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## Bankruptcy--Loss of Exemptions in Bankruptcy--the Section 6 Proviso

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gence, even though the defendant, by virtue of the fifth amendment, conceals facts essential to that defense. To deny affirmative relief in one situation and grant what amounts to affirmative relief in the other is arguably inconsistent.

If the defendant in a civil suit is allowed to assert both his privilege against self-incrimination and an affirmative defense, he has a decided advantage. The party bringing the action must submit to being fully deposed, but will be effectively denied the right to take the defendant's deposition, and will thereby be deprived of a prime opportunity to obtain admissions and impeachable statements. Furthermore, the plaintiff must face the perils of cross-examination at trial, while the defendant sits comfortably behind the fifth amendment.

The *Pulliam* court acknowledged that ". . . in some situations the ruling . . . will present hardships to other litigants."<sup>32</sup> Such hardships would be greatly reduced if the court would apply consistent reasoning and bar affirmative defenses as well as direct affirmative relief when a party utilizes the fifth amendment shield.

JOEL WILSON

## BANKRUPTCY— LOSS OF EXEMPTIONS IN BANKRUPTCY— THE SECTION 6 PROVISIO

*In re Myers*<sup>1</sup>

Ten days before filing a voluntary petition in bankruptcy, the bankrupt conveyed title to residential property, which she had held as sole owner, to her husband and herself as tenants by the entirety. The trustee in bankruptcy filed a petition to take possession and control of the property on the ground that the conveyance was fraudulent under section 67d of the Bankruptcy Act.<sup>2</sup> After a hearing, the referee found that the transfer was made without fair consideration, at a time when the bankrupt was insolvent, and with actual intent to defraud creditors, in violation of sections 67d(2)(a) and 67d(2)(d) of the Bankruptcy Act.<sup>3</sup> He ordered the

32. 514 S.W.2d at 561.

1. 383 F. Supp. 251 (W.D. Mo. 1973).

2. 11 U.S.C. § 107d (1970).

3. Sections 67d (2) (a) and (2) (d) provide that:

Every transfer made and every obligation incurred by a debtor within one year prior to the filing of a petition initiating a proceeding under this Act by or against him is fraudulent (a) as to creditors existing at the time of such transfer or obligation, if made or incurred without fair consideration by a debtor who is or will be thereby rendered insolvent, without regard to his actual intent; or . . . (d) as to then existing and future creditors, if made or incurred with actual intent as distinguished from intent presumed in law, to hinder, delay, or defraud either existing or future creditors.

conveyance set aside and possession of the premises given up for sale by the trustee. The bankrupt objected to the referee's order alleging that it made no provision for her homestead exemption as provided by section 513.475, RSMo 1969.<sup>4</sup> The referee rejected this claim on the ground that the proviso to section 6 of the Bankruptcy Act<sup>5</sup> specifically provides that the bankrupt cannot claim an exemption in property recovered by the trustee. Pursuant to section 39c of the Bankruptcy Act,<sup>6</sup> bankrupt sought review of the referee's order disallowing the homestead exemption. On review, the district court upheld the referee's order.<sup>7</sup>

Section 6 of the Bankruptcy Act provides:

This title shall not affect allowance to bankrupts of the exemptions which are prescribed by the laws of the United States or by the State laws in force at the time of the filing of the petition in the State wherein they have had their domicile. . . .<sup>8</sup>

It is well-established that this language "makes the state laws . . . the measure of the right to exemptions"<sup>9</sup> allowed a bankrupt. This means that the variety of exemptions allowed by state law are to be recognized in bankruptcy, as well as the construction state courts have given the exemption laws.<sup>10</sup> State law, however, is not always the only consideration, because "even if the state law permits the exemption, it also must be one allowable under federal law."<sup>11</sup> The federal law which must be considered in bankruptcy is, of course, the Bankruptcy Act itself.

In 1938 Congress amended the Bankruptcy Act by passing the Chandler Act.<sup>12</sup> This Act added the following proviso to section 6:

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4. Section 513.475, RSMo 1969, provides:

The homestead of every housekeeper or head of a family, consisting of a dwelling house and appurtenances, and the land used in connection therewith, not exceeding the amount in value herein limited, which is or shall be used by such housekeeper or head of a family as such homestead, shall, together with the rents, issues and products thereof, be exempt from attachment and execution, except as herein provided; such homestead in the country shall not include more than one hundred and sixty acres of land, or exceed the total value of fifteen hundred dollars; and in cities having a population of forty thousand or more, such homestead shall not include more than eighteen square rods of ground, or exceed the total value of three thousand dollars; and in cities having a population of ten thousand and less than forty thousand, such homestead shall not include more than thirty square rods of ground, or exceed the total value of fifteen hundred dollars; and in cities and incorporated townships and villages having a population of less than ten thousand, such homestead shall not include more than five acres of ground, or exceed the total value of fifteen hundred dollars.

5. 11 U.S.C. § 24 (1970).

6. 11 U.S.C. § 67c (1970).

7. 383 F. Supp. at 262.

8. 11 U.S.C. § 24 (1970).

9. *White v. Stump*, 266 U.S. 310, 312 (1924).

10. See *Phillips v. C. Palomo & Sons*, 270 F.2d 791, 793 (5th Cir. 1959). See generally 1A COLLIER ON BANKRUPTCY, ¶ 6.03 [3] at 798-803 (14th ed. 1975).

11. *In re Hygrade Envelope Corp.*, 272 F. Supp. 451, 455 (E.D.N.Y. 1967), *rev'd on other grounds*, 393 F.2d 60 (2d Cir. 1968).

12. Act of June 22, 1938, c. 575. 52 Stat. 847, 11 U.S.C. § 324 (1970).

*Provided, however,* that no such allowance shall be made out of the property which a bankrupt transferred or concealed and which is recovered or the transfer of which is avoided under this Act for the benefit of the estate, except that, where the voided transfer was made by way of security only and the property recovered is in excess of the amount secured thereby, such allowance may be made out of such excess.<sup>13</sup>

Prior to the adoption of this proviso there was a split of authority as to whether a bankrupt could claim exemptions in property that had been recovered by the trustee in bankruptcy following the bankrupt's fraudulent conveyance of the property.<sup>14</sup> "Most of the decisions had reference to the applicable state law, since the Bankruptcy Act had no express provisions on the subject."<sup>15</sup> Where such claims were made, the decisions allowing the exemptions rested on one of two bases. First, to the extent of the exemption, the conveyance was considered not to have harmed creditors.<sup>16</sup> Second, the statutory provision for the homestead exemption was deemed to be for the benefit of the bankrupt's family as well as the bankrupt; thus, to deny the exemption would be to give "creditors a profit out of the attempted fraud, at the expense of the family. . . ."<sup>17</sup> Some decisions denying the exemptions rested upon the ground that the bankrupt forfeited his exemption by his fraudulent conduct.<sup>18</sup> Others held that when the conveyance was set aside as fraudulent, title did not again vest in the bankrupt; thus, the bankrupt owned no property out of which an exemption could be claimed at the time the petition in bankruptcy was filed.<sup>19</sup>

Congress enacted the proviso to section 6 in an effort to resolve this conflict.<sup>20</sup> Judges,<sup>21</sup> commentators,<sup>22</sup> and treatises<sup>23</sup> all seem to agree that

13. 11 U.S.C. § 24 (1970).

14. 1A COLLIER ON BANKRUPTCY ¶ 6.11[4], 856-57 (14th ed. 1975); 161 A.L.R. 1009, 1018-1019 (1946).

15. 1A COLLIER ON BANKRUPTCY ¶ 6.11[4], 856-57 (14th ed. 1975).

16. See, e.g., *In re Thompson*, 140 F. 257 (D.C. Wash. 1905). This is the view taken by Missouri courts. See cases cited note 36 *infra*.

17. See, e.g., *Cox v. Wilder*, 6 Fed. Cas. 684 (No. 3,308) (C.C. Mo. 1872).

18. See, e.g., *In re Hupp*, 43 F.2d 159 (S.D. Cal. 1930); *In re Coddington*, 126 F. 891 (M.D. Pa. 1904).

19. See, e.g., *In re Heeg*, 22 Am. Bankr. R. 120 (D.C. Ref. Wisc. 1932).

20. In the proviso added to [section 6] no allowance shall be made for exemptions out of property which is recovered after a preference or fraudulent transfer. The decisions are conflicting and it is considered that the law should be made clear that a bankrupt should not profit at the expense of the creditors from the efforts of the trustee in undoing the bankrupt's own acts.

H.R. REP. NO. 1409, 75th Cong., 1st Sess. 9 (1937).

21. See, e.g., *In re Grisanti*, 58 F. Supp. 646 (W.D. Ky. 1945):

[I]t was the intention of Congress in enacting this proviso in the 1938 Act to clear up this conflict by making the matter uniform throughout the country and not to permit an allowance to be made out of property which is recovered after a preference or fraudulent transfer.

*Id.* at 647. *Accord, In re Rogers*, 45 F. Supp. 297, 299 (E.D.N.Y. 1942).

22. [I]t would seem that a bankrupt may not claim a homestead in property fraudulently conveyed, transferred by way of preference, or concealed from the trustee and creditors in the bankruptcy proceedings.

this proviso effectively eliminates a bankrupt's right to claim exemptions in property once it has been recovered by the trustee after having been fraudulently conveyed by the bankrupt. In *Myers* the referee found the conveyance of the bankrupt's homestead to be fraudulent. The bankrupt did not seek review of this finding.<sup>24</sup> The referee set aside the conveyance and correctly denied the bankrupt's claim to a homestead exemption under the proviso to section 6.

Section 70c of the Bankruptcy Act allows the trustee to assume the position of a creditor who possesses a lien on the property of the bankrupt.<sup>25</sup> Thus, where state law dictates that an exemption cannot be claimed against a creditor who has levied on property of the debtor, it also cannot be claimed against the trustee, who represents all creditors in a bankruptcy proceeding.<sup>26</sup> Bankrupts have lost their homestead exemption, for example, by failing to perfect the exemption with a filing required under local law declaring their residence a homestead.<sup>27</sup> Such a result would not occur where no filing is required to perfect a homestead or other exemption.<sup>28</sup>

In Missouri, the homestead exemption is automatically perfected against all causes of action which mature after the filing of the deed vesting title in the debtor.<sup>29</sup> To establish a homestead in Missouri the debtor is merely required to own and occupy the residence as a homestead.<sup>30</sup> Failure to continue to meet the requirements of ownership and occupancy may be deemed a waiver or abandonment of the homestead exemption. What constitutes an abandonment depends upon the facts of each case.<sup>31</sup> For

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Haskins, *Homestead Exemptions*, 63 HARV. L. REV. 1289, 1318 (1950).

23. Under the terms of the Act of 1938, the conflict has been stilled. . . . It is clear, therefore, that wherever the trustee recovers property transferred or concealed by the bankrupt, or where any transfer can be avoided under the terms of the Act, the bankrupt will not be allowed to amend his schedules and claim exemptions out of that particular property, save in the situation within the "except" clause.

1A COLLIER ON BANKRUPTCY ¶ 6.11[4], 857 (14th ed. 1975).

24. The referee's finding that the conveyance was fraudulent and may be set aside in toto, even though a portion of the property may have been exempt, was undoubtedly correct under sections 67d(2)(a) and 67d(2)(d) of the Bankruptcy Act. See Haskins, *Homestead Exemptions*, 63 HARV. L. REV. 1289, 1318 (1950):

[I]f both the homestead and nonexempt property are fraudulently conveyed in one parcel, or if an *excessive homestead* or one reachable by some creditors is fraudulently conveyed, the trustee may set aside the transfer and the bankrupt can not claim a homestead exemption. (Emphasis added).

See also 4 COLLIER ON BANKRUPTCY ¶ 67.30, 490 (14th ed. 1975).

25. 11 U.S.C. § 110(c) (1970).

26. *Meyers v. Matley*, 318 U.S. 622 (1943); *White v. Stump*, 266 U.S. 310 (1924).

27. See 1A COLLIER ON BANKRUPTCY ¶ 6.15, 877 (14th ed. 1975).

28. See, e.g., *In re Trammell*, 5 F.2d 326 (N.D. Ga. 1925).

29. *Dent v. Dent*, 350 Mo. 560, 568, 166 S.W.2d 582, 586 (1942); *Palmer v. Omer*, 316 Mo. 1188, 1194, 295 S.W. 123, 125 (1927).

30. *Rouse v. Caton*, 168 Mo. 288, 296, 67 S.W. 578, 579 (1902).

31. *New Madrid Banking Co. v. Brown*, 165 Mo. 32, 37, 65 S.W. 297, 299 (1901).

example, although a lease of property which was a homestead may constitute abandonment, it has been held that temporarily renting the homestead does not.<sup>32</sup> A valid conveyance by a debtor of his homestead clearly constitutes an abandonment of the claim to the exemption.<sup>33</sup>

A conveyance which consists only of exempt property cannot be set aside in a Missouri state court as a fraud against creditors, even though made without consideration and with intent to defraud creditors. This is because creditors could not have reached the property even if the conveyance had not been made.<sup>34</sup> Where a transfer is made of property which includes exempt homestead property, but is in excess of the exemption allowed with respect to acreage or value,<sup>35</sup> the conveyance may be set aside as fraudulent. The debtor, however, may still claim his homestead exemption out of the property conveyed on the theory that, to the extent of the exemption, the conveyance was not fraudulent.<sup>36</sup> Simply stated, the law of Missouri is that the conveyance of a homestead is fraudulent only to the extent that the value of the property conveyed exceeds the exemptions which could have been claimed therein had it not been conveyed. Therefore, such a conveyance does not destroy the exemption.

Were state law the only factor to be considered, then, the bankrupt in *Myers* would not have lost her homestead exemption by her conveyance of the homestead property, even though the property conveyed may have been in excess of the exemption and in fraud of her creditors. Where exemptions are claimed in a bankruptcy proceeding, however, state law is preempted by the Bankruptcy Act. "Once bankruptcy has intervened, the time manner and conditions under which such exemption may be claimed as against the trustee are matters of federal law, and are determined by the Bankruptcy Act."<sup>37</sup> In *Myers* the proviso to section 6 preempted Missouri law to deny the bankrupt her exemption.

32. *Spratt v. Early*, 169 Mo. 357, 369, 69 S.W. 13, 17 (1902).

33. *Mercantile Bank v. Becker*, 43 S.W.2d 862, 863 (1931).

34. This proposition is accepted by both state courts and bankruptcy courts. See *Phillips v. C. Palomo & Sons*, 270 F.2d 791 (5th Cir. 1959); *Kilgo v. United Distributors*, 223 F.2d 167 (5th Cir. 1955); *Beall v. Pinckney*, 150 F.2d 467 (5th Cir. 1945); *Bostian v. Jones*, 244 S.W.2d 1 (Mo. 1951); *Moberly v. Watson*, 340 Mo. 820, 102 S.W.2d 886 (1937); *May v. Gibler*, 319 Mo. 672, 4 S.W.2d 769 (1928); *Armor v. Lewis*, 252 Mo. 568, 161 S.W. 251 (1913); *Seilert v. McAnally*, 223 Mo. 505, 122 S.W. 1064 (1909); *Reed Bros. v. Nicholson*, 189 Mo. 396, 88 S.W. 71 (1905); *Stam v. Smith*, 183 Mo. 464, 81 S.W. 1217 (1904); *Spratt v. Easley*, 169 Mo. 357, 69 S.W. 13 (1902); *Rose v. Smith*, 167 Mo. 81, 66 S.W. 940 (1901); *Bartels v. Kinninger*, 144 Mo. 370, 46 S.W. 163 (1898); *Hart v. Leete*, 104 Mo. 315, 15 S.W. 976 (1891); *Davis v. Land*, 88 Mo. 436 (1885); *State v. Diving*, 66 Mo. 375 (1877).

35. See statute quoted note 4 *supra*.

36. See *Bank of New Cambria v. Briggs*, 361 Mo. 723, 236 S.W.2d 289 (1951), where, in a suit by a levying judgment creditor, it was held that a conveyance of homestead property by an insolvent debtor was fraudulent only to the extent that the property's value exceeded the exemption. See also *Moberly v. Watson*, 340 Mo. 820, 102 S.W.2d 886 (1937); *May v. Gibler*, 319 Mo. 672, 4 S.W.2d 769 (1928); *Reed Bros. v. Nicholson*, 189 Mo. 396, 88 S.W. 71 (1905).

37. *Gardner v. Johnson*, 195 F.2d 717, 719 (9th Cir. 1952). The court in

The Missouri practitioner should be mindful of the differences between ordinary debtor-creditor cases and those involving bankruptcy. Where the debtor seeks an exemption in property, the fraudulent conveyance of which has been set aside by a levying creditor, the debtor will generally be allowed the exemption. Where bankruptcy is involved, however, the proviso to section 6 will apply and the exemption will be denied. The only exceptions to the application of the proviso appear to be where the trustee has set aside a general assignment for the benefit of the bankrupt's creditors<sup>38</sup> and where the transfer that was set aside was made by way of security within the "except" clause to the proviso.<sup>39</sup>

Counsel for an insolvent client should advise against conveying or concealing property out of which exemptions may be claimed, in order to avoid the proviso's application. If a fraudulent conveyance of homestead property has already been made, as was the case in *Myers*, the debtor should attempt to have the conveyance rescinded prior to any action by the trustee to recover the property. If this is done, it may be argued that the proviso applies only if there has been a recovery of property under the Bankruptcy Act, and that a voluntary recovery by the bankrupt is not such a recovery.

BRUCE H. BECKETT

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*Gardner* denied a claimed exemption out of property recovered by the trustee under the proviso to section 6 of the Bankruptcy Act, holding that setting aside a fraudulent conveyance did not revert title in the bankrupt so as to allow him to claim an exemption out of the property so recovered, and that even if title did return to the bankrupt, the proviso would bar an amendment of his schedules of property and exemptions claimed. For other cases concerning the application of the proviso, see *In re Smith*, 366 F. Supp. 1213 (D.C. Idaho 1973) (the proviso has no application where the conveyance of bankrupt's homestead was by deed of trust for security purposes); *In re Sherk*, 108 F. Supp. 138 (N.D. Ohio 1952) (where trustee recovered money settlements from transferees of the bankrupt in lieu of setting aside the transfers as fraudulent, the bankrupt was denied an exemption out of those settlements); *In re Grisanti*, 58 F. Supp. 646 (W.D. Ky. 1945) (where a creditor was denied status as a secured creditor because the encumbrance given him by the bankrupt was fraudulent, the bankrupt's claimed homestead exemption in the encumbered property was denied); *In re Rogers*, 45 F. Supp. 297 (E.D.N.Y. 1942) (bankrupt could not claim exemptions out of the cash surrender value of a life insurance policy he owned which he had attempted to conceal from the trustee in bankruptcy).

38. *In re Knapp*, 319 F. Supp. 1070 (S.D. Ill. 1970); 1A COLLIER ON BANKRUPTCY ¶ 6.11[6], 860-63 (14th ed. 1975).

39. 1A COLLIER ON BANKRUPTCY ¶ 6.11[4], 857 (14th ed. 1975).