infra* text accompanying notes 136-59.

thought reachable under state law.¹⁰¹ Litigation is likely, therefore, to center on the exempt or nonexempt status of such items of property. The cause of action for personal injuries, the subject of special attention in the Chandler Act Amendments of 1938,¹⁰² clearly will be an item prompting recurring disputes and can illustrate the problems most opt-out provisions have precipitated.¹⁰³

Most state law has, in effect, immunized from the claims of creditors a debtor's unliquidated claims for damages for personal injuries.¹⁰⁴ Under the 1898 Bankruptcy Act this meant that those claims did not vest in the trustee,¹⁰⁵ and, following bankruptcy, the debtor was free to prosecute the claims and retain the resulting judgments. The result was not achieved by reference to state exemption statutes but, rather, by reference to the reachability of that cause of action under applicable state process. At times the courts justified their construction of the applicable state law by reference to bankruptcy policy,¹⁰⁶ the driving force of which is vividly expressed by the court in *Cesner v. Schmelzer (In re Schmelzer)*:¹⁰⁷

[The] goals of the Bankruptcy Act can hardly be achieved if the trustee is permitted to take over the bankrupt's unliquidated claims for serious personal injuries including claims for future pain and suffering, continued disability, and

101. The insatiability and creativity of the trustee have a long history. See, e.g., *Shoemaker v. Keeley*, 2 U.S. (2 Dall.) 213 (1793), in which an early assignee claimed he was vested with the debtor's deceit action that accrued prior to the assignment.

102. The Chandler Act, ch. 575, 52 Stat. 840 (1938), added the proviso in the Act's § 70(a)(5) that read: *Provided*, That rights of action *ex delicto* for libel, slander, injuries to the person of the bankrupt or of a relative whether or not resulting in death, seduction, and criminal conversation shall not vest in the trustee unless by the law of the State such rights of action are subject to attachment, execution, garnishment, or other judicial process.

Id. at 880. The changes were said to be declaratory of existing law, added for clarification. H.R. REP. NO. 1409, 75th Cong., 1st Sess. 1, 34 (1937), reprinted in *House Hearings, supra* note 21, Supplemental Appendix, part I, at 674, 707.

103. Congress eliminated two other major sources of potential problems by making the status of the spendthrift trust and the tenancy by the entirety turn on applicable state law. Section 541(c)(2) protects the beneficial interest of the debtor in a spendthrift trust in accordance with state law by providing that "[a] restriction in the transfer of a beneficial interest of the debtor in a trust that is enforceable under applicable nonbankruptcy law is enforceable in a case under this title." 11 U.S.C. § 541(c)(2) (1980) (emphasis added).

If state exemption provisions are applicable either through debtor election or a state's opt-out, the debtor's interest in a tenancy by the entirety is protected to the extent protected under state law. In addition to property exempt under state law applied through § 522(b)(2)(A), a debtor using state exemptions in bankruptcy may exempt

any interest in property in which the debtor had, immediately before the commencement of the case, an interest as a tenant by the entirety or joint tenant to the extent that such interest as a tenant by the entirety or joint tenant is exempt from process under applicable nonbankruptcy laws.

11 U.S.C. § 522(c)(2)(B) (1980) (emphasis added).

104. See, e.g., *Cesner v. Schmelzer (In re Schmelzer)*, 480 F.2d 1074 (6th Cir. 1973) (Ohio); *In re Anderson*, 345 F. Supp. 840 (E.D. Tenn. 1972). See also S. RIESENFELD, CREDITORS' REMEDIES AND DEBTORS' PROTECTION 229 (3d ed. 1979); Plumb, *The Recommendations of the Commission on the Bankruptcy Laws—Exempt and Immune Property*, 61 VA. L. REV. 1, 43-47 (1975); Annot., 66 A.L.R. 2D. 1217 (1959).

105. Bankruptcy Act of 1898, ch. 541, § 70(a)(5), 30 Stat. 544 (1898).

106. See, e.g., *Cesner v. Schmelzer (In re Schmelzer)*, 480 F.2d 1074, 1077 (6th Cir. 1973) (Ohio); *Hayes v. Buda (In re Buda)*, 323 F.2d 748, 750 (7th Cir. 1963) (Wisconsin).

107. 480 F.2d 1074 (6th Cir. 1973).

loss of earnings in the future. It seems almost against public policy to permit the trustee in bankruptcy to prosecute such as [*sic*] action in his own name.¹⁰⁸

While bankruptcy policy may continue to justify protecting at least parts of the debtor's personal injury claim,¹⁰⁹ it is reasonably clear that the personal injury claim no longer remains outside the estate under the expanded definition of property of the estate in the Code.¹¹⁰ In many opt-out states creditors in bankruptcy might therefore obtain distributions of the value of the plaintiff's personal injury claim, which they are unable to reach outside bankruptcy. Under the Code, unless that claim is held to be "exempt under . . . State or local law,"¹¹¹ such a result, at least in larger personal injury claims, seems inevitable.

A court in that situation will be called on to decide what meaning to attach to "exempt under . . . State or local law" when state law supplies no statutory exemption but instead uses common-law principles to protect the debtor's personal injury claim from creditors outside bankruptcy. Does the common-law immunity of the debtor's personal injury claim qualify as exempt for purposes of section 522(b)(2)(A)? The answer is far from clear.

One might logically begin a search for the answer with the Code's legislative history. Congress could have intended that section 522(b)(2)(A) be read expansively to include state common-law immunities. The evidence, however, is to the contrary.

The Senate bill, which contained no federal exemptions,¹¹² referred to "State or local law" and was said to "track current law."¹¹³ The few courts that considered the meaning of "exemption" under predecessor section 6 of the 1898 Act¹¹⁴ rejected an interpretation that would equate "exempt" with "immune under state law."¹¹⁵ Under the broadest interpretation, the inquiry

108. *Id.* at 1077. *Cf.* *Hayes v. Buda (In re Buda)*, 323 F.2d 748 (7th Cir. 1963): "[I]t is not . . . the policy of the law to take from a wrongfully injured person the compensation for his injury to satisfy his creditors in a bankruptcy proceeding." *Id.* at 750 (citing *Sihley v. Nason*, 196 Mass. 125, 81 N.E. 887 (1907)).

109. *See, e.g.*, 11 U.S.C. § 522(d)(11)(D)-(E) (1980). *Cf.* UTAH CODE ANN. § 78-23-5(9) (Supp. 1981); OKLA. STAT. ANN. tit. 31, § 1A(19) (West Supp. 1981).

110. *See supra* text accompanying notes 91-100.

111. 11 U.S.C. § 522(b)(2)(A) (1980). Several opt-out states have recognized the expansive nature of the Code's property of the estate and have enacted exemptions to encompass the personal injury claim that will eliminate this problem in bankruptcy. Most have patterned their exemption of such interests on Code § 522(d)(11), 11 U.S.C. § 522(d)(11) (1980). *See, e.g.*, ARK. STAT. ANN. § 36-211 (Supp. 1981); KY. REV. STAT. § 427.150(2) (Supp. 1981); N.D. CENT. CODE § 28-22-03.1 (Supp. 1981); OR. REV. STAT. § 23.160(j)(B) (1981). There are, however, variants. *E.g.*, COLO. REV. STAT. § 13-54-102(n) (Supp. 1981) (personal injury award proceeds exempt "except for obligations incurred for treatment of any kind"); OKLA. STAT. ANN. tit. 31, § 1A(19) (West Supp. 1981) (interest in personal injury claim exempt up to \$50,000 not including a claim for exemplary or punitive damages); UTAH CODE ANN. § 78-23-5(9) (Supp. 1981) (proceeds exempt "to the extent that such proceeds are compensatory").

112. S. 2266, 95th Cong., 2d Sess. § 522(b)(1)(A) (1977).

113. S. REP. NO. 989, 95th Cong., 2d Sess. 75, *reprinted in* 1978 U.S. CODE CONG. & AD. NEWS 5787, 5861.

114. The use of state law in defining the 1898 Act's property of the estate made it unnecessary for a court to face this question very often. Only when the interest was not leviable and yet transferable by the debtor could it be included within property of the estate, yet arguably be exempt. *See Note, supra* note 12, at 1478-80.

115. *See, e.g.*, *Page v. Edmonds*, 187 U.S. 596, 601-06 (1902); *Garber v. Bankers' Mortgage Co.*, 27 F.2d 609, 610-12 (D. Kan. 1928); *In re T.C. Burnett & Co.*, 201 F. 162, 165 (E.D. Tenn. 1912).

was whether the highest state court could conclude that the interest was exempt under state law for bankruptcy purposes;¹¹⁶ at its narrowest, "exempt" was simply equated with state exemption legislation.¹¹⁷ If the Senate intended its version to follow former section 6, an expansive reading of "exempt" was not intended.

The radically different House provision allowed the debtor to select either federal bankruptcy exemptions found in the Code or the exemptions provided by "Federal, State, or local law, other than subsection (d) of this section."¹¹⁸ That bill contained no opt-out provision; the state-law option was intended to permit states to set their own exemption levels within the parameters of the overriding fresh start policy of the Code.¹¹⁹ The House probably contemplated that state legislatures would establish these exemption levels.

More importantly, perhaps, Congress expressly addressed the exempt or immune status of tenancies by the entirety and spendthrift trusts in the Code.¹²⁰ If "exempt under . . . State or local law" were intended to include property immune from creditors under a state's common law, both types of interests would have become exempt under section 522(b)(2)(A), and further Code provisions would have been unnecessary. Indeed, the very specificity of the Code when dealing with the exempt or immune status of various interests suggests that legislation is the intended method for creating categories of exempt property.¹²¹

Whether property interests not found in an opt-out state's exemption statutes yet protected from creditors under state law are to be protected in bankruptcy as well is thus decided by interpreting state legislation. While it may well have been the congressional intent that no interest in property not actually specified in an opt-out state's exemption provisions may be exempt under section 522(b)(a)(A),¹²² it seems on balance more consistent with the intent behind the Code's opt-out authorization¹²³ to look to state law itself to determine whether an unlisted, de facto exemption is to operate in bankruptcy. Unfortunately, in most opt-out states the only pertinent legislation on that question is the opt-out provision itself, and most of these provisions are too abbreviated to support a definitive conclusion one way or the other.

116. *E.g.*, *Garber v. Bankers' Mortgage Co.*, 27 F.2d 609, 610-12 (D. Kan. 1928).

117. *E.g.*, *Page v. Edmonds*, 187 U.S. 596, 601-06 (1902).

118. H.R. 8200, 95th Cong., 2d Sess. § 522(b)(2)(A) (1977).

119. HOUSE REPORT, *supra* note 42, at 126. Since the selection was the debtor's, and since there was no opt-out provision at this point, providing the debtor with that option appears to be a compromise to attract those states with state exemption provisions larger than those in the Code.

120. 11 U.S.C. §§ 522(b)(2)(B), 541(c)(2) (1980). *See supra* note 103.

121. *See also Ray v. Dawson (In re Dawson)*, 10 Bankr. 680 (Bankr. E.D. Tenn.), *aff'd*, 14 Bankr. 822 (E.D. Tenn. 1981), in which the court distinguished "exempt from process" in § 522(b)(2)(B) from "exempt under . . . State or local law" in § 522(b)(2)(A): "Congress for some reason said 'exempt from process' rather than 'immune from process.' 'Exempt' suggests statutory exemptions but Congress apparently meant common law immunity. That should be obvious since state statutory exemptions are covered in the sub-paragraph (A) of the same subsection." 10 Bankr. 680, 683 (Bankr. E.D. Tenn. 1981).

122. *Cf. Page v. Edmonds*, 187 U.S. 596, 601-06 (1902).

123. The intent, apparently, was to recognize the rights of states to control exemptions in bankruptcy as they had before. *See infra* text accompanying notes 175-81.

In a state that has simply denied its debtors use of the federal exemptions, the trustee will argue that the debtor's personal injury claim is not exempt because the state legislature was fully aware of basic Code changes (including the detailed federal exemptions dealing with personal injury claims) and, given that knowledge, intended to replace the Code's list of exemptions with its own statutory list. The debtor's counterargument will be that the opt-out was intended to return the state to the old pre-Code system of exemptions. Since the former system protected the debtor's personal injury claim in accordance with state nonbankruptcy law, the state legislature intended the former exemption to be recognized in bankruptcy. While the latter argument is probably more consistent with most opt-out states' legislative intent,¹²⁴ it seems clear that unnecessary litigation will result from a legislature's failure to speak to the question.

The foregoing problem is exacerbated in the replacement format, in which an opt-out state not only deprives the debtor of the federal bankruptcy exemptions, but affirmatively refers in a cryptic form to the exemptions the debtor gets in bankruptcy. For example, when Indiana permits the debtor in bankruptcy to exempt "only that property *specified* by Indiana law,"¹²⁵ what does the legislature intend about common-law immunities available to non-bankrupt debtors? Are those immunities *specified* in state law? Virginia supplies perhaps a more glaring example. In opting out the Virginia legislature expressed itself in the following language: "No individual may exempt from the property of the estate in any bankruptcy proceeding the property specified in subsection (d) of 522 of the Bankruptcy Reform Act (Public Law 95-598), *except as may otherwise be expressly permitted under this title.*"¹²⁶ Since Virginia's exemption statutes said nothing about the personal injury cause of action, which was immune from creditors under state law, the literal result is that the personal injury claim becomes part of the bankruptcy estate and is not exempt from liquidation and distribution to creditors. This obviously produced a serious disparity in the treatment of debtors in and out of bankruptcy. Resolving the question in the debtor's favor¹²⁷ required considerable judicial ingenuity and an expenditure of resources that could have been avoided.¹²⁸

124. Cf. *In re Musgrove*, 7 Bankr. 892 (Bankr. W.D. Va. 1981).

125. IND. CODE § 34-2-28-0.5 (Burns Supp. 1982) (emphasis added).

126. VA. CODE § 34-3.1 (Supp. 1982) (emphasis added).

The language was apparently drafted by counsel for the Virginia Bankers Association. See Note, *The Failure of the Virginia Exemption Plan*, 21 WM. & MARY L. REV. 851, 878 n.141 (1980). Bankers were involved in the passage of Nebraska's comparably narrow opt-out, retaining only the "personal exemptions provided under Nebraska Statutes and the Nebraska Constitution," NEB. REV. STAT. §§ 25-15,-105 (Supp. 1981). Duncan, *Through the Trap Door Darkly: Nebraska Exemption Policy and the Bankruptcy Reform Act of 1978*, 60 NEB. L. REV. 219, 233 n.61 (1981).

127. *In re Musgrove*, 7 Bankr. 892 (Bankr. W.D. Va. 1981).

128. While the resources to pay for this litigation came initially from the estate available for distribution to creditors, as we are often reminded, the costs of bankruptcy (and hence the costs of unfortunate legislative drafting) ultimately fall on consumers of credit. See *Future Earnings: Hearings on the Bankruptcy Reform Act of 1978*

A central problem with most state opt-out legislation, then, is the uncertainty it has generated about the status of interests immune from creditors under state common law and therefore not found within a state's exemption statutes. The uncertainty invites unnecessary litigation, particularly in a state that has opted out and limited the debtor to that property specified in state law or in its statutes. The powerful notion that creditors should not be able to strip a debtor of a claim to personal injuries,¹²⁹ particularly when the effects of those injuries will continue after bankruptcy,¹³⁰ will continue to drive courts to protect the debtor's de facto exemptions despite strong but nonspecific statutory language such as Virginia's.

The solution is, of course, for opt-out state legislatures to come to grips with the basic changes effected by the Bankruptcy Code and to recognize that opting out not only deprives a debtor of the federal bankruptcy exemptions but also injects into a very changed bankruptcy law the state's own policy. That policy should be articulated by the state legislature in terms consistent with its use in the new Code and not, as is more common, in terms of state law that no longer has the use in bankruptcy that it once had.

The legislatures of those states that have opted out and, for whatever reasons, wish to leave the debtor with the same exemptions in or out of bankruptcy should make clear their intent that common-law immunities applicable outside bankruptcy will operate in bankruptcy as well. Amending the opt-out provision by the simple incorporation by reference of state-law immunities would make legislative intent clear on this point and thereby eliminate uncertainty and unnecessary litigation within the system.¹³¹ The process of incorporation by reference may result in questioning the underlying policy of the state's common-law immunities,¹³² a potentially complex but probably overdue process. Nevertheless, that process, while complex, seems preferable to uncertainty and unnecessary litigation that will result from legislative silence.

Before the Subcomm. on Courts, Senate Comm. on the Judiciary, 97th Cong., 1st Sess. 19-20 (1981) (statement of Robert W. Johnson, Krannert Graduate Sch. of Management, Purdue U.).

But perhaps borrowers will not ultimately bear all the unnecessary costs of the poorly drafted statute after all. Implicit in the analysis of those who claim that increased costs are borne entirely by borrowers is the assumption that the supply of credit is perfectly elastic. That assumption is very questionable. Weston, *Some Economic Fundamentals for an Analysis of Bankruptcy*, 41 LAW & CONTEMP. PROBS. 47, 47-51 (1977).

129. See *supra* notes 104-08.

130. See *supra* text accompanying note 108.

131. A revised opt-out provision might read as follows: "A debtor in this state in bankruptcy may exempt from the bankruptcy estate all interests in property permanently exempt or immune from creditors in this state outside bankruptcy." "Permanently" is necessary to make clear that it is not the legislative intent to permit the debtor to exempt in bankruptcy interests in the equity of redemption or in growing crops, which are given temporary exemptions in some states outside bankruptcy. See *Garber v. Bankers' Mortgage Co.*, 27 F.2d 609 (D. Kan. 1928) (equity of redemption); *In re T.C. Burnett & Co.*, 201 F. 162 (E.D. Tenn. 1912) (growing crops).

132. The common-law immunity of the debtor's entire personal injury claim in bankruptcy may, for example, be questioned on two fronts, at least: the propriety of allowing the debtor to exempt reimbursement for unpaid pre-filing medical expenses, which bankruptcy will discharge, and the policy of differentiating, for exemption purposes, a personal injury claim from its resulting judgment. The Code exemption provisions address both problems. See 11 U.S.C. § 522(d)(11)(D)-(E) (1980). Cf. N.C. GEN. STAT. § 1C-160(a)(8) (Supp. 1981); UTAH CODE ANN. § 78-23-5(9) (Supp. 1981).

B. *The Propriety of Using the Same Exemptions in the Two Systems*

As indicated earlier, the apparent intent of much opt-out legislation is to create a parity in the exemptions a debtor enjoys in and out of bankruptcy. As already discussed, the ostensible failure of many states to recognize basic changes effected by the Code has produced gaps in the expression of legislative intent on the status of the debtor's personal injury claim and perhaps on other interests that are immune but not statutorily exempt under state law. Those particular gaps can be eliminated if desired. The focus here is shifted to a substantive theme running through much of the opt-out legislation: that of attempting to create a parity in the exemption rights of debtors in and out of bankruptcy.

If there is such an effort to create parity, it will not succeed in most places because different law will change the substance of the state exemption rights when they are asserted in bankruptcy.¹³³ Moreover, as will be discussed, more basic differences in the operation of the two debtor-creditor systems suggest that the same exemptions will almost always have a different impact on the debtor depending on whether the debtor is in or out of bankruptcy.

Finally, attempting to leave the debtor with the same exempt assets in both systems may itself be questionable policy. It may be that the two systems have become sufficiently different that the notion that exemptions satisfactory for one system can serve adequately the other ought to be carefully examined.¹³⁴ If the parity-of-exemptions idea rests on questionable assumptions, they should be exposed in order to increase an opt-out state's flexibility to develop and experiment with novel exemptions specifically designed for use in bankruptcy. The place to begin is with an examination of the reasons that might support a policy of having the same exemption provisions both in and out of bankruptcy.

1. *Symmetry.*

Support for the notion that exemptions should be the same inside bankruptcy as outside might come from beliefs that could be grouped under the heading of "symmetry." Exemptions strike a balance between creditor rights and debtor protection, and it seems plausible that the balance at a particular time should be independent of the procedure—bankruptcy or levy and execution—through which the creditor obtains satisfaction of debts due. In terms of debtor protection, the idea might be that procedure should be irrelevant to the protection afforded debtors through exemption statutes and common-law immunities. Shifting the focus to the creditor, a related notion might be that creditors assess risk and lend money, in part, by evaluating the amount and availability of a debtor's nonexempt property.¹³⁵ The exempt or nonexempt

133. See *infra* text accompanying notes 135–60.

134. See *supra* text accompanying notes 31–65.

135. Cf. Vukowich, *Debtors' Exemptions Rights*, 62 GEO. L.J. 779, 856–59 (1974); Note, *Bankruptcy Exemptions: A Full Circle Back to the Act of 1800?*, 53 CORNELL L. REV. 663, 667 (1968).

status of the debtor's property on which those decisions are made arguably should not vary with the procedures ultimately utilized to obtain it in satisfaction of debt. This symmetry notion might be superficially compelling in its apparent order and simplicity. It offers little support, however, for a state's using the same exemptions in and out of bankruptcy.

The symmetry notion fails because of its underlying premises. The proposition is that with the same exemption provisions operating in both systems, it will be immaterial to the debtor or creditor whether bankruptcy or state levy and execution is utilized to distribute the debtor's property: in both cases the debtor will come out with the same exempt property, and creditors will come out with the same nonexempt property. Implicit in the symmetry idea, therefore, is the proposition that the same statutory exemption provisions will produce the same ultimate impact on debtor and creditor property interests in both systems. As will be seen, the notion breaks down at this point because a variety of factors that directly affect the ultimate impact of a given exemption provision are different in the two systems. These factors make it unlikely that the same exemption provision will have the same impact in both systems or, put differently, that for given statutorily exempt property the debtor and creditor will be treated in the same way in both systems.

The symmetry notion fails to support a policy of identical exemptions in the two systems primarily because federal law will be used in bankruptcy to decide exemption-related questions that are decided by state law outside bankruptcy, and federal law can produce results in bankruptcy different from those produced by the same exemption provisions outside bankruptcy. The real impact on a debtor and on a creditor of a given exemption provision depends not only on the provision itself but on the procedure for claiming it, the validity of a waiver of the exemption right, and other related rules through which the exemption provision produces tangible exempt property for the debtor and takes it away from the creditor. For the symmetry argument to support a policy of identical exemptions, the other rules that have an impact on the proceeds of the exemption provisions must be identical as well, so that the impact on the debtor and creditor in the two systems will be the same. Almost invariably, different legal rules that have an effect on the impact of exemption provisions operate in the two systems.

The symmetry notion was considerably more plausible under the 1898 Act, under which it probably developed,¹³⁶ because in contrast with the new Code's approach, most questions concerning the exempt status of a debtor's property were decided by state law. Exempt property was then outside the jurisdiction of the bankruptcy court,¹³⁷ and as a result, the validity of the exemption as against all types of creditors was determined by state law in the

136. The symmetry idea could only develop with a bankruptcy statute making state and bankruptcy exemptions the same in all cases. The 1898 Act was the first such bankruptcy statute in the United States. See *supra* text accompanying notes 21-33.

137. *Lockwood v. Exchange Bank*, 190 U.S. 294 (1903).

state court.¹³⁸ Creditors claiming special rights in the exempt property existed then as now and included those given special status under state law such as tort claimants or alimony claimants,¹³⁹ those in whose favor the debtor had executed a waiver of exemptions,¹⁴⁰ or those holding a valid lien on the exempt property.¹⁴¹ The 1898 Act's system of using state law to decide the rights of these creditors to otherwise exempt assets of the bankrupt debtor and of using state law to exclude nontransferable, nonleviable property from the bankruptcy estate¹⁴² suggested a roughly comparable treatment of the debtor's exempt or immune property in bankruptcy or out.¹⁴³

The current Code takes an approach different from that of the 1898 Act by supplying federal law to decide exemption-related questions formerly decided under state law. Federal bankruptcy law and analogous opt-out state law are apt to differ in their approach to exempt-property questions in at least two respects: first, the extent to which the law protects statutorily exempt property in which a security interest has been created for the creditor; and second, the availability of statutorily exempt property to satisfy the debts of classes of creditors given special rights under state law.

A security interest in exempt property is not nearly as secure in bankruptcy as it is under most state law. Congress extended to debtors in bankruptcy the right to avoid nonpossessory, nonpurchase-money security interests in certain classes of property if that property is exempt under section 522(b) of the Code.¹⁴⁴ This provision makes good sense because such a security interest, easily created under Article 9 of the Uniform Commercial

138. See generally Note, *supra* note 12, at 1475-78.

139. See Countryman, *supra* note 43, 708-09. An analogous exception is that extended, even without a security interest, to holders of a purchase-money claim to the exempt property. For example, Colorado's legislation provides: "No exemption for purchase price. None of the property described in section 13-54-102 shall be exempt from levy and sale on writ of attachment or writ of execution for the purchase price of such property." COLO. REV. STAT. § 13-54-103 (Supp. 1981). See also OR. REV. STAT. § 23.220 (1981).

140. See Countryman, *supra* note 43, at 709; Note, *supra* note 12, at 1494-97.

141. See Note, *supra* note 12, at 1475-76.

142. See *supra* text accompanying notes 81-100.

143. The comparable legal treatment generally accorded exempt assets had some exceptions. For example, nonleviable but transferable assets were brought into the estate and distributed to creditors in bankruptcy when they would not have been outside. See Note, *supra* note 12, at 1478-79. In addition, the debtor could destroy a waiver-holder's interest in the debtor's exempt property simply by waiving the exemption in bankruptcy. The effect would be a bankruptcy distribution of that property to all creditors. *Id.* at 1494-95.

144. 11 U.S.C. § 522(f)(2) (1980). It provides:

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

....

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

- (A) household furnishings, household goods, wearing apparel, appliances, books, animals, crops, musical instruments, or jewelry that are held primarily for the personal, family, or household use of the debtor or a dependent of the debtor;
- (B) implements, professional books, or tools of the trade of the debtor or the trade of a dependent of the debtor; or
- (C) professionally prescribed health aids for the debtor or a dependent of the debtor.

Code,¹⁴⁵ may be simply a modern form of the executory waiver of exemptions¹⁴⁶ condemned by most states as violative of public policy.¹⁴⁷

In an opt-out state the effect of the Bankruptcy Code provision is that such a lien on specified classes of state-created exempt property will be avoidable in bankruptcy. Outside bankruptcy, on the other hand, the security interest likely will be enforceable since most states, somewhat incomprehensively,¹⁴⁸ have not recognized this waiver in Article 9 guise.¹⁴⁹ Since such security interests are created as a matter of routine in many consumer loan transactions,¹⁵⁰ in many cases an opt-out state debtor will be entitled to different amounts of exempt property under the same exemption provisions depending on whether he is in bankruptcy or not.¹⁵¹

Just as some creditors are given special rights when state law recognizes their lien on exempt property, other creditors are given special rights to exempt property by the exemption statutes themselves. Most states have created special classes of creditors against whom the debtor's exemption rights will not run.¹⁵² Common classes of excepted creditors include alimony and family-support claimants, tort claimants, wage claimants, those with claims arising from the supply of necessities to the debtor, and tax claim-

145. See U.C.C. § 9-203 (1972).

146. Cf. S. RIESENFELD, CREDITORS' REMEDIES AND DEBTORS' PROTECTION 309-10 (3d ed. 1979).

147. NATIONAL ASSOCIATION OF CREDIT MANAGEMENT, CREDIT MANUAL OF COMMERCIAL LAWS 576 (1981); Note, *supra* note 12, at 1496; Annot., 94 A.L.R. 2D 967, 974, 981 (1964). See *Mayhugh v. Coon*, 460 Pa. 128, 331 A.2d 452 (1975), and authorities there cited.

148. One suspects that because such a security interest is not called a waiver, because property rights are more clearly implicated by the different form of words the debtor signs, and because Article 9 of the U.C.C. will be involved, the public policy arguments, however strong, supporting the nonwaivability of exemption rights are less easily embraced when the waiver is in Article 9 form.

149. A handful of states have extended the no-waiver-of-exemptions principle to the nonpossessory, nonpurchase-money security interest situation in varying degrees. See Haines, *Security Interests in Exempt Personalty: Toward Safeguarding Basic Exempt Necessities*, 57 NOTRE DAME LAW. 215, 234 (1981). Maine, ME. REV. STAT. ANN. tit. 14, § 4401 (1980), New Hampshire, N.H. REV. STAT. ANN. § 399-A:7 (Supp. 1981), North Carolina, N.C. GEN. STAT. § 1C-1601(e)(7) (Supp. 1981), and Virginia, VA. CODE § 34-28 (1976), are opt-out states in this group.

150. See *House Hearings*, *supra* note 21, at 761-62 (statement of David H. Williams); *id.* at 939-41 (statement of Earnest L. Sarason, Jr.).

151. Analogous, but far less controversial, is Congress' inclusion of a provision making ineffective waivers of rights to exemptions, 11 U.S.C. § 522(e) (1980). This provision is likely to cause disparate treatment of debtors in and out of bankruptcy only in Alabama, the only opt-out state that continues to recognize some such waivers. *Broadway v. Household Fin. Corp.*, 351 So. 2d 1373 (Ala. Civ. App.), *cert. denied*, 351 So. 2d 1378 (Ala. 1977). Even in Alabama, however, the effectiveness of waivers is somewhat restricted by statute. ALA. CODE § 6-10-126 (1977). See generally, Haines, *Security Interests in Exempt Personalty: Toward Safeguarding Basic Exempt Necessities*, 57 NOTRE DAME LAW. 215, 234 (1981).

A direct legislative attempt to avoid the impact of the Code provision in bankruptcy (*e.g.*, perhaps, OHIO REV. CODE ANN. § 2329.661(c) (Page 1980)) will probably fail under the supremacy clause. Unless they are eliminated entirely, cutting back on state household goods or tools of the trade exemptions to which § 522(f)(2) is limited will only decrease the differential impact, not eliminate it. Perhaps the only way a state might neutralize this difference is to recognize that voiding such security interests is simply a logical extension of a policy voiding executory waivers of exemption rights, (S. RIESENFELD, CREDITORS' REMEDIES AND DEBTORS' PROTECTION 309-10 (3d ed. 1979)), particularly since the enactment of U.C.C. Article 9, and to enact legislation comparable to § 522(f)(2) at the state level.

152. See generally Joslin, *Debtors' Exemption Laws: Time for Modernization*, 34 IND. L.J. 355, 372 (1959); Vukowich, *Debtors' Exemption Rights*, 62 GEO. L.J. 779, 852-63 (1974). See also *supra* note 139

ants.¹⁵³ The special status of such creditors was recognized in proceedings under the 1898 Act by permitting the excepted creditor to utilize state procedure outside bankruptcy to obtain the exempt assets over which the bankruptcy court had no jurisdiction.¹⁵⁴ The implications of *Lockwood v. Exchange Bank*,¹⁵⁵ in turn, postponed the debtor's discharge so that the excepted creditor could proceed against the exempt property in state court with a viable, undischarged claim.¹⁵⁶

Code section 522(c) now provides that "property exempted under this section" will not be liable during or after the case for any debts other than alimony and support debts, tax liabilities, and certain liens.¹⁵⁷ Since it is through section 522 that either state or federal bankruptcy exemptions are implemented, this Code provision appears to define excepted creditors for bankruptcy purposes independently of a state's policy on the same question.¹⁵⁸ Thus, even when an opt-out state's exemptions operate in bankruptcy, that portion of the state exemption policy dealing with excepted creditors will probably¹⁵⁹ be superseded by the Code provision. To the extent that a state has defined classes of excepted creditors differently, the same exemption provisions will operate differently in bankruptcy than outside.

Symmetry in the legal principles used inside and outside bankruptcy to determine what a debtor ultimately can reserve from creditors, in short, does not now generally exist in most jurisdictions that have opted out and have injected the state exemptions in effect outside bankruptcy into the Code. This divergence represents a substantial change from pre-Code law, which recognized in its operation a state's policy toward creditors holding special rights to exempt property. The present difference in the substantive legal principles

153. See Countryman, *supra* note 43, at 708-09; Joslin, *Debtors' Exemption Laws: Time for Modernization*, 34 IND. L.J. 355, 372-75 (1959); Note, *supra* note 12, at 1469-70.

154. See *supra* text accompanying notes 136-43.

155. 190 U.S. 294 (1903).

156. See generally Countryman, *supra* note 43, at 709-11; Kennedy, *supra* note 17, at 462; Note, *supra* note 12, at 1475-78. The broad criticism levelled by these and other authors at the *Lockwood* doctrine undoubtedly influenced the decision to overrule the case by including the debtor's exempt property in the estate under Code § 541(a)(1).

157. 11 U.S.C. § 522(c) provides:

(c) Unless the case is dismissed, property exempted under this section is not liable during or after the case for any debt of the debtor that arose, or that is determined under section 502 of this title as if such claim had arisen before the commencement of the case, except—

(1) a debt of a kind specified in section 523(a)(1) or section 523(a)(5) of this title; or

(2) a lien that is—

(A) not avoided under section 544, 545, 547, 548, 549, or 724(a) of this title;

(B) not voided under section 506(d) of this title; or

(C) (i) a tax lien, notice of which is properly filed; and (ii) avoided under section 545(2) of

this title.

158. On the complex interaction of state and federal bankruptcy law on the excepted creditor question, see Stern, *State Exemption Law in Bankruptcy: The Excepted Creditor as a Medium for Appraising Aspects of Bankruptcy Reform*, 33 RUTGERS L. REV. 70, 73-82 (1980).

159. It is possible to argue that the entire state exemption policy enters the Code through § 522(b)(2)(A), and that therefore, when state exemptions are operable, the state excepted creditor policy is as well. The specificity of § 522(c) and Congress' awareness of the *Lockwood v. Exchange Bank* doctrine under the 1898 Act suggests the contrary. See also Stern, *State Exemption Law in Bankruptcy: The Excepted Creditor as a Medium for Appraising Aspects of Bankruptcy Reform*, 33 RUTGERS L. REV. 70, 73-82 (1980).

operable in the two systems results frequently in differences in the impact of the same provision on debtors and creditors in the two systems.¹⁶⁰

Just as a state could reduce by suitable legislation the problems prompted by the Code's questionable recognition of state common-law immunities in bankruptcy,¹⁶¹ a state could reduce the foregoing differences in impact by making its own law on these exemption-related questions track the Code's. Unfortunately, other aspects of the two systems make it likely that exemptions designed to have a specified impact on the debtor-creditor balance in one system will have a different impact on that balance in the other. A couple of observations should suffice to illustrate that there is—and probably can be—no symmetry in fact in the impact of the same exemptions in the two systems.

Consider, for example, the vastly different contexts the two systems offer for the overextended debtor to assert rights to exempt property. Outside bankruptcy, the claim of a personal property exemption will be prompted by a levy on specific property and asserted within the context of a levy and execution proceeding. State procedures for the debtor to make the exemption claim will vary widely. It is sufficient for present purposes to observe that the debtor in this creditor-initiated situation likely will be caught by surprise and likely will not be represented by counsel. Moreover, a number of states will permit him to waive his exemptions at some stage during the levy and execution proceedings.¹⁶²

In contrast, consider the debtor in bankruptcy with the same statutory exemption rights. It is likely that the debtor, not the creditor, precipitated the bankruptcy proceeding in which the claim of exempt property will be made.¹⁶³ The debtor in bankruptcy will be more likely than his counterpart faced with levy and execution to be represented by counsel. And even without counsel, it seems unlikely that in a proceeding that concludes with the debtor being separated from all nonexempt property and sent off with a fresh start, the debtor's exemption rights will be lost through ignorance, inadvertence, or some form of waiver.¹⁶⁴

160. The symmetry discussion in the text is focussed on the debtor's bankruptcy estate as of a particular date and on the way in which the two systems with given exemption provisions differ in the division of that property between the debtor and creditors. From a broader perspective, the discharge in bankruptcy has always made the two systems asymmetrical. Once the hypothetical estate is divided outside bankruptcy, the partially satisfied creditor class is left with claims against the debtor for unsatisfied debt; in bankruptcy most of those claims are discharged. Obviously, to the extent that those claims have value, the creditor class gets less in bankruptcy than outside.

In addition, the trustee's avoiding powers, while not affecting the share of the creditor class vis-à-vis the debtor, can drastically change a particular creditor's returns in bankruptcy from what they would have been outside bankruptcy. See generally 4 COLLIER ON BANKRUPTCY § 547.01-02 (L. King ed. 15th ed. 1981).

161. See *supra* text accompanying notes 129-32.

162. For a summary of states that do and do not permit these waivers, see NATIONAL ASSOCIATION OF CREDIT MANAGEMENT, CREDIT MANUAL OF COMMERCIAL LAWS 576-78 (1981).

163. For the 12 month period ending June 30, 1981, there were 360,329 bankruptcy cases commenced, 358, 997 of which were voluntary filings. ANNUAL REPORT OF THE DIRECTOR, ADMIN. OFFICE OF THE U.S. COURTS A-122 (1981).

164. Paradoxically, outside bankruptcy it may be that the risk that a debtor will lose rights by ignorance or inadvertence is greater than in bankruptcy because the class of debtors most needing the shelter of state

The notion that exemption provisions should be the same in both systems because debtors and creditors should be treated the same in both systems thus fails on two levels. First, federal and state legal rules directly affecting the shares of the debtor's assets the competing sides receive are likely to produce differing results from the same exemption provision in the two situations. Second, even if one made all the exemption-related rules operate the same way in both systems, the different contexts suggest that the debtors would be likely in most places to receive a different measure of exemption protection in bankruptcy than outside.

Simply put, the reason that the symmetry notion fails to support the same exemptions in both systems is that the systems themselves are not now symmetrical in the rules they apply to an exemption provision to produce its ultimate take home value, nor are they similar in the trappings of procedure, judicial attitude, or emphasis, which also have an unquantifiable but probably real effect on the ultimate benefit received by the debtor in the two systems. The differences in the legal rules applied to given exemption provisions have come with the enactment of the Bankruptcy Reform Act and its change from state to federal law in several areas dealing with exemptions. The asymmetry in the thrust of the systems themselves has developed incrementally as bankruptcy has changed to its present focus on debtor relief. The asymmetry of the two systems means that the same exemptions will not automatically produce equal treatment for debtor and creditor in both systems. One must search further for a rationale for a state's use through an opt-out of the same exemption provisions in both systems.

2. Incentive

A second rationale for making exemptions in and out of bankruptcy the same—indeed, a reason asserted for opting out¹⁶⁵—is that differences in the exemptions available in the two systems will drive up the bankruptcy rate. This close relative of the symmetry argument is bottomed on the probably

exemptions might be those least likely to be aware of them or those most easily persuaded to waive them. What are the characteristics of the typical debtor in need of exemption protection, but for whom bankruptcy is not a viable option? We know that debtors in bankruptcy typically are high school educated and have incomes. See D. STANLEY & M. GIRTH, *BANKRUPTCY: PROBLEM, PROCESS, REFORM* 42-44 (1971); cf. Schuchman & Rhorer, *Personal Bankruptcy Data for Opt-Out Hearings and Other Purposes*, 56 AM. BANKR. L.J. 1, 9-14 (1982). Might those in real need of exemption protection outside bankruptcy be in a lower socioeconomic class? If so, exemption legislation designed to protect them is incomplete without suitable provisions for advising those persons of their rights and rigorously scrutinizing any supposed waiver of those rights. Some states take just this approach. See, e.g., N.C. GEN. STAT. §§ 1C-1601(c), 1C-1603(4) (Supp. 1981). Cf. *Finberg v. Sullivan*, 634 F.2d 50 (3d Cir. 1980).

165. A recent expression of the argument was presented in connection with a plea to the South Carolina Legislature to opt out:

[U]nless the General Assembly enacts a specific statute depriving debtors of the right to claim the federal exemptions enumerated in section 522(d), a substantial and perhaps irresistible incentive to file consumer bankruptcies will arise with the probable result of a significant increase in the rate of consumer bankruptcies in South Carolina.

Lacy, *South Carolina's Statutory Exemptions and Consumer Bankruptcy*, 30 S.C.L. REV. 643, 687 (1979). South Carolina ultimately opted out. S.C. CODE ANN. § 15-41-425 (Law. Co-op. Supp. 1981).

irrebuttable economic idea that larger bankruptcy exemptions will give some debtors an incentive to file for bankruptcy.

The idea that different exemptions in and out of bankruptcy would induce more bankruptcies appears first to have surfaced in one of the seminal exemption-reform articles.¹⁶⁶ The idea was that uniform exemptions in bankruptcy would induce debtors in states with smaller nonbankruptcy exemptions to elect bankruptcy in order to retain more property and would induce creditors in states with larger nonbankruptcy exemptions to precipitate bankruptcy to get more property. While the same author apparently changed his views after he became head of the Bankruptcy Commission,¹⁶⁷ the idea picked up adherents. The argument that the exemption provisions of the Reform Act might have an impact on bankruptcy rates and that opting out and making exemptions the same in both systems can eliminate that impact requires examination.

In most states the insertion of state exemptions into the Bankruptcy Reform Act through an opt-out does not necessarily eliminate an exemption-related incentive for someone to file a bankruptcy petition. As indicated above, even when the statutory exemptions are identical for both systems, there seldom will be an identical impact on the debtor because of the different applicable rules and contexts of the two systems. For example, if a debtor has created a nonpossessory, nonpurchase-money security interest in statutorily exempt furniture,¹⁶⁸ it is likely that, even with identical exemptions, bankruptcy will be more attractive because the debtor is threatened¹⁶⁹ with the loss of his furniture outside bankruptcy whereas in bankruptcy he may retain it.¹⁷⁰ At least for the reasonably well-advised debtor, it is therefore not justifiable to conclude that making the exemptions the same in both systems automatically will eliminate whatever exemption incentive there might be toward bankruptcy.

But even though debtors may simply look at the statutory exemptions available in the two systems and conclude that federal bankruptcy exemptions offer more retained property and therefore an incentive toward bankruptcy, it requires a second step to conclude that the incentive supplied will control the

166. Kennedy, *supra* note 17, at 452.

167. See *House Hearings*, *supra* note 21, at 170, quoted *infra* note 173.

168. As indicated above, see *supra* text accompanying note 150, those security interests are created routinely in consumer loan transactions. A Federal Trade Commission study conducted from 1972 to 1974 suggested that the consumer credit industry employed "the more severe forms of contractual remedies, such as wage assignments, seizure of property, etc., to collect approximately 240 million dollars from some 350,000 delinquent consumers each year." *House Hearings*, *supra* note 21, at 759 (statement of David H. Williams).

169. It is apparently the threat of seizure of household goods that is most valuable to creditors since the goods themselves depreciate rapidly and are seldom worth much to the creditor. It turns out in practice that such goods are seldom seized despite the creditor's right to repossess them. *House Hearings*, *supra* note 21, at 761-62 (statement of David H. Williams). Cf. Leff, *Injury, Ignorance, and Spite—The Dynamics of Coercive Collection*, 80 *YALE L.J.* 1, 5-18 (1970).

170. See *supra* text accompanying notes 144-51. In an analogous context, if it appears that a debtor's large personal injury claim might be reachable in bankruptcy but not outside, a possibility in many opt-out states, see *supra* text accompanying notes 102-30, creditors will have an incentive to file an involuntary bankruptcy petition to obtain distribution of that property.

bankruptcy decision in more than a handful of cases. This is because the incentive argument actually has two components: first, that higher exemptions in bankruptcy offer some debtors an incentive toward bankruptcy, and second, that the incentive supplied by that difference in exemptions influences the rate of bankruptcy filings. The first component is difficult to rebut because it expresses the preference of more property to less. In view of the other factors probably influencing a decision to file a bankruptcy petition, however, it seems unlikely that the second proposition is valid.

Considered in a vacuum, an overwhelmed debtor who could keep more in bankruptcy than outside would inevitably choose bankruptcy. But the debtor operates not in a vacuum but in a complicated world where a decision to choose bankruptcy carries complex legal, moral, and personal consequences. Because entitlement to exempt property is only one of many factors to be considered in the often momentous decision to choose bankruptcy as a solution to debt, the relationship between disparity in a debtor's exempt property in and out of bankruptcy and the bankruptcy rates is likely to be weaker than might be expected at first glance. The availability of discharge from debt, the avoidance of certain security interests, the stay of creditor enforcement actions, the stigma still attached to and sense of personal shame associated with bankruptcy, the required surrender of all interests in property, and the different procedure and legal fees associated with bankruptcy are among the many factors a consumer debtor might consider in making a decision whether to proceed with bankruptcy. In this complex of factors, which includes stay of creditor enforcement and discharge from most debts on one side and the personal admission of financial failure implied by personal bankruptcy on the other, the statutorily defined amount of exempt property in or out of bankruptcy is likely to assume, in most cases, a subordinate role in the debtor's decision about bankruptcy.¹⁷¹ Indeed, preliminary and inconclusive empirical studies have begun to suggest that more generous federal exemptions in bankruptcy do not have a demonstrable impact on bankruptcy rates.¹⁷²

Moreover, larger bankruptcy exemptions can only act as an incentive to bankruptcy when a debtor is aware of the disparity between bankruptcy and nonbankruptcy exemptions. A debtor who has reached the point of measuring state debtors' exemptions out of bankruptcy against different exemptions available in bankruptcy likely will have sought professional help, will have faced the personal crisis one contemplating personal bankruptcy must face, and perhaps will be somewhat predisposed towards a bankruptcy solution. Given the magnitude of the other factors and the likely level of sophistication of the debtor in a position to measure all the factors, it is unreasonable to

171. Analogously, the creditor decision to put a debtor into bankruptcy involuntarily is similarly complex. That creditors might have some incentive to do so, *see supra* note 170, does not without more tell us that they will.

172. Schuchman & Rhorer, *Personal Bankruptcy Data for Opt-Out Hearings and Other Purposes*, 56 AM. BANKR. L.J. 1, 1-3 (1982).

assume that a disparity in the exemptions afforded by state law outside bankruptcy on the one hand and federal or state law in bankruptcy on the other will have a decisive impact on the debtor's decision in more than a handful of cases.¹⁷³ Until data are assembled, and because potential reasons for disparate treatment exist, it makes absolutely no sense to bottom policy on the incentive hypothesis, the validity of which is to be seriously doubted.¹⁷⁴

3. Legal Constraint

A final argument that might be raised to support an opt-out state's use of the same exemptions in and out of bankruptcy is that the states are without authority to do anything other than opt out, that is, that Congress did not authorize a state to develop bankruptcy-only exemption provisions. Because the legislative history of the last-minute opt-out compromise is so scant, it is difficult to assess definitively congressional intent on this question. Available evidence suggests, however, that the Code includes at least limited authority to develop exemptions specifically for state debtors in bankruptcy.

Code section 522(b)(2)(A) recognizes as exempt in an opt-out state "any property that is exempt under . . . State or local law applicable on the date of filing of the petition . . ." ¹⁷⁵ The legislation itself contains no limit on an opt-out state's ability to develop exemption legislation for bankruptcy purposes only.

173. In the words of Professor Kennedy, testifying for the Bankruptcy Commission: The Commission was aware of and concerned by the possibility that a discrepancy between state and federal exemptions may provide an artificial incentive for filing petitions in bankruptcy. If the federal exemptions are more generous than the state exemption, a debtor may seek relief in bankruptcy in order to get the advantage of the larger allowance against creditors. If the federal exemptions are less liberal than the state law, creditors may wish to place their debtor in bankruptcy to reach the property that is exempt under state law. The Commission was at first troubled and deterred by this consideration from proposing federal exemptions but ultimately concluded that it was an insufficient basis for recommending either pre-emption of the field by federal law or retention of the present incorporation of state exemption laws by reference into the Bankruptcy Act. The fact that bankruptcy is an available recourse for the debtor or the creditors will be a limitation on the extent to which the parties will rely on their rights as determined by state law. They will negotiate and settle in the light of what advantages and disadvantages are available under both systems. The fact that bankruptcy requires a surrender of all nonexempt property and still carries a stigma will be deterrents to a person contemplating voluntary bankruptcy to get the advantage of a more generous exemption. The realization that the debtor will probably get a discharge and that all creditors will share in the distribution of proceeds of the sale of nonexempt assets will be substantial deterrents to creditors contemplating involuntary bankruptcy as a way of reaching assets of their debtor that are beyond their reach under state law.

House Hearings, *supra* note 21, at 170.

174. An implicit assumption in the text is the widely held notion that it is desirable to keep the bankruptcy rates as low as possible. That assumption is not self-evident and has been made here for purposes of analysis only. It is unclear just what lies behind this widely held belief. For example, it would seem that if the bankruptcy fresh start does, in fact, revitalize debtors and make them more productive than they were before, an increase in the bankruptcy rate would result in a national economic and psychological boost. *Cf. House Hearings*, *supra* note 21, at 388.

Creative thought about the bankruptcy process ought to include the examination of such basic, widely held, and seemingly unassailable assumptions. *Cf. Schuchman, An Attempt at a "Philosophy of Bankruptcy,"* 21 U.C.L.A. L. REV. 403, 438-39 (1973). See also *infra* notes 246-47.

175. 11 U.S.C. § 522(b)(2)(A) (1980).

Moreover, it appears that the opt-out compromise was perceived as a states' rights victory.¹⁷⁶ Rather than allowing the source of bankruptcy exemptions to be changed to the federal government for the first time in recent history, the opt-out provision preserved for states the option of maintaining a measure of authority over that component of the bankruptcy process, as they had under the old Act. It seems more consistent with a states' rights purpose and with notions of federalism that Congress permitted states maximum flexibility to specify "State or local law" for purposes of bankruptcy¹⁷⁷ independently of the exemption provisions otherwise applicable within their states.¹⁷⁸ In any event, at least seven states have enacted bankruptcy-only exemptions under the new law,¹⁷⁹ and no one has thus far mounted a successful challenge based on congressional intent to states' authority to do so under the Code.¹⁸⁰ It seems unlikely that such a challenge will succeed.¹⁸¹

176. Senator Wallop, commenting on the opt-out provision in the compromise Bill, maintained that "we have won an important victory for the rights of States to determine exemptions for the debtors of the States," 124 CONG. REC. 33,992 (1978) (remarks of Sen. Wallop on the compromise Bill).

177. Indeed, part of the Senate's justification for retaining the 1898 Act's system of looking entirely to state law for exemption provisions was that "current law has allowed the several State legislatures flexibility to meet the needs and fresh start requirements of the debtors of their particular States." S. REP., 95th Cong., 2d Sess. 6 (1977), reprinted in 1978 U.S. CODE CONG. & AD. NEWS 5787, 5792. See also *supra* note 64; *infra* note 243.

178. To this effect, see *In re Vasko*, 6 Bankr. 317, 320 (Bankr. N.D. Ohio 1980); cf. *Curry v. Associates Fin. Serv.*, 11 Bankr. 716, 720 (Bankr. N.D. Ohio 1981).

179. ARK. STAT. ANN. § 36-211 (Supp. 1981); GA. CODE ANN. § 51-1301.1 (Supp. 1981); IOWA CODE § 627.6 (Supp. 1982); KY. REV. STAT. § 427.160 (Supp. 1980); N.D. CENT. CODE § 28-22-03.1 (Supp. 1981); OHIO REV. CODE ANN. § 2329.66 (Page Supp. 1981); W. VA. CODE § 38-10-4 (Supp. 1982).

180. In *Kanter v. Moneymaker (In re Kanter)*, 505 F.2d 228 (9th Cir. 1974), in question was the constitutionality of a California statute that made the debtor's personal injury claim unreachable in bankruptcy when it was reachable by creditors outside bankruptcy. The court held that the statute was invalid under the supremacy clause because it thwarted the congressional intent of the 1898 Act to give creditors in bankruptcy what they were entitled to outside bankruptcy. While the opinion contains language suggesting that creditors must get the same assets in both systems under the Act, *id.* at 231, the case is readily distinguishable from the situation under the current Code. The court noted, for example, that in the Act's § 70a(5) Congress had specifically vested the Trustee with the debtor's personal injury claim to the extent that creditors could reach the claim under state law. *Id.* The evidence showed there was a congressional intent that parity exist at least in personal injury claims. By contrast, when enacting the current Code, Congress rejected the parity idea by incorporating into the Code federal exemptions that may produce property far in excess of that available to debtors outside bankruptcy in a state that has not opted out. It has also rejected the idea by the use of federal exemption-related rules, which made creditors' shares of the pie different from what they might be outside bankruptcy. See *supra* text accompanying notes 142-59. In short, the case is readily distinguishable because the Code reflects the congressional intent that a fresh start for the debtor is more important than a policy of giving creditors the same assets in both systems. Cf. *In re Vasko*, 6 Bankr. 317, 322 (Bankr. N.D. Ohio 1980).

181. An argument that a state is precluded from enacting special exemptions only for bankruptcy purposes could be pieced together from several items of legislative history. The Senate Bill had no federal exemptions whatsoever and simply made exempt those interests in property "exempt under Federal, State, or local law." S. 2266, 95th Cong., 2d Sess. § 522(b)(1)(A) (1977). The accompanying Senate report said that the provision "tracks current law." S. REP. NO. 989, 95th Cong., 2d Sess. 75 (1977), reprinted in 1978 U.S. CODE CONG. & AD. NEWS 5861. "Current law" could include the congressional intent, as interpreted in *Kanter*, of keeping creditors' shares the same in both systems. Finally, commenting on the opt-out provision of the compromise Bill, Senator DeConcini stated: "In the area of exemptions, it was agreed that a Federal standard will be codified but that the states could at any time reject them [sic] in which case the State exemption laws would continue to prevail." 124 CONG. REC. 33,990 (1978) (remarks of Sen. DeConcini on the compromise Bill).

As suggested in the text, it seems on balance more consistent with the Code as enacted that parity of creditors' rights in both systems has given way to the fresh start as the dominant federal policy in the exemption area. It seems more consistent with that intent that a state be permitted under the supremacy clause to enact bankruptcy-only exemptions to further the fresh start policy even if the result will be a somewhat different distribution in bankruptcy than outside. While there are probably limits, grounded in the bankruptcy policy of equitable distribution of assets, to a state's expansion of exemptions in bankruptcy, it seems highly unlikely that those limits, whatever they might be, will be approached by any state in the near future.

The Code has been challenged as being unconstitutional insofar as it permits a state to enact exemptions for use only in bankruptcy.¹⁸² The source of the challenges is the constitutional grant of congressional power to establish "uniform laws on the subject of bankruptcies throughout the United States,"¹⁸³ and *Hanover National Bank v. Moyses*,¹⁸⁴ in which the Supreme Court interpreted the clause in connection with the 1898 Act's exemption provision. The foundation of the argument is the *Hanover* statement that

the system is, in the constitutional sense, uniform throughout the United States when the trustee takes in each state whatever would have been available to the creditors if the bankrupt law had not been passed. The general operation of the law is uniform although it may result in certain particulars differently in different states.¹⁸⁵

While several courts¹⁸⁶ and commentators¹⁸⁷ have discussed the constitutionality of the opt-out provision in general terms and have concluded that the provision is constitutional, the rationale is generally that if the 1898 Act's exemption provision was constitutional, so must be the current Code's. Perhaps because of the relatively recent development of the fresh start concept and its association with exemptions in bankruptcy, a state's creation of special exemptions for use in bankruptcy never came up under the old Act.

However, the question has come up under the Code in Ohio, an opt-out state that has created specific exemptions to operate only in bankruptcy.¹⁸⁸ Ohio's scheme has survived constitutional challenges under the uniformity clause in several cases;¹⁸⁹ the dominant rationale appears to be based on the second sentence of the *Hanover* statement quoted above. Uniformity in this context seems to require only that the same bankruptcy law apply to all the states without discrimination—so long as all states can do the same thing, the law is uniform in the constitutional sense. As one Ohio court¹⁹⁰ put it: "The uniformity which is required by the Constitution relates to the law itself and not to its results upon the varying rights of debtor and creditor under the laws of the several states."¹⁹¹

182. See, e.g., *Stover v. Thorp Credit Inc. (In re Stover)*, 13 Bankr. 1 (Bankr. S.D. Ohio 1980); *In re Vasko*, 6 Bankr. 317 (Bankr. N.D. Ohio 1980).

183. U.S. CONST. art. I, § 8, cl. 4.

184. 186 U.S. 181 (1902).

185. *Id.* at 190.

186. See, e.g., *In re Sullivan*, No. 81-1921 (7th Cir. May 10, 1982); *In re Lausch*, 12 Bankr. 55, 55-56 (Bankr. M.D. Fla. 1981).

187. See, e.g., Hertz, *Bankruptcy Code Exemptions: Notes on the Effect of State Law*, 54 AM. BANKR. L.J. 339, 342-54 (1980); Comment, *Exemptions and Lien Avoidance Under the Bankruptcy Reform Act of 1978 and Ohio Law*, 14 AKRON L. REV. 632-47 (1981).

188. OHIO REV. CODE ANN. § 2329.66(A)(4)(A), (A)(17) (Page Supp. 1980). The provisions permit the debtor in bankruptcy in appropriate circumstances to exempt an additional \$400 in cash and "any property" respectively. On the Ohio exemption provisions, see generally Fisher, *The Federal Exemption Scheme: Delayed Until 1983 For Ohio Bankrupts*, 49 CIN. L. REV. 791 (1980); Note, *Ohio Opt Out of the Federal Bankruptcy Exemptions and Revises its Exemption Laws*, 5 U. DAYTON L. REV. 461 (1980).

189. E.g., *Stover v. Thorp Credit Inc. (In re Stover)*, 13 Bankr. 1, 3-5 (Bankr. S.D. Ohio 1980); *In re Vasko*, 6 Bankr. 317, 320 (Bankr. N.D. Ohio 1980); see also *Central Bank v. Ambrose (In re Ambrose)*, 4 Bankr. 395 (Bankr. N.D. Ohio 1980); *In re Hill*, 4 Bankr. 310 (Bankr. N.D. Ohio 1980).

190. *Stover v. Thorp Credit Inc. (In re Stover)*, 13 Bankr. 1 (Bankr. S.D. Ohio 1980).

191. *Id.* at 4 (citing *Thomas v. Woods*, 173 F. 585 (8th Cir. 1909)). Cf. Hertz, *Bankruptcy Code Exemptions: Notes on the Effect of State Law*, 54 AM. BANKR. L.J. 339, 342 (1980).

While the meaning of, and limits (if any) imposed by, the uniformity clause remain uncertain and perplexing in this context,¹⁹² it appears unlikely that a uniformity clause challenge to an opt-out state's exemption legislation designed specifically for bankruptcy purposes will be sustained.

IV. A POLICY APPROACH TO BANKRUPTCY EXEMPTIONS

Arguments supporting an opt-out state's use of the same exemptions in and out of bankruptcy have been addressed because sound reasons support an opt-out state legislature's ability and attempt to develop exemption provisions specifically for bankruptcy purposes. One justification for permitting states to opt out is state diversity: differing state conditions support varying exemption levels in the bankruptcy context.¹⁹³ The idea, in part, is to permit states to adjust a component of the bankruptcy remedy to local conditions. It seems plausible, for example, that debtors in rural areas have different exemption needs from those in urban areas¹⁹⁴ and that local traditions in the treatment of debtors and creditors might be recognized by offering a more finely tuned federal bankruptcy remedy. The local diversity rationale suggests that an opt-out state should be able to focus on bankruptcy to determine what the needs of its debtors and creditors are in the bankruptcy context and should legislate accordingly.¹⁹⁵ And if, indeed, a state were to conclude that its own nonbankruptcy situation were different from bankruptcy, or that its debtors in the two situations had different exemption needs, it would make little sense to require that state to impose on debtors in bankruptcy exemptions developed for debtors outside bankruptcy, or to require that state to develop one set of exemptions to apply in two situations that it had concluded were different. If a state is permitted to opt out and thereby conclude that the federal bankruptcy exemptions are inappropriate for its debtors, it also should be able to determine the exemptions that are appropriate without being constricted by its own nonbankruptcy exemption provisions.

192. The Supreme Court's recent decision in *Railway Labor Executives Ass'n v. Gibbons*, 102 S. Ct. 1169, *reh'g denied*, 102 S. Ct. 1997 (1982), while consistent in dicta with the view espoused in *Stover*, is not dispositive. In *Gibbons* the Court struck down federal legislation applicable by its terms only to one debtor and indicated that, at minimum, bankruptcy legislation had to be applicable to more than one debtor. *Id.* at 4263. While the issue with which the opinion dealt is not specifically pertinent to the discussion here, the majority's, and particularly the concurrence's, emphasis on the flexibility of congressional power under the bankruptcy clause suggests that a uniformity clause challenge to an opt-out state's bankruptcy-only exemptions will fail.

193. See H.R. REP. NO. 595, 95th Cong., 2d Sess. 126, reprinted in 1977 U.S. CODE CONG. & AD. NEWS 5963, 6087; *House Hearings*, *supra* note 21, at 762 (statement of David Williams); *id.* at 2043 (statement of William T. Plumb, Jr.).

194. From an economic perspective, this justification is flawed because economic diversity is regional and is very seldom observed when one crosses state lines. Moreover, with increasing uniformity of state commercial law, the related multistate nature of much of contemporary business, and the 20th century revolution in communications and transportation, a justification based on state economic diversity seems misplaced. *Cf. Note, Bankruptcy Exemptions: A Full Circle Back to the Act of 1800?*, 53 CORNELL L. REV. 663, 667 (1968).

The legislative history sheds little light on the extent to which Congress actually considered the merits of diversity in the opt-out compromise. The opt-out provision may well have been simply a political compromise with little or no direct thought having been given to the question.

195. *Cf. C. LINDBLOM, THE POLICYMAKING PROCESS* (1968).

Moreover, greater focus by opt-out states on the bankruptcy process and on the exemption needs within that process can yield substantial benefits and, indeed, can arguably help justify the Code's opt-out authorization itself. Exemption provisions only recently have come to be recognized as vitally important to the bankruptcy process.¹⁹⁶ While the Code contains Congress' formulation of the exemptions that optimally will advance bankruptcy policy, the provisions are necessarily the product of broad compromise and are but a first, recent effort at designing specific provisions to serve a perceived function in the bankruptcy process. The effectiveness of the federal exemptions in meeting their design objectives will be unknown for many years. An opt-out state's development of bankruptcy exemptions following a direct and undistracted focus on the policies to be advanced and the functions to be served by exemptions within the Code can advance our knowledge of the roles exemptions play in the bankruptcy process and, perhaps, of the relationship between bankruptcy exemptions and debtor revitalization. In short, local economic and social experimentation,¹⁹⁷ which the Code's opt-out provision makes possible,¹⁹⁸ yields substantial federalism benefits. Those benefits will be maximized if opt-out states direct their exemption policymaking efforts specifically to the bankruptcy situation in which bankruptcy exemptions are to operate. The remainder of this Article will suggest different approaches that opt-out states might take in this process.

A. Policy Determinants

All exemptions by definition reserve some of the debtor's property free from creditor claims. Eliminating *a priori* reasons for using state nonbankruptcy exemptions in bankruptcy frees a state to inquire more directly into why it is preserving for the debtor in bankruptcy some of his property through exemption provisions. One can add content to the exemption concept only by deciding what purpose the exemption is to serve or what it is being designed to do. Outside bankruptcy purposes of exemptions are varied and often overlapping. For example, protecting the debtor's personal dignity is a policy often articulated¹⁹⁹ as a basis for exemption of items such as family pictures, religious articles, or family keepsakes.²⁰⁰ The policy of maintaining the debtor's productivity²⁰¹ supports exemptions of tools of the trade and the loss-of-

196. See *supra* text accompanying notes 34-47.

197. See *New State Ice Co. v. Liebmann*, 285 U.S. 262, 309-11 (1932) (Brandeis, J., dissenting).

198. The opt-out provision only makes such experimentation more possible because a state could develop bankruptcy-only exemptions, which a debtor could choose through § 522(b), without opting out. The likely press of other legislation, however, makes it unlikely that such a state would take on this legislative burden, given the availability of the federal bankruptcy exemptions for its debtors.

199. E.g., Resnick, *Prudent Planning or Fraudulent Transfer? The Use of Nonexempt Assets to Purchase or Improve Exempt Property on the Eve of Bankruptcy*, 85 COMM. L.J. 238, 242-43 (1980).

200. Virtually all states protect such property either through exemptions specifically listing such items, e.g., ILL. ANN. STAT. ch. 52, § 13(1)(a) (Smith-Hurd Supp. 1981), or through a blanket personal property exemption with a limit that lets the debtor assess the personal value of such items and choose those of greatest personal value, e.g., IND. CODE § 34-2-28-1 (Supp. 1981).

201. See Resnick, *supra* note 199, at 243.

future-earning-capacity portion of a personal injury award, as well as restrictions on wage garnishment.²⁰² The overarching, humanitarian policy of preventing the total destitution of the debtor or of the debtor and his family is perhaps the most generally agreed upon policy underlying debtors' exemptions.²⁰³ All these policies might properly be reflected in exemptions for use in bankruptcy, and suggestions of specific exemption provisions to advance such policies are numerous.²⁰⁴

But formulating exemptions for bankruptcy purposes is unlike formulating state debtors' exemptions because bankruptcy exemptions formulated by an opt-out state must fit and operate within a much larger federal statute. A state developing exemptions for bankruptcy is localizing one component of a much larger federal law, which has reasonably well-defined goals and objectives set by Congress. The exemptions injected into the Code by an opt-out state have the capability of advancing or retarding the federal objectives within the opt-out state; a state risks the undoing of its opt-out legislation if that legislation is perceived as thwarting federal objectives.²⁰⁵

As indicated earlier, a central objective of the reform movement culminating in the Bankruptcy Reform Act was to ensure that an individual emerged from bankruptcy with a fresh start.²⁰⁶ The increased interest in bankruptcy exemptions preceding the Code and the criticism levelled at the old system,²⁰⁷ as well as legislative history of section 522 itself,²⁰⁸ suggest that reformers perceived that exemptions in bankruptcy played a vital role in the fresh start a debtor would receive with bankruptcy.

The fresh start seems to be a mixed idea of economic relief and revitalization, as expressed by the Supreme Court in *Local Loan Co. v. Hunt*.²⁰⁹ "One of the primary purposes of the bankruptcy act is to 'relieve the honest debtor from the weight of oppressive indebtedness and permit him to start afresh free from the obligations and responsibilities consequent upon business misfortunes.'"²¹⁰ Central is the notion that the removal of that "oppressive indebt-

202. Restrictions on wage garnishment are found both at the federal and state levels. *E.g.*, Consumer Credit Protection Act, 15 U.S.C. § 1671 (1980); 42 PA. CONS. STAT. ANN. § 8127 (Purdon 1981).

203. *See, e.g.*, Kennedy, *supra* note 17, at 446-48; Resinick, *supra* note 199, at 241-43; Vukowich, *Debtors' Exemption Rights*, 62 GEO. L.J. 779, 784 (1974). *Cf.* COMMISSION REPORT, *supra* note 42, part I, 172; R. WAPLES, HOMESTEAD AND EXEMPTION 764 (1893). Approaches that limit exemption rights to heads of families, *e.g.*, FLA. CONST. art. 10, § 4, ILL. REV. STAT. ch. 52, § 1 (Supp. 1981), also reflect a strong policy of family protection or promotion. *See* R. WAPLES, HOMESTEAD AND EXEMPTION 3 (1893).

204. *See, e.g.*, UNIFORM EXEMPTIONS ACT (1979); Vukowich, *Debtors' Exemption Rights*, 62 GEO. L.J. 779, 866-76 (1974); Note, *supra* note 12, at 1459-1514.

205. Two opt-out statutes have been held unconstitutional under the supremacy clause as being in conflict with overriding federal policies: Tennessee's, *Rhodes v. Stewart* (*In re Rhodes*), 14 Bankr. 629 (Bankr. N.D. Tenn. 1981), and Illinois', *Bradshaw v. Beneficial Fin. Co.* (*In re Balmann*), 16 Bankr. 780 (Bankr. N.D. Ill. 1982). Illinois' statute has been brought back to life by the Seventh Circuit. *In re Sullivan*, No. 81-1921 (7th Cir. May 19, 1982). *See infra* text accompanying notes 236-44.

206. *See supra* text accompanying notes 48-53.

207. *See supra* text accompanying notes 40-47.

208. H.R. REP. NO. 595, 95th Cong., 1st Sess. 126 (1977), *reprinted in* 1978 U.S. CODE CONG. & AD. NEWS 5963, 6087. *See also supra* note 64.

209. 292 U.S. 234 (1934).

210. *Id.* at 244 (quoting *Williams v. United States Fidelity and Guar. Co.*, 236 U.S. 549, 554-55 (1915)).

edness" might reinstate the positive incentive of personal gain thought important in order to revitalize the debtor's productivity.²¹¹ Given voluntary bankruptcy as a remedy for troubled debtors,²¹² it is in the interests of debtors, creditors, and the state alike that this revitalizing potential of bankruptcy be maximized. Conversely, it is in no one's interest to permit voluntary bankruptcy on the one hand but to insert into the Code a set of state exemptions that make debtor revitalization unlikely.²¹³ An opt-out state's focus on the bankruptcy process and on the role of exemptions in the debtor's fresh start can reduce the risk that local bankruptcy will not achieve the debtor revitalization that is a partial justification for the bankruptcy process itself.²¹⁴

B. Illustrative Approaches

Two opt-out states that have separated exemptions for bankruptcy purposes from nonbankruptcy exemptions illustrate different approaches to the creation of state exemptions specifically designed for bankruptcy.

One approach is to deal only with bankruptcy exemptions in connection with an opt-out. Georgia followed this pattern and modelled a set of bankruptcy-only exemptions on the federal exemptions in the Code.²¹⁵ Indeed, Georgia so replicated the federal scheme that it continues to offer debtors a choice of exemptions in bankruptcy even though it has opted out.²¹⁶ The approach's merits are in separating the bankruptcy situation for focussed treatment and in using as a model the federal exemptions, which were specifically designed for the Code and with the fresh start in mind. This is an economical approach because much of the legislative work in the area of bankruptcy exemptions—hearings, opinion solicitation, and drafting—has been completed by Congress, and much of it is readily transferable to the state level. The Georgia approach may also avoid state constitutional and federal contracts clause

211. See J. MACLACHLAN, HANDBOOK OF THE LAW OF BANKRUPTCY § 100 (1956); Rendleman, *The Bankruptcy Discharge: Toward a Fresher Start*, 58 N.C.L. REV. 723, 726 (1980); Whitford, *A Critique of the Consumer Credit Collection System*, 1979 WIS. L. REV. 1047, 1100; Discussion, *Economics of Bankruptcy*, 41 LAW & CONTEMP. PROBS. 123, 150-51 (1977).

212. There have been suggestions that voluntary bankruptcy should be restricted more than it is now, perhaps through involuntary Chapter 13 plans. See, e.g., Eisenberg, *Bankruptcy Law in Perspective*, 28 U.C.L.A. L. REV. 953, 976-91 (1981). The suggestion was rejected by Congress in enacting the Bankruptcy Reform Act, H.R. REP. NO. 595, 95th Cong., 2d Sess. 120-21 (1977), reprinted in 1978 U.S. CODE CONG. & AD. NEWS 5963, 6080-82, and had been rejected by Congress at least once earlier. *Id.*

213. "It does not serve the public interest to enforce the expectations of the creditor at the expense of making the debtor a ward of the state." *Curry v. Associates' Fin. Serv.*, 11 Bankr. 716, 718 (Bankr. N.D. Ohio 1981). Cf. *House Hearings*, *supra* note 21, at 341 (statement of Prof. Vern Countryman).

214. See *supra* text accompanying notes 34-41.

215. GA. CODE ANN. § 51-1301.1 (Supp. 1981). West Virginia has also followed this pattern. W. VA. CODE § 38-10-4 (Supp. 1982). Compare Delaware, which permits debtors in bankruptcy or state insolvency proceedings \$5000 worth of any property, without regard to exemptions available outside of such proceedings. DEL. CODE ANN. tit. 10, § 4914(b) (Supp. 1981).

216. The Georgia choice is between the bankruptcy-only exemptions and the exemptions available to debtors generally. GA. CODE ANN. § 51-1301.1 (Supp. 1981).

restrictions on expanding obsolete exemptions²¹⁷ on the theory that a state which creates such bankruptcy exemptions is exercising delegated federal authority²¹⁸ and that neither restriction applies to delegated federal authority.²¹⁹

An alternative approach is suggested by Ohio's exemption legislation. That state extensively reconsidered and rewrote its state exemption statutes, made most exemptions applicable to debtors in both situations and, in addition, added specific exemptions for bankruptcy debtors only. Ohio permitted its debtors to exempt an additional eight hundred dollars in cash and other property in bankruptcy.²²⁰

Since exemptions in bankruptcy share a number of the same purposes as exemptions outside bankruptcy, there are legislative economies to be gained by considering exemptions for both systems at the same time. The policy of preventing total destitution might, for example, generate a number of exemptions for use in both systems.²²¹ Once the step of constructing exemptions to satisfy exemption policy goals shared by the bankruptcy and nonbankruptcy system is completed, the second step is to develop specific exemptions to satisfy goals not shared by the two systems. For bankruptcy, this requires a focus on the central idea of debtor revitalization and a determination whether that purpose or the context of a bankruptcy proceeding or both require more, less, or different types of debtor property to be protected.

This analysis should also take into account the different context in which bankruptcy places the debtor,²²² bankruptcy's greater efficiency in separating the debtor from nonexempt assets,²²³ the implications of the bank-

217. Inadequate state exemptions, state constitutional restrictions on expanding them, and the thought that the relatively larger federal bankruptcy exemptions would increase the bankruptcy rates prompted one commentator to call for an opt-out despite the inadequacies of the state exemptions. Lacy, *South Carolina's Statutory Exemptions and Consumer Bankruptcy*, 30 S.C.L. REV. 643, 687-94 (1979). In that state it was said that any changes in state debtors' exemptions had to be preceded by a state constitutional amendment. *Id.*

218. See *Bradshaw v. Beneficial Fin. Co. (In re Balgemann)*, 16 Bankr. 780, 781-82 (Bankr. N.D. Ill. 1982); *Rhodes v. Stewart (In re Rhodes)*, 14 Bankr. 629, 631 (Bankr. M.D. Tenn. 1981). *Cf. In re Sullivan*, No. 81-1921 (7th Cir. May 19, 1982), discussed *supra* note 64, *infra* note 243.

219. *Cf. Countryman, supra* note 43, at 728-30.

220. OHIO REV. CODE ANN. §§ 2329.66(A)(4)(a), (A)(17) (Page Supp. 1982). Kentucky, a state taking a similar approach, gives debtors in bankruptcy an additional \$1000. KY. STAT. § 427.160 (Supp. 1981). Arkansas adds bankruptcy exemptions for the debtor's residence, motor vehicle, wedding bands, and tools and implements. ARK. STAT. ANN. § 36-210(a) (Supp. 1981). North Dakota adds an exemption of \$7500 in lieu of a homestead exemption and exemptions for the debtor's motor vehicle, life insurance, and proceeds from various rights of action. N.D. CENT. CODE § 28-22-03.1 (Supp. 1981).

One can infer from these differences only that the state legislature thought that bankruptcy was different. Whether the perceived difference was policy, procedure, or other aspects of the differing effects of bankruptcy on the debtor is unknown.

221. A legislature constructing exemptions for use in both systems should recognize the differential impact the differing procedure, exemption-related rules, and context will likely produce. See *supra* text accompanying notes 135-64. If these differences can be quantified, they might appropriately be reflected in different provisions for the two systems.

222. See *supra* text accompanying notes 161-64.

223. In bankruptcy the debtor is stripped of all assets that are not exempt. By comparison, state collection machinery is extremely inefficient in separating a debtor from all nonexempt assets. See generally Leff, *Injury, Ignorance, and Spite—The Dynamics of Coercive Collection*, 80 YALE L.J. 1, 5-18 (1970). It would seem,

ruptcy discharge, which is unavailable outside bankruptcy,²²⁴ and the potentially different socioeconomic classes to whom bankruptcy and non-bankruptcy exemptions might be most useful.²²⁵ Differences in any of these areas or in fundamental purposes of exemptions within the two systems might well be reflected in different exemption provisions applicable in the two systems.²²⁶ One can only speculate on how these differences might translate into different exemption treatment.²²⁷ Ohio's approach of recognizing differences in the form of a modest exemption in addition to exemptions provided to debtors generally²²⁸ certainly should be but a point of departure for other creative approaches.²²⁹

C. Pioneering Possibilities

The Ohio approach requires an answer to the question, "What is different about bankruptcy or about debtors in that process?" The central policy difference is the fresh start policy of bankruptcy, not present outside bankruptcy. This suggests a final approach that would be considerably more pioneering: to consider directly the exemption implications of the fresh start and to attempt to develop exemptions in response to those implications. Threshold questions to be pursued are whether the fresh start idea is a useful construct in developing bankruptcy exemptions and what the idea might mean in the exemption context. These are obviously areas ripe for further analysis and research. One possibility is suggested by cases and statutory reforms articulating the fresh start policy.

Many cases and reforms alike implement the fresh start by attempting to separate the bankruptcy past clearly and decisively from the future. The emphasis in the fresh start is on making a clean break with the economic past. For example, concluding that vacation pay which accrued prior to bankruptcy was not property of the estate under the 1898 Act, the Court in *Lines v. Frederick*²³⁰ opined:

therefore, that a debtor outside bankruptcy in most places will at any given time have more nonexempt or nonimmune assets than will the debtor in bankruptcy with the same exemption protection.

On the other hand, any widespread creation and recognition of security interests in exempt assets would tend to decrease the protection the debtor outside bankruptcy would receive from state exemption statutes. See *supra* text accompanying notes 144-51.

224. At minimum, the debtor with a bankruptcy discharge and relief from continued creditor collection efforts probably has a better chance for future solvency than his counterpart without a discharge.

225. See *supra* note 164.

226. If exemption users in the two systems are primarily of different socioeconomic classes, an implication of different exemptions for the two systems is that the two classes will be treated differently. An equal protection attack on the Ohio statute based on its differing treatment of debtors in the two systems failed in *In re Bloom*, 5 Bankr. 451 (Bankr. N.D. Ohio 1980).

227. It has been suggested, for example, that the bankruptcy debtor's discharge justifies lower bankruptcy exemptions. See Vukowich, *Debtors' Exemption Rights Under the Bankruptcy Reform Act*, 58 N.C.L. REV. 769, 802 (1980). No state has taken such an approach. See, e.g., *supra* note 220.

228. It is unknown what differences in the two systems Ohio's \$800 represents. See *supra* note 220.

229. See also *supra* note 221. Iowa has also recognized that bankruptcy is a different situation for a debtor and has provided bankrupt debtors a special \$1000 cash exemption, which is applied against the total \$5000 available to all debtors for various categories of property. IOWA CODE ANN. § 627.6 (West Supp. 1982).

230. 400 U.S. 18 (1970).

The wage-earning bankrupt who must take a vacation without pay or forego a vacation altogether cannot be said to have achieved the "new opportunity in life and [the] clear field for future effort unhampered by the pressure and discouragement of preexisting debt," . . . which it was the purpose of the statute to provide.²³¹

A similar thrust is also seen in many bankruptcy reforms. The broadening of the automatic stay and discharge injunctions,²³² the prohibition of governmental units from discriminating against former bankrupts,²³³ and the elaborate procedures required for a debtor to reaffirm a prior debt²³⁴ all suggest a concern with the cleavage of the bankruptcy past from the debtor's future. The "clear field for future effort" apparently follows the discharge of debt because with the discharge come spending and investing options foreclosed prior to bankruptcy. If there are incentive aspects to the fresh start, it appears that they are conceptually related to these options.

One might speculate at this point on implications for bankruptcy exemption policymakers. Building on the cleavage notion, perhaps the objective should be to ensure that discharged debt is not simply replaced with new involuntary demands on postbankruptcy income, such as rental or debt payments to obtain necessary furniture, tools, appliances, or other property required by the typical person emerging from bankruptcy, regardless of the financial ability to procure them.²³⁵ If a prime focus is to maintain the incentive of relatively free use of one's income, exemptions developed for bankruptcy purposes might ultimately turn out more generous than nonbankruptcy exemptions designed to prevent the debtor's total destitution or to preserve personal dignity.²³⁶

231. *Id.* at 20 (quoting *Local Loan Co. v. Hunt*, 292 U.S. 234 (1934)).

232. 11 U.S.C. §§ 362, 524 (1980). See generally Rendleman, *The Bankruptcy Discharge: Toward a Fresher Start*, 58 N.C.L. REV. 723, 750-54 (1980).

233. 11 U.S.C. § 525 (1980). See generally Rendleman, *The Bankruptcy Discharge: Toward a Fresher Start*, 58 N.C.L. REV. 723, 754-56 (1980).

234. 11 U.S.C. § 524(c)-(d) (1980).

235. "Involuntary" and "necessary" are normative standards that simply move the problem to a different arena. One still must determine which and how much exempt property is dictated by those standards. One could attempt to develop exemptions to suit the typical or average debtor in bankruptcy, a person who may well be better off socioeconomically than persons for whom nonbankruptcy exemptions might be formulated. Alternatively, it might be possible to use a more personalized approach, which would focus on the individual debtor and his necessities given his particular needs. Cf. Note, *Bankruptcy Exemptions: A Full Circle Back to the Act of 1800?*, 53 CORNELL L. REV. 663, 680 (1968).

236. Generosity in bankruptcy exemptions is likely to encounter substantial opposition from creditor interests from whom the value of exempt property is transferred. In a more obvious way than other aspects of bankruptcy, bankruptcy exemptions involve a redistribution of property. See Schuchman, *An Attempt at a "Philosophy of Bankruptcy,"* 21 U.C.L.A. L. REV. 403, 471-74 (1973); Meckling, *Financial Markets, Defaults, and Bankruptcy: The Role of the State*, 41 LAW & CONTEMP. PROBS. 13, 25 (1977). An exemption has a relatively direct impact on creditors, who do not obtain distribution of the exempt property, and on their customers, who in turn, bear part of the theoretically increased costs of credit. See Weston, *Some Economic Fundamentals for an Analysis of Bankruptcy*, 41 LAW & CONTEMP. PROBS. 47, 48-61 (1977). Therefore, insofar as exemptions advance fresh start policy, the advance is financed by creditors and their customers.

Creditor opposition is predictable and understandable because for the nearly certain cost of an exemption to creditor interests, a benefit of unknown value is promised. We know very little about the economic effects of a fresh start and even less about the extent to which bankruptcy exemptions contribute to the unknown benefit. It is hoped that the opportunity for state experimentation offered by the opt-out provision will lead to some answers to these questions.

Whatever the approach a state might take to providing or advancing the fresh start through bankruptcy exemptions, it clearly makes practical sense for a state at minimum to avoid depriving a debtor in bankruptcy of a fresh start by incorporating into the Code through an opt-out a set of exemptions designed for other purposes. While they are in conflict with *In re Sullivan*,²³⁷ a later decision of a court of appeals, two lower courts built on the fresh start objectives articulated in the bankruptcy reform movement and invalidated two state opt-outs for their failure to provide the debtor before the court with a fresh start. The *Rhodes v. Stewart (In re Rhodes)*²³⁸ bankruptcy court invalidated the Tennessee opt-out because the resulting state exemptions incorporated into the Code discriminated against nonhomeowners by providing them nothing comparable to the Tennessee homestead exemption.²³⁹ And the court in *Bradshaw v. Beneficial Finance Co. (In re Balgemann)*,²⁴⁰ relying on *Rhodes*, invalidated the Illinois opt-out for similar reasons. Both courts analyzed the opt-out authorization as Congress' partial delegation of bankruptcy policymaking to the states and opined that with that delegation came the fresh start guidelines found in the Code.²⁴¹ Although the Seventh Circuit's analysis in *Sullivan* disagrees on the delegation question, it may be that a number of state opt-outs that afford special protection to householders²⁴² are in jeopardy.²⁴³ It also seems likely that debtors will mount other challenges to opt-outs on the ground that the federal right to a fresh start is inadequately protected

237. No. 81-1921 (7th Cir. 1982).

238. 14 Bankr. 629 (Bankr. M.D. Tenn. 1981).

239. *Id.* at 634-35.

240. 16 Bankr. 780 (Bankr. N.D. Ill. 1982). *Balgemann* is no longer good authority because of the contrary decision in *Sullivan*, which sustained the Illinois opt-out.

241. 14 Bankr. 629, 633 (Bankr. M.D. Tenn. 1981); 16 Bankr. 780, 782-84 (Bankr. N.D. Ill. 1982). The *Rhodes* court relied heavily on *Cheeseman v. Nachman*, 656 F.2d 60 (4th Cir. 1981), which it said supported its conclusion that the opt-out authority is a considerably circumscribed delegation of federal authority.

242. *E.g.*, A.L.A. CODE § 6-10-2 (Supp. 1981); KAN. STAT. ANN. § 60-2301 (Supp. 1982).

243. The Seventh Circuit's analysis may be open to question.

As discussed, *supra* note 64, the *Sullivan* court opined that it was the Senate's intent to allow states to set bankruptcy exemption levels for their debtors as they had under the 1898 Act. Interpretation of the opt-out compromise, as the *Sullivan* court recognized, requires reconciliation of this position with that of the House, which did not entirely entrust to the states the exemption components of the bankruptcy fresh start. One infers from a compromise that each house of Congress moved somewhat from its initial position. The *Sullivan* court suggests that the movement on the Senate side was from its initial position to that of allowing state law to control bankruptcy exemptions only when a state affirmatively chose to exercise that power. Unfortunately, the opinion can be read to suggest that, as a matter of congressional intent, state power in this regard is unconstrained and beyond inquiry even if it clashes with the fresh start policy, which the court attributed only to the House. Given the history of the development of the Code and the evils to which it was responding, it seems difficult to attribute to Congress such an intent.

An alternative closer to the middle ground seems at least as plausible. Given the clear intent of the House on the question, the fresh start thrust of other major provisions of both the Senate and House bills, the Senate's own recognition of the fresh start in this context (*see supra* note 64), the reduction of the dollar limits of the federal exemptions found in the House bill pursuant to its compromise with the Senate (*see* 1978 U.S. CODE CONG. & AD. NEWS 6521), and the criticism of the Senate provision in Senate hearings on the House and Senate bills (*see Senate Hearings* at 619, 650, 684, 835; *cf. id.* at 578), Congress may have given opt-out states a considerable range of discretion to determine bankruptcy exemptions for their debtors, subject at the fringes to the overriding fresh start policy found in the legislative history and throughout the provisions of the Code.

In any event, fresh start standards may well be constitutionally required regardless of Congress' intent to provide them. In this regard, the Code differs substantially from the 1898 Act, which preceded it. The *Sullivan*

under an opt-out state's resulting exemptions.²⁴⁴ It undoubtedly will take considerable time to work out the federalism implications of the Code's opt-out provisions.

Local economic implications also may follow a state's depriving a debtor of a fresh start through its exemption provisions. If the fresh start of bankruptcy does revitalize some debtors,²⁴⁵ and if bankruptcy exemptions can influence the odds in favor of revitalization, it could make economic sense for a state to ensure that its debtors who choose voluntary bankruptcy are not deprived of the revitalization potential that bankruptcy offers. Unlike most debtors outside of bankruptcy, the honest bankrupt debtor emerges from the process with no assets but those given exempt status by the legislature. If those assets are insufficient to combine with the discharge to produce a reasonable chance at a fresh start, the result probably will be fewer effective bankruptcies, because the discharge and the immediate relief from creditor collection efforts probably will continue to attract many debtors to bankruptcy despite its lack of any revitalization potential.²⁴⁶ If lowered economic

court concluded that there was no unconstitutional delegation of federal power because states retain the power to enact bankruptcy laws as long as such laws do not conflict with federal bankruptcy legislation. No. 81-1921, slip op. at 13 (7th Cir. May 19, 1982). According to the court, state exemptions in bankruptcy were merely an exercise of states' preexisting bankruptcy powers; there could be no conflict with the Code because, as a matter of congressional intent, Congress expressly permitted states to make their own exemption provisions effective without regard to the fresh start. Assuming the court is correct on intent, the court's conclusion here ultimately is bottomed on the notion that it is state power, not federal bankruptcy power, that a state exercises when its exemption provisions are made effective in bankruptcy through an opt-out. The court could "find no distinction, relevant to the delegation argument, between the 1898 Act and the Code." *Id.*

The Code does not simply recognize state law in the area of exemptions as the Act did, however. To the contrary, under the Code a state's power to make state exemptions operate in bankruptcy comes from the Code itself and not from preexisting state power; without the opt-out authorization, there would be no state power to control exemptions in bankruptcy at all. While it is not without doubt, opting out seems more realistically to be a state exercise of federally granted power under the Code rather than an exercise of preexisting state power to enact state bankruptcy laws. The extreme detail of the Code and the narrow scope given to state exemptions operating in bankruptcy, *see supra* text accompanying notes 143-60, reinforce the impression.

If the opt-out provision is, in fact, a delegation of federal power, with that delegation must come standards for its exercise. *Schechter Poultry Corp. v. United States*, 295 U.S. 495 (1935). Incorporating fresh start standards into the exercise of a state's opt-out power gives the opt-out provision a constitutional interpretation consistent with a view of the role of exemptions expressed by both houses of Congress prior to the opt-out compromise. *See generally* Note, *Determining the Constitutionality of the Bankruptcy Code "Opt Out" Provisions: A Critical Look at In re Sullivan*, 15 IND. L. REV. 849 (1982).

In any event, there are, as discussed in the text, a variety of other reasons supporting a state's considering the bankruptcy fresh start in developing exemptions for use within the Bankruptcy Code whether or not that focus is required by federal law.

244. One such challenge based on the failure of some states to consider the Code's expanded property of the estate occurred to the *Rhodes* court: "If, for example, states fail to provide exemptions for such property as tort claims and alimony they would effectively deny to debtors with significant rights to such property interests the filing of a bankruptcy petition as a means of dealing with their debts." 14 Bankr. 629, 633 (Bankr. M.D. Tenn. 1981).

245. If revitalization can be partly measured by a debtor's staying clear of a second bankruptcy, the Brookings Study data are impressive: No more than 22% of all debtors in any bankruptcy proceedings had prior insolvency proceedings experience. D. STANLEY & M. GIRTH, *BANKRUPTCY: PROBLEM, PROCESS, REFORM* 58-59 (1971).

246. Stanley and Girth reported that some 43% of the personal bankrupts they interviewed listed threats of legal action as the immediate cause of their seeking bankruptcy relief. *Id.* at 47. Actual legal action constituted the immediate cause for another 18%, and 15% said they went bankrupt "to avoid paying debts." *Id.* at 48.

It appears that there is an incentive toward bankruptcy because bankruptcy offers significant debtor relief that is generally unavailable under state law. A state wishing to decrease its bankruptcy rate might consider

productivity or increased demands on the public assistance system result from the loss of revitalization potential—and these are questions for economic analysis—the expense may be borne by all state citizens.²⁴⁷

The Code has left us at a point of departure for further analysis and empirical study. The relationship between exemptions and the bankruptcy fresh start, the economic impact on a state of particular types and quantities of exemptions for use in bankruptcy, and indeed, whether the fresh start is useful at all either in generating specific exemption provisions or in effecting a revitalization of debtors following bankruptcy are areas about which very little is known. The Code's opt-out provision and the recent crystallization of the fresh start policy have combined to offer a unique opportunity for local experimentation, which can supply data to help answer some of these questions. The bulk of current opt-out legislation has not made use of the opportunity.

A first and necessary step is wider recognition that the past operation of state law in bankruptcy cannot be recreated by the simple device of an opt-out and that the operation and objectives of the bankruptcy and nonbankruptcy systems have changed sufficiently in the last fifty years to be considered separately for policymaking purposes. These constraints on creativity removed, the promise of innovative local legislation to advance articulated federal objectives in the best spirit of federalism seems more possible.

V. CONCLUSION

A survey of the opt-out states suggests that the simple insertion of state exemptions into the Code effected by most opt-outs has created and will create difficult problems of interpretation and costs to the bankruptcy system. Those problems are due largely to an expansion of the bankruptcy estate to include interests in property that creditors cannot reach under state law and that therefore are not found within a state's exemption statutes. Beyond that, the opt-out pattern suggests a prevailing notion that exemptions should or must be the same in both systems. There seem to be no persuasive reasons to support that idea. Considering the systems separately and designing exemp-

increasing available debtor protection under state law. This would, by hypothesis, reduce the relative attractiveness of bankruptcy and might lower the bankruptcy rate. Indeed, the Brookings Study suggests that a state can have a real impact on its own bankruptcy rate by increasing debtor protection. The researchers found that relatively high bankruptcy rates were related to relatively low exemptions of wages from creditor garnishment, and vice versa. *Id.* at 236-41. *Cf.* Schuchman & Jantscher, *Effects of Federal Exemption from Wage Garnishment on Nonbusiness Bankruptcy Rates*, 77 *COM. L.J.* 360 (1972).

247. The distributional aspects of this analysis are relevant to the further question, "Who should bear the expenses associated with the bankruptcy fresh start?" To the extent the fresh start is advanced by exemption provisions, creditors and their customers pay for the benefits that are more widely distributed; to the extent that inadequate exemptions impair the fresh start, creditors and their customers benefit from larger property distributions while a wider population suffers from lower productivity and higher demands for public assistance. That creditors profit from debt creation might justify their financing debtor revitalization. On the other hand, because the public in general theoretically benefits *supra* from fresh starts, perhaps the cost of producing such benefits should be publicly financed. *Cf.* Kennedy, *supra* note 17, at 449.

tions to suit the different needs of the two systems offer a potentially closer relationship between policy concerns and legislation, an opportunity for new thinking in the area, and a better chance at legislation suited to the needs of modern creditors and debtors.