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An Analysis of Kentucky's New Exemption Law

By JOE LEE*

Kentucky's new exemption law,¹ which became effective June 16, 1966, exempts from execution one motor vehicle, without regard to value. But in their zeal to assure distressed debtors adequate transportation to and from their places of employment, our legislators failed to carry forward from the old law the exemption for such basic necessities as food and clothing.²

The purpose of this article is both to compare the new exemption statute with the old law and to indicate whether the new law improved the distressed debtor's legal environment. Before discussing the exemption laws in relation to the debtor's legal environment, it seems appropriate to compare the old and the new laws in detail as to who may claim exemptions, what property is exempt, and how exemptions are claimed.

I. OLD AND NEW LAWS COMPARED

A. Persons Entitled to Claim Exemptions

The new law affords the same personal property and wage exemption to a single person without dependents as to a person with a family or the head of a household.³ This differs from the old law which did not allow a personal property or wage exemption for an unmarried person without dependents.⁴ The new law authorizes a personal property and wage exemption for "a person

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¹ KY. REV. STAT. § 427.010 (1966). [Hereinafter cited as KRS].

² Ky. Acts 1891-93, ch. 219, art. XV, § 1.

³ KRS § 427.010(1) (1966).

⁴ Ky. Acts 1891-93, ch. 219, art. XV, § 1; Ky. Acts 1910, ch. 120, § 1, at 341. Under the Act of 1893 wages not to exceed fifty dollars were exempt. The Amendment of 1910 increased the exemption to sixty-seven dollars and fifty cents and limited the wage exemption to persons with a family resident in Kentucky. Thus single persons without dependents and nonresidents were not entitled to either a personal property or wage exemption.

or person with a family or head of household resident in this state. . . ."⁵ The old law provided such exemptions only for a "person with a family resident in this state."⁶ In view of the extension of exemptions to any "person . . . resident in this state," the words "person with a family or head of household" may be superfluous.

One question certain to arise is whether a nonresident employed in this state is entitled to an exemption of any portion of his wages which are subjected to garnishment or attachment. A nonresident may be sued in any county in which he can be served with process.⁷ Ordinarily, this is the same county in which his employer, the garnishee defendant, does business. Therefore, if the complaint alleges nonresidency of the defendant as a bar to the exemption, the complainant may demand remission to the court of all the debtor's wages, subject to a determination that he is entitled to any exemption. This practice would defeat the automatic exemption provided by the new law,⁸ since it requires the defendant to answer and plead residency in order to establish his right to an exemption.

The Act of 1893 limited the personal property exemption to a person with a family resident in the Commonwealth, but extended the wage exemption to all persons who worked for wages, without regard to residency.⁹ This appears to be a more farsighted policy than the present law. Not until 1910 was the Act amended to limit the wage exemption to residents.¹⁰ In view of the number of nonresidents employed in the state, a return to the policy of the earlier Act seems desirable. A nonresident should be accorded the same wage exemption as a resident.

B. Property Exempt

1. *Wearing Apparel.*—The old law exempted all wearing apparel, including valuable items of jewelry and mink coats, so long as it was held for personal adornment rather than investment.¹¹ Also exempt was all the spun yarn and cloth manufactured by the

⁵ KRS § 427.010(1) (1966).

⁶ Ky. Acts 1891-93, ch. 219, art. XV, § 1; Ky. Acts 1910, ch. 120, § 1 at 341.

⁷ KRS § 425.135 (1952).

⁸ KRS § 425.210 (1966).

⁹ Ky. Acts 1891-93, ch. 219, art. XV, § 1.

¹⁰ *Ibid.*; Ky. Acts 1910, ch. 120, § 1 at 341.

¹¹ Ky. Acts 1891-93, *Id.*; *In re* Leech, 171 Fed. 622 (6th Cir. 1909).

family and necessary for its use.¹² Further, there was no monetary limitation on this exemption.¹³ In comparison, the new law does not provide any exemption for wearing apparel. As a result of this apparent oversight on the part of the General Assembly, militant creditors and trustees in bankruptcy may find a new source of recovery in jewelry, mink coats, and perhaps even in wigs, which are now so much in vogue.

2. *Foodstuff*.—The old law exempted provisions, including breadstuff and animal products, necessary to sustain the family for one year, and provender for livestock not to exceed seventy dollars in value.¹⁴ The new law does not exempt foodstuff. The failure to exempt food is not entirely frightening in this day of the air-conditioned supermarket, since today food is usually consumed the same week it is purchased. Nevertheless, many families have deep freezes, well-stocked with frozen meats and dinners. It seems anomalous that the deep freeze is exempt as a household furnishing, whereas the frozen foods therein are not. Although it will not affect everyone, the Legislature's failure to provide an exemption for foodstuff and provender may have serious consequences for farmers, since they often lay up stores for the family and farm animals.

3. *Farm Tools, Equipment, and Livestock*.—The old law specifically enumerated the exempt farm tools and equipment as two plows and gear; one wagon, cart or dray and gear; two axes, three hoes, one spade, one shovel, two saddles and their appurtenances, and two bridles.¹⁵ Further, the livestock provision specified that two work beasts, or one work beast and one yoke of oxen, two cows and calves, poultry on hand, not to exceed one hundred dollars in value, and ten head of sheep, not to exceed twenty-five dollars in value, would be exempt.¹⁶ The new law rejects this specificity approach and exempts tools, equipment and livestock, including poultry, of a person engaged in farming, not exceeding fifteen hundred dollars in value.¹⁷ It also permits the debtor to select the items to be retained, so long as their total value does

¹² Ky. Acts 1891-93, *Id.*

¹³ *In re Leech*, 171 Fed. 622 (6th Cir. 1909).

¹⁴ Ky. Acts 1891-93, ch. 219, art. XV, § 1.

¹⁵ *Ibid.*

¹⁶ *Ibid.*

¹⁷ *Ibid.*

not exceed the allowable exemption.¹⁸ This new blanket-exemption approach should prove less cumbersome to administer. However, the overall monetary exemption appears unrealistically low in view of the present cost of farm machinery. For example, the price of a tractor with necessary attachments exceeds the total allowable exemption.¹⁹

4. *Household Furnishings.*—The old law enumerated with specificity such exempt items of furniture as:

beds, bedding and furniture sufficient for family use; one loom and spinning wheel and pair of cards; books not to exceed seventy-five dollars in value; six chairs, or so many as do not exceed ten dollars in value; one cradle; washing apparatus, not to exceed seventy-five dollars in value; one sewing machine; all family portraits and pictures; one cooking stove and appurtenances and cooking utensils, not to exceed twenty-five dollars in value.²⁰

The new law simply provides an exemption for "all household furnishings," not to exceed fifteen-hundred dollars in value, and allows the debtor to select which items of property he chooses to retain.²¹

The descriptive phraseology "household furnishings" is sufficiently broad to include such modern household appliances as air conditioners, deep freezes, stereos, and color television sets. However, there are many items of personal property, commonly kept in or about the home, which are not ordinarily thought of as household furnishings. These include such familiar items as bowling balls, golf clubs, fishing tackle, camping equipment, power lawn mowers, ham radio equipment, and school children's band instruments. Another issue is whether books which were specifically exempt under the old law²² now qualify for exemption as household furnishings. Consequently, the terminology "household furnishings" may not assure exemption of all items of intimate personal property which the General Assembly probably intended to include.

¹⁸ KRS § 427.020 (1966).

¹⁹ The price of a medium size tractor is \$3100, as quoted by local dealers.

²⁰ Ky. Acts 1891-93, ch. 219, art. XV, § 1.

²¹ KRS §§ 427.010, .020 (1966).

²² Ky. Acts 1891-93, ch. 219, art. XV, § 1.

5. *Motor Vehicles*.—The new statute permits exemption of one motor vehicle and its necessary accessories, including one spare tire, owned by a person who farms or uses his car in his employment or in traveling to and from his place of employment.²³ There is no monetary limitation on the value of a vehicle which may be claimed exempt. If a debtor owns more than one vehicle, presumably he will be entitled to select the vehicle to retain.²⁴ Motor vehicles were not exempt under the old law.²⁵

The statute also authorizes exemption of one service vehicle of a mechanic, electrician, plumber, or repairman.²⁶ In addition, the statute exempts one motor vehicle of a minister, attorney, physician, surgeon, chiropractor, veterinarian, or dentist.²⁷ This specific exemption of a motor vehicle for professional persons may be redundant, since they would ordinarily be within the class which uses a vehicle in their employment or in traveling to and from their place of employment.²⁸ The specific exemption of the service vehicle of a mechanic or repairman and of one motor vehicle of a person engaged in the practice of a profession is in lieu of the old law's exemption of one work beast.²⁹ The motor vehicle is the modern counterpart of the work beast.

It may be possible for two motor vehicles to be exempted. For example, if a husband and wife each own an automobile and each is employed so that they use the vehicles in traveling to and from their respective places of employment, they would be entitled to have both vehicles exempt from the claims of creditors.³⁰ Also, a person engaged in business as a service repairman, plumber, or the like, might be entitled to exempt both his service vehicle and the automobile used to commute to his business.³¹

One problem which frequently arises is whether a debtor is entitled to an exemption for a mobile home or housetrailer. Neither the old nor the new law provides for such an exemption, although housetrailer havens are now rather commonplace. Possibly, the homestead exemption might be construed to include a

²³ KRS § 427.010 (1966).

²⁴ KRS § 427.020 (1966).

²⁵ *In re McEuen*, 19 F. Supp. 924 (W.D. Ky. 1937).

²⁶ KRS § 427.030 (1966).

²⁷ KRS § 427.040 (1966).

²⁸ KRS § 427.010(1) (1966).

²⁹ Ky. Acts 1891-93, ch. 219, art. XV, §§ 3, 4.

³⁰ KRS § 427.010(1) (1966).

³¹ KRS §§ 427.010(1), .030 (1966).

housetrailer permanently affixed to a plot of land. However, it seems appropriate to deal with this exemption under the subject of motor vehicles, since our state statutes generally describe them in terms broad enough to include housetrailer.³² Further, an adequately drafted exemption law should make the same provision for debtors who invest in this type of "castle" as for those who prefer the cozy subdivision home.

6. *Mechanics Tools*.—The new statute increases the monetary limitation on the exemption of a mechanic's tools from one-hundred³³ to three hundred dollars.³⁴ The new law, like the old law, permits the debtor to select which tools to retain so long as their value does not exceed the limitation.³⁵

7. *Professional Libraries, Instruments, and Furnishings*.—The new law retains the old law's exemption for the professional libraries of ministers and attorneys and the instruments of physicians and surgeons.³⁶ The monetary limitation on this exemption has been increased from five hundred to one thousand dollars. In addition, the description of exempt property has been broadened to include office furnishings. Under the new law, chiropractors, veterinarians, and dentists have been added to the list of persons entitled to the professional exemption.³⁷

8. *Wages, Salaries, and Other Income from Labor*.—The new exemption statute liberalizes considerably the exemption of income which is earned by the labor of workmen, servants, clerks, salesmen, and all others of this class whose income is in the form of wages or commissions. Under the old law, as a practical matter, the wage exemption was limited to sixty-seven and one-half dollars per month.³⁸ Although the old statute exempted all but ten per cent of salary, wages, or income earned by labor of every person earning seventy-five dollars or less per month, this ninety per cent exemption ceased to have any legal effect by the early 1900's since most workmen, as a result of inflationary pressures during

³² KRS §§ 186.010(7) (a) and (b) (1962).

³³ Ky. Acts 1891-93, ch. 219, art. XV, § 3.

³⁴ KRS § 427.030 (1966).

³⁵ KRS § 427.020 (1966); Ky. Acts 1891-93, ch. 219, art. XV, § 3.

³⁶ Ky. Acts 1891-93, *Id.* at § 4.

³⁷ KRS § 427.040 (1966).

³⁸ Ky. Acts 1891-93, ch. 219, art. XV, § 1; Ky. Acts 1910, ch. 120, § 1 at 341.

World War I, began earning more than seventy-five dollars per month.³⁹ Consequently, the old law's alternative exemption of sixty-seven and one-half dollars for any person earning in excess of seventy-five dollars per month has been the standard exemption in Kentucky for the past fifty years.⁴⁰

The new statute exempts seventy-five per cent of the net wages, salary, commissions, or income due in any pay period of every resident, when earned by labor.⁴¹ The exemption is limited to fifty per cent of net earnings, when the debt to be collected was incurred in obtaining necessities.⁴²

Since the new wage-exemption is based on net wages and determined by reference to the debtor's pay period,⁴³ it is more generous than might first appear. When the old exemption law was enacted, payroll deductions were uncommon for federal, state, and local income taxes, social security, union dues, and insurance programs. Therefore, under the old law, gross earnings within the thirty day period prior to service of garnishment could be offset against the sixty-seven and one-half dollars monthly exemption, with the result that the debtor's take home pay might be substantially less than this amount per month. Further, if the debtor earned and received more than this amount in gross wages during the first week of any month, he could be denied an exemption of any wages garnished during the remaining three weeks.⁴⁴ This hardship has been eliminated by the new law as it gauges the exemption to the debtor's pay cycle.

Procedurally, the new wage-exemption statute is advantageous to both debtor and employer. It is advantageous to the debtor since the employer is authorized to pay immediately to him the exempt portion of his wages.⁴⁵ Under the old law, the employer paid into court all accrued wages as of the date of service of garnishment. Then, the debtor, by established practice, was required to file an answer to the complaint of the attaching creditor

³⁹ Snyder, *Garnishment in Kentucky—Some Defects*, 45 Kx. L.J. 322, 329 (1956-57).

⁴⁰ Ky. Acts 1891-93, ch. 219, art. XV, § 1; Ky. Acts 1910, ch. 120, § 1 at 341.

⁴¹ KRS § 427.010(2) (1966).

⁴² *Ibid.*

⁴³ KRS § 425.210 (1966).

⁴⁴ *In re Willis Roscoe Sturgeon, Bankruptcy*, No. 64-4004, E.D. Ky., March 30, 1965, *Frazier v. Nashville Veterinary Hospital*, 139 Tenn. 440, 201 S.W. 751 (1917).

⁴⁵ KRS § 425.210 (1966).

and plead his wage exemption or forfeit it. In many instances, the debtor's failure to file a timely answer resulted in a denial of his exemption. In those instances where the debtor retained legal counsel, some portion of the wages ultimately exempt were utilized to pay the attorney's fees. The amount remaining for the debtor and his family was paltry indeed. The new law assures the debtor the full benefit of the wage-exemption by making it automatic. He no longer has to appear in court or retain legal counsel in order to obtain the exemption. The new law is less burdensome from the employer's viewpoint in that he need be concerned only with the pay period in effect at the time of garnishment.

By eliminating the multiple pay period problem, the new law has simplified the administrative burden which wage attachments place upon employers. Normally, most industrial employers pay their employees the previous week's earnings not earlier than the following Wednesday and usually a day or two later than that. This delay in payment allows the employer time to make the various computations and deductions required by federal and state laws and labor-management agreements. The old practice, which allowed sequestration of wages earned up to the day and hour of service of an attachment, required the employer to split a pay period and remit to the court all wages accrued as of the date the attachment was received. The new law subjects to the claim of a creditor who causes a garnishment or attachment to be issued only those wages due at the end of the pay period in progress when the attachment is received. Consequently, the debtor is entitled on payday, free of attachment, to any wages earned during any pay period prior to the one in which the attachment is levied.⁴⁶ In addition, at the end of a pay period in progress when an attachment is received, the employer must also release to the debtor the exempt portion of his wages and remit to the court the non-exempt portion.⁴⁷

Of course many questions remain to be answered. For example, will the "first in time, first in right" rule prevail if more than one garnishment is received in the same pay period, or must there be a pro rata distribution of the nonexempt wages among the attaching creditors? Is vacation pay, which is ordinarily accrued over

⁴⁶ 1964-1968 Ky. ATT'Y GEN. OP. 66-522 (Aug. 18, 1966).

⁴⁷ KRS § 425.210 (1966).

many pay periods, entirely exempt from the claims of creditors? These matters will have to be adjudicated before a final answer can be given.

The new law prescribes that the order of attachment must inform the employer that only net wages are being sequestered, that the employee is entitled to an exemption, and that the percentage of net income to be paid the employee and the percentage to be forwarded to the court must be specified.⁴⁸ The order of attachment must be served on the employer in triplicate; the employer must deliver one copy to the employee,⁴⁹ and he may retain a copy for his files.⁵⁰ Thus the employee will ordinarily have some notice that a portion of his wages, due at the end of the pay period in progress when the attachment was served, will not be available to him. Under the old law, the debtor frequently was unaware of attachment until he appeared to receive his pay. Moreover, he did not receive information as to who attached his wages. The new law requires the employer to certify on the third copy of the order of attachment the amount of net wages due the employee at the end of the pay period in progress at the time the order was served. The certified copy must then be returned to the court along with the required percentage of net wages.⁵¹

The employee is entitled to an exemption of seventy-five per cent of all net wages due in any pay period. However, if the debt was incurred in obtaining necessities, only fifty per cent of net earnings are exempt.⁵² Some confusion probably will occur in the administration of the law as a result of this sliding scale wage exemption and the ambiguous statutory language.

The new act provides that "if the judgment to be collected is for the furnishing of necessities and the verified complaint judgment and order of attachment so state then only fifty per cent of all earnings in any pay period shall be exempt."⁵³ Frankly, the verified complaint judgment is nonexistent. Apparently, it was intended that a comma should be inserted in the bill between the words "verified complaint" and "judgment" so the statute might properly read "verified complaint, judgment and order of attach-

⁴⁸ *Ibid.*

⁴⁹ *Ibid.*

⁵⁰ *Ibid.*

⁵¹ *Ibid.*

⁵² KRS § 427.010(2) (1966).

⁵³ *Ibid.*

ment." A better wording would be "verified complaint or judgment and order of attachment."

From the statute's present wording, one might infer that there can be no attachment before judgment. However, whether this construction of the statute can be sustained is doubtful, since it must be read in harmony with Kentucky Revised Statutes Section 425.185, which permits an attachment at or after the commencement of an action for recovery of money or property.

The requirement that the complaint be verified when the judgment is for the furnishing of necessities apparently conflicts with the Rules of Civil Procedure, which abolish the practice of verifying of complaints.⁵⁴

As originally introduced in the General Assembly, the statute defined necessities as being limited to articles of food, clothing (including shoes), medicine, medical services, drugs, rent, and public utilities.⁵⁵ This bill was passed by the House of Representatives by a vote of sixty-nine to eighteen on March 8, 1966,⁵⁶ and received by the Senate Rules Committee the next day.⁵⁷ While in that committee, the bill was amended by adding "furniture and household appliances" to the classification of necessities. The amended bill was passed by the Senate⁵⁸ and the House in March, 1966, in the final days of the legislative session.⁵⁹

The amendment adding "furniture and household appliances" to the list of necessities was unfortunate. All the items or services in this category in the original bill were consumables. Therefore, the seller or person furnishing the services could not bring an action for replevin. However, furniture and household appliances are customarily sold subject to a security interest retained by the seller. He ordinarily has a remedy by contract and at law for recovery of his property. Therefore, it is questionable whether he should be permitted to attach fifty per cent of the debtor's net wages as payments on the contract of sale. Moreover, once the seller has reclaimed his security, it is even more doubtful that the former exemption rate should prevail in a suit to recover any

⁵⁴ CLAY KY. PRACTICE 184 (1963).

⁵⁵ H.B. 291, 1966 Ky. Gen. Assembly, Reg. Sess.

⁵⁶ 7 LEGIS. REC., 1966 Ky. Gen. Assembly, Reg. Sess., No. 46 at 28 (March 19, 1966).

⁵⁷ *Ibid.*

⁵⁸ *Ibid.*

⁵⁹ *Ibid.*

deficiency balance under the sales contract. Another possibility is that the fifty per cent exemption rate might be held applicable in suits by small loan companies on notes which are secured by security agreements covering furniture and household appliances. These loans, which remain collectible over a fifteen year period,⁶⁰ should not fall in the same classification as open-account sales of consumable goods and services, the collection of which may be barred by the five year statute of limitations.⁶¹

Another issue is whether the seventy-five or fifty per cent exemption rate is applicable in a bankruptcy proceeding. In a typical noncommercial bankruptcy proceeding instituted by an employed wage earner, the debtor will owe approximately twenty creditors, at least ten of which will have claims for goods and services which are classified as necessities by the new exemption law. It has been held that the lower exemption rate applies in a bankruptcy proceeding when at least one of the claims on file is based on a judgment for necessities.⁶² On the authority of this case, it appears that the lower exemption rate will ordinarily apply in an individual bankruptcy proceeding involving an employed wage earner.

In previous Kentucky bankruptcy proceedings, wages earned subsequent to the filing of the petition in bankruptcy did not pass to the trustee. Under the new exemption law, it has been argued that the cutoff date for wages passing to the trustee is not the date the petition was filed, but the end of the pay period in effect when the petition is filed. This is because Section 70 (c) of the Bankruptcy Act⁶³ vests the trustee, as of the date of bankruptcy, with all the rights, remedies, and powers of a creditor holding a lien on property upon which a creditor of the bankrupt could have obtained a lien by legal or equitable proceedings, regardless of whether such a creditor actually exists. Since under the new law a creditor can sequester wages to the end of the pay period, may the trustee in bankruptcy recover wages earned after bankruptcy? For example, if a debtor, paid monthly, files a petition in bankruptcy on the first day of the month, is the trustee entitled to one-

⁶⁰ KRS § 413.090 (1918).

⁶¹ KRS § 413.120 (1932).

⁶² *In re French*, 250 Fed. 644 (W.D. Wash. 1918).

⁶³ Bankruptcy Act § 70(c), 11 U.S.C. 110(c) (1952).

half the wages earned in the ensuing month as assets of the estate? These questions were answered in the negative in a recent case which held that a trustee in bankruptcy is not entitled to any wages earned subsequent to bankruptcy.⁶⁴

II. THE DEBTOR'S LEGAL ENVIRONMENT

A. Waiver of Exemptions

The rule that a debtor may waive his personal property exemption in an agreement securing a loan remains unchanged.⁶⁵ As a practical matter, the exemption of personal property is rather meaningless if a debtor is permitted to convey a security interest in exempt property to secure loans made by small loan companies. It is not at all unusual for three or more of these loan companies to hold security agreements covering the same household goods. The value of this security lies not in the intrinsic value of the furniture, but in the humiliating prospect of having one's personal belongings repossessed in front of neighbors and family. Under Kentucky case law, the personal property exemption may not be waived in advance,⁶⁶ but this does not prohibit the contractual waiver of exemption in specific property.⁶⁷

The high interest rates which small loan companies are permitted to charge presumably are based on the rationalization that these companies are in the high risk, unsecured lending business. If they are actually making secured loans, the interest rates should be reduced accordingly. Apparently, repossessions of household furniture are rarely affected when debtors default on loans to small loan companies.⁶⁸ According to statistics furnished the Kentucky Department of Banking by Kentucky Finance Company, which operated forty-eight offices in Kentucky in 1964 and forty-seven

⁶⁴ *In re Fisher*, Bankruptcy, No. 35887, W.D. Ky., Nov. 10, 1966. Unreported opinion by District Judge Brooks.

⁶⁵ *Collett v. Jones & Hall*, 41 Ky. Rep. 19 (1841); *Harris v. Prather*, 8 Ky. Op. 799 (1876); *Smith v. D. Wilson & Co.*, 11 Ky. Op. 946, 947 (1883); *Margues v. Brendon*, 13 Ky. L. Rep. 636 (1892).

⁶⁶ *Moxley v. Regan*, 73 Ky. Rep. 156 (1874).

⁶⁷ *Collett v. Jones & Hall*, 41 Ky. Rep. 19 (1841), and cases cited *supra* note 65.

⁶⁸ Based on analysis of reports of suits, possessions, and sales of chattels filed with Comm'r of Ky. Dept. of Banking by small loan licenses pursuant to KRS § 288.250.

offices in 1965, this company repossessed household goods on thirty-two accounts in 1964 and 34 accounts in 1965.⁶⁹ These figures suggest that small loan companies would not be seriously hampered if their right to take mortgages on household goods was abrogated. This would allow the debtor to receive more benefit from his personal property exemption.

In order to assure the debtor the full benefit of the personal property exemption, the exemption statute should be buttressed by a companion one invalidating all mortgages, other than vendors' liens, on exempt property.

B. Garnishments

A recent study in Oregon, which has the highest percentage of bankruptcies based on population of any state, revealed that out of 12,000 garnishments issued by the District Court of Multnomah County, Portland, Oregon, ninety-eight per cent were suits by collection agencies.⁷⁰ A similar study in California, which has more bankruptcy petitions than any other state, indicated comparable findings.⁷¹

Collection agencies derive their profit from handling the "left-overs" of our credit economy. Generally, the usual collection procedures are exhausted before claims are turned over to these agencies for collection. The Kentucky Court of Appeals has recognized that collection agencies are a necessary evil.⁷² Often their militant efforts in behalf of clients precipitate bankruptcy. Thus, collection agencies sometimes operate to the detriment of other creditors whose claims are also discharged in bankruptcy.

Actually, the threat of garnishment is the most important cause of bankruptcy. A 1963 study of bankruptcy filings in Flint, Michigan, revealed that only ten per cent of the individual bankrupts had been garnished within four months filing. However, eighty per cent of the interviewed bankrupts indicated that they had been threatened with garnishment. Seventy-five per cent in-

⁶⁹ Analysis of reports of suits, possessions, and sales of chattels, and discussion, *supra* note 68.

⁷⁰ Snedecor, *Why So Many Bankruptcies in Oregon?* 40 REF. J. 78, 79 (1966).

⁷¹ Brunn, *Wage Garnishment in California: A Study and Recommendations*, 53 CALIF. L. REV. 1214, 1239 (1965).

⁷² *Mutual Bankers Corp. v. Covington Bros. & Co.*, 277 Ky. 33, 125 S.W.2d 202 (1938); see also *Rohan v. Johnson*, 156 N.W. 936 (N.D. 1916).

licated that garnishment or the threat thereof precipitated their filing.⁷³

The Michigan garnishment law, like Kentucky's limits attachment to one pay period.⁷⁴ Thus, theoretically a creditor owed a sizeable debt must use a series of garnishments (multiple garnishment) to collect. However, in Flint, Michigan, during 1963, few debtor-bankrupts were victims of multiple garnishment. Less than one per cent of those studied had been garnished more than once within six months of bankruptcy. Apparently, multiple garnishment was not a significant problem to the Flint bankrupts. Although the threat of a second garnishment could be used as leverage, interviews with the bankrupts indicated that it was rarely used.⁷⁵

Opponents of Kentucky's new exemption law argued that the high exemption rate would lead to multiple garnishments and be more burdensome to debtors than the old law. The Michigan experience indicates this argument may be without substance.

Contrary to proponents' hopes, the Michigan study also indicates that the new exemption law will not cause a significant reduction in bankruptcy filings. This is because it is the threat of garnishment rather than actual garnishment which causes the debtor to file bankruptcy. So long as the threat exists, bankruptcy filings are apt to remain high. Most debtors resort to bankruptcy, not because they cannot or will not pay their debts, but merely to avoid loss of employment, which almost inevitably results from repeated wage attachments. Actually, bankruptcy filings in the Eastern District of Kentucky have increased since enactment of the new exemption law.⁷⁶

C. Debt-Adjusters

The business of debt-adjusting or debt-pooling has grown considerably since World War II because of the increase in consumer

⁷³ Dolphin, *An Analysis of Economic and Personal Factors Leading to Consumer Bankruptcy* at 181, Bureau of Business and Economic Research, Michigan State University Graduate School of Business Administration, Occasional Paper No. 15 (1965).

⁷⁴ 23 MICH. STAT. ANN. § 27(A), at 7511.

⁷⁵ Dolphin, *An Analysis of Economic and Personal Factors Leading to Consumer Bankruptcy*, *supra* note 73, at 17.

⁷⁶ In the Eastern District of Kentucky, 843 bankruptcy cases of all types were filed in the first six months of 1966, and 891 cases were filed in the last six months of the year. The comparison shows an increase of 49 cases. The new exemption statute became effective on June 16, 1966.

credit and the need of over-burdened debtors for assistance. Generally, the debt-adjuster contracts with the debtor to act as an intermediary between the debtor and his creditors. The debtor agrees to make regular payments to the debt-pooler, who in turn promises to distribute the money on such terms as the creditors will accept, which is not necessarily pro rata. The debt-poolers' fees are comparatively high and, in reality, usually amount to stacking debt on debt. One non-participating creditor can ruin the whole arrangement by garnisheeing the debtor's wages. This would render the debtor unable to make payments to the debt-pooler. Once the arrangement proves unworkable, the debtor ends up owing the debt-pooler for his services in addition to all the original debts.

Unfortunately, there is no assurance the debt-pooler has any more business acumen than the debtor, and in fact, many "sharp operators" have entered the debt-adjustment business. In 1962, officials of two debt-pooling firms in Louisville were indicted on thirty-six counts of embezzlement and grand larceny. They were accused of accepting payments from debtors and appropriating the money to their own use.⁷⁷

At that time, a Louisville newspaper editorial pointed out that some debt-poolers charge their victims as much as eighty per cent, under a complicated system of hidden charges and misleading terminology. Others take their percentage "off the top," *i.e.*, they take their fee before applying any of the debtor's payments to his debts.⁷⁸ Under this practice, creditors become restless and garnishee the debtor's wages, causing a termination of the plan. This occurs about the time the debt-pooler receives his fee, thereby relieving him of any further burden of administration.

In three states, the business of debt-pooling has been outlawed as constituting the practice of law.⁷⁹ Thirteen other states have outlawed the activity under their police powers,⁸⁰ and

⁷⁷ The Louisville Times, Oct. 18, 1962, § 1, p. 1, col. 8; The Courier-Journal, Oct. 18, 1962, § 2, p. 6, col. 1; The Louisville Times, Aug. 30, 1962, § 1, p. 1, col. 6; The Louisville Times, Aug. 31, 1962, § 1, p. 1, col. 1.

⁷⁸ The Courier-Journal, Nov. 17, 1962, § 1, p. 6, col. 1.

⁷⁹ *Are Commercial Debt-Poolers Engaged in the Unauthorized Practice of Law?* 18 PERSONAL FIN. L.Q. REP. 53 (1964). (Discusses an opinion by Attorney General of Rhode Island).

⁸⁰ *Ibid.*

numerous cities have adopted ordinances on the subject.⁸¹ The Louisville Board of Alderman enacted a regulatory ordinance following the debt-pooling scandal in that city. The danger of a regulatory ordinance is that it may be misconstrued as approving debt-pooling. Former Indiana Governor Matthew Welch recognized this possibility in a message he issued in connection with his pocket veto of an act to license and regulate debt-pooling companies. He stated that there was no practical way to regulate them and that debt-pooling plainly constituted the practice of law by lay persons.⁸²

The Supreme Court has upheld the constitutionality of the Kansas Prohibitory Debt-Adjustment Act, which makes it unlawful for any person other than an attorney to engage in debt-adjusting.⁸³ In accord are the Supreme Courts of Massachusetts⁸⁴ and New Jersey.⁸⁵ In an opinion dated December 26, 1963, the Attorney General of Rhode Island concluded that the state's regulatory debt-pooling act was unconstitutional since it authorized the practice of law by persons, partnerships, associations, or corporations. The Attorney General stated that the Legislature could not authorize lay persons to practice law, since the right to regulate and control the practice of law was a prerogative of the judicial power and, under the constitution of that state, it was vested inherently and exclusively in the judiciary.⁸⁶

Kentucky's legislators need to consider the debt-pooling facet of the debate's legal environment. The instances in which debtors are forced to resort to bankruptcy are increasing in this state due to the failure of debt-pooling arrangements. These arrangements tend to prevent the debtor from receiving adequate counseling at an early stage of his financial difficulty, before his situation becomes hopeless.

⁸¹ *Baltimore Adopts Ordinance to Prohibit Debt-Management Business*, 18 PERSONAL FIN. L.Q. REP. 57 (1964).

⁸² See Veto Message, reprinted in 18 PERSONAL FIN. L. Q. REP. 59 n. 1 (1964).

⁸³ *Ferguson v. Skrupa*, 372 U.S. 726 (1963).

⁸⁴ *Home Budget Service, Inc. v. Boston Bar Assn.*, 335 Mass. 228, 139 N.E. 2d. 287 (1957).

⁸⁵ *American Budget Corp. v. Furman*, 175 A.2d 622 (N.J. 1961).

⁸⁶ *Are Commercial Debt-Poolers Engaged in the Unauthorized Practice of Law?* note 79 *supra*.

D. Bankruptcy

In fiscal year 1966, a record total of 192,354 bankruptcy cases were filed in the United States. Compared to the 180,323 cases filed during fiscal 1965, the 1966 total was an increase of 12,031 cases, or 6.7 per cent.⁸⁷ This was the fourteenth consecutive year in which the number of cases filed exceeded the total for the previous year. Actually, bankruptcies have increased every year since 1948, except for 1952, when there was less than a one per cent decrease, attributable to the effect of the Korean war on our economy.⁸⁸ The rate of increase per year has been erratic. It has ranged from a low of four and one-half per cent in 1956 to a high of thirty-three and one-third per cent in 1961, with a simple average annual increase in filing of over fourteen per cent.⁸⁹ The rate of increase in nonbusiness bankruptcies in Kentucky for the past ten years—from 1038 cases in fiscal 1956 to 4256 cases in fiscal 1966—is typical of the national trend.⁹⁰

As one author has pointed out, the rise in bankruptcies since 1945 has been at approximately the same rate as the rise in consumer credit. Figures for intermediate and short-term consumer credit obtained from the Board of Governors of the Federal Reserve System reveal that consumer credit increased from \$5.6 billions in 1945 to \$62.3 billions in March 1963, an increase of eleven times. Bankruptcies totaled 12,862 in 1945, contrasted with 155,493 in 1963, a twelve-fold increase.⁹¹

The national population figures show that bankruptcies are rising faster than the population. The number of people in the United States rose from 132 million in 1940 to 189 million in 1963. This represents an increase of 43% while bankruptcies increased 197% in the same period. Looking at it another way, in 1940 one out of every 2,500 persons filed bankruptcy in 1963 it was one out of every 1,200 persons.⁹²

⁸⁷ [1966] ADMIN. OFFICE U.S. CTS., ANNUAL REP. OF DIR. at V-1.

⁸⁸ [1965] ADMIN. OFFICE U.S. CTS., ANNUAL REP. OF DIR. at V-1.

⁸⁹ *Ibid.*; Bauner, *Personal Bankruptcies Trends and Characteristics* 2 (Ohio State University College of Commerce, Division of Research, Bureau of Business Research, Monograph No. 124, 1965).

⁹⁰ NAT. CONSUMER FIN. ASS'N RESEARCH SERVICE DIV., REPORT ON 1966 NONBUSINESS BANKRUPTCIES BY STATES (Oct. 6, 1966).

⁹¹ Misbach, *Personal Bankruptcy in the United States and Utah* at 12, May 1964 (unpublished Masters thesis at University of Utah College of Business).

⁹² *Ibid.*

These statistics do not present the bankruptcy picture in true focus, since filings vary considerably from state to state. For example, six states with only 26% of the United States population accounted for 52% of all bankruptcy petitions filed in 1966.⁹³ These states—California, Ohio, Illinois, Alabama, Tennessee, and Georgia—are all prosperous, industrialized states. That over one-half the bankruptcies in fiscal 1966 were filed in these six states suggests there is a definite relationship between bankruptcy filings and collection procedures available to creditors.

In states which exempt all wages from garnishment or attachment, there are very few individual bankruptcies. For example, in fiscal 1966 Texas and North Carolina had only 426 and 204⁹⁴ non-business bankruptcies respectively, while Kentucky had 4,256 cases.⁹⁵

III. CONCLUSION

Kentucky's new exemption law is deficient in failing to provide the exemptions for food and clothing which existed under the old law. The personal property exemption, while generous except with respect to farm machinery, is negated by the law which permits the debtor to mortgage exempt property. The new law should prove less burdensome to employers in responding to wage attachments. Since the wage exemption applies automatically, the law benefits the debtor by relieving him of the duty of setting up a formal claim. However, the law has not affected a significant enough change in the debtor's legal environment to stem the tide of bankruptcies. Only an exemption of all wages from attachment can substantially reduce bankruptcies.

⁹³ NAT. CONSUMER FIN. ASS'N RESEARCH DIV., *op. cit. supra* note 90.

⁹⁴ *Ibid.*

⁹⁵ *Ibid.*