1984

Lien Avoidance by Debtors in Chapter 13 of the Bankruptcy Act of 1978

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by

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I. INTRODUCTION

On October 1, 1979, the Bankruptcy Reform Act of 1978[1] [hereinafter referred to as the Code] went into effect. This new law made substantial changes in the area of bankruptcy law. One of the more controversial changes is found in section 522(f).[2] This provision enables debtors to avoid certain kinds of liens on limited types of exempt property.[3] The Bankruptcy Act of 1898[4] [hereinafter referred to as the Act] contained no similar provision. Debtors[5] under the Code have used section 522(f) to avoid liens as

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[1]Bankruptcy Reform Act of 1978, Pub L. No. 95-598, 92 Stat. 2549 (1978) [hereinafter cited as the Code].

[2]Section 522(f) states:

> Notwithstanding any waiver of exemptions, the debtor may avoid the fixing of a lien on an interest of the debtor in property to the extent that such lien impairs an exemption to which the debtor would have been entitled under subsection (b) of this section, if such lien is __ (1) a judicial lien; or (2) a nonpossessory, nonpurchase-money security interest in any __ (A) household furnishings, household goods, wearing apparel, appliances, 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.

11 U.S.C. § 522(f) (Supp. V 1981).

[3]Section 522 gives an individual debtor the right to elect between exemptions available under the state law of his domicile or the exemptions set forth in subsection (d) of section 522 itself. However, section 522 also authorizes the states to "opt out" of subsection (d)'s exemptions. By so "opting out" a state limits the debtor to those exemptions available under state law. 11 U.S.C. § 522(b) (Supp. V 1981). For a more detailed discussion of the "opt out" provision *see infra* notes 102-123 and accompanying text.

[4]Bankruptcy Act of 1898, Ch. 541, 30 Stat. 544 (1898) (repealed 1978).

[5]The term "bankrupt" is not used in the Code. Entities who file petitions under the Code are called "debtors." Thus the anomaly of no bankrupts in bankruptcy proceedings.

allowed therein in cases under chapters 7, 11, and 13.[6] However, some courts have not allowed debtors in chapter 13 cases to use section 522(f). A simple explanation of the effect and purpose of section 522(f) is as follows:

> The common sense reading of 522(f) is that a debtor may avoid a security interest in property that the debtor could exempt "if the security interest did not exist" . . . .Section 522(f) . . . creates equity equal to the amount that could be exempted if the security interest did not exist.[7]

For example, if a debtor has encumbered all of his household furnishings by the granting of a nonpossessory, nonpurchase-money security interest in connection with a thousand dollar loan, he can avoid this security interest to the extent of his allowable exemption. Under section 522(d)[8] that exemption is two hundred dollars for each particular item of furniture. Therefore the debtor will now have up to two hundred dollars in equity in each item where none previously existed due to the presence of the security interest.

This article will analyze case law dealing with the applicability of the debtor's right to avoid certain specified types of liens pursuant to section 522(f) of the Code in a chapter 13 proceeding. The Code's legislative history will also be reviewed.[9] Other topics to be included are: (1) the procedural aspects of how one goes about avoiding such a lien, with special emphasis on the time limitations thereof; and (2) the effect of a state's "opting out"[10] of the federal exemptions of section 522(d) of the Code[11] on the availability of section 522(f) to the debtor.

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[6]The Code is divided into chapters. Chapters 1, 3, and 5 are generally applicable in a case under chapter 7, 11, or 13 of the Code. Chapter 1 contains general provisions. Chapter 3 contains provisions dealing with case administration. Chapter 5 is entitled "Creditors, the Debtor, and the Estate." Chapter 7 is commonly known as the "straight bankruptcy" chapter and contains the specific provisions on liquidation cases. Chapter 11 contains the specific provisions on business reorganizations. Chapter 13 is entitled "Adjustment of Debts of an Individual With Regular Income" and is frequently referred to as the "Wage Earner" Chapter.

[7]*In re* Redin, 14 Bankr. 727, 729 (Bankr. D. Colo. 1981). This is overly simple because section 522(f) does not allow a debtor to avoid all liens on otherwise exempt property. *See supra* note 2.

[8]Section 522(d)(3) reads:

> The debtor's interest, not to exceed $200 in value in any particular item, in household goods, wearing apparel, appliances, books, animals, crops, or musical instruments, that are held primarily for the personal, family, or household use of the debtor or a dependent of the debtor.

11 U.S.C. § 522(d)(3) (Supp. V 1981).

[9]S. REP. No. 989, 95th Cong., 2d Sess., *reprinted in* 1978 U.S. CODE CONG. & AD. NEWS 5787 [hereinafter cited as S. REP. No. 989]; H.R. REP. No. 595, 95th Cong., 1st Sess., *reprinted in* 1978 U.S. CODE CONG. & AD. NEWS 5963 [hereinafter cited as H.R. REP. No. 595]; see also Klee, *Legislative History of the New Bankruptcy Law*, 28 DUKE L.J. 941 (1979).

[10]*See infra* note 102 and accompanying text; 11 U.S.C. § 522(b)(1)(Supp. V 1981); *In re* Sullivan, 680 F.2d 1131 (7th Cir. 1982) ("opt out" provision held consistent with constitutional mandate that bankruptcy laws be uniform).

[11]11 U.S.C. § 522(d) (Supp. V 1981).

II. THE PROVISIONS OF SECTION 522(f)

Section 522 is commonly referred to as the exemption section. Section 541[12] is closely related to section 522. Section 541 substantially changes the concept of what is property of the estate as provided in section 70a[13] of the Act. Under section 541(a) the filing of a bankruptcy petition creates an estate basically consisting of all legal or equitable interests of the debtor in property as of the date of filing.[14] Therefore, unlike under old section 70a,[15]

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[12]11 U.S.C. § 541 (Supp. V 1981).

[13]11 U.S.C. § 110 (1976) (repealed 1978).

[14]Section 541 provides in part:

> (a) The commencement of a case under section 301, 302, or 303 of this title creates an estate. Such estate is comprised of all the following property, wherever located: (1) . . . all legal or equitable interests of the debtor in property as of the commencement of the case.

11 U.S.C. § 541 (Supp. V 1981). *See also In re* Smith, 640 F.2d 888 (7th Cir. 1981) (wherein the court said that property of the estate includes causes of action such as claims against lenders for violations of federal and state truth-in-lending provisions); State of Missouri v. United States Bankruptcy Court for the Eastern District of Arkansas, 647 F.2d 768 (8th Cir. 1981) (the court concluded that even though the debtors' interest only consisted of possession and a minute ownership interest it fell within the broad definition of property in section 541.)

[15]11 U.S.C. § 110 (1976) (repealed 1978). This section provided in part:

> (a) The trustee of the estate of a bankrupt and his successor or successors, if any, upon his or their appointment and qualification, shall in turn be vested by operation of law with the title of the bankrupt as of the date of the filing of the petition initiating a proceeding under this title, except insofar as it is to property which is held to be exempt, to all of the following kinds of property wherever located (1) documents relating to his property; (2) interests in patents, patent rights, copyrights, and trademarks, and in applications therefor: *Provided*, That in case the trustee, within thirty days after appointment and qualification, does not notify the applicant for a patent, copyright, or trademark of his election to prosecute the application to allowance or rejection, the bankrupt may apply to the court for an order revesting him with the title thereto, which petition shall be granted unless for cause shown by the trustee the court grants further time to the trustee for making such election; and such applicant may, in any event, at any time petition the court to be revested with such title in case the trustee shall fail to prosecute such application with reasonable diligence; and the court, upon revesting the bankrupt with such title, shall direct the trustee to execute proper instruments of transfer to make the same effective in law and upon the records; (3) powers which he might have exercised for his own benefit, but not those which he might have exercised solely for some other person; (4) property transferred by him in fraud of his creditors; (5) property, including rights of action, which prior to the filing of the petition he could by any means have transferred or which might have been levied upon and sold under judicial process against him or otherwise seized, impounded, or sequestered: *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, sequestration, or other judicial process: *And provided further*, That when any bankrupt, who is a natural person, shall have any insurance policy which has a

even exempt property is included in the estate of the debtor under the Code. However, the debtor is allowed under section 522 to exempt certain property out of the estate.[16] Property so exempted is not liable during or after the bankruptcy case for any debt of the debtor which arose prior to the commencement of the case.[17] This is not true of the debtor's interest in property subject to a valid lien held by a secured creditor.[18] Some liens on exempt property which are valid outside of bankruptcy are also valid in bankruptcy. However, other liens that are valid outside of bankruptcy are subject to being invalidated as a result of bankruptcy, because the Code contains various provisions which may result in otherwise valid liens being invalidated in bankruptcy.[19] In addition to these general invalidation provisions, section 522(f) enables the debtor to avoid judicial liens on all exempt property and consensual liens arising by virtue of nonpurchase-money, nonpossessory security interests on certain household goods, tools of the trade,

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> cash surrender value payable to himself, his estate, or personal representatives, he may, within thirty days after the cash surrender value has been ascertained and stated to the trustee by the company issuing the same, pay or secure to the trustee the sum so ascertained and stated, and continue to hold, own, and carry such policy free from the claims of the creditors participating in the distribution of his estate under the bankruptcy proceedings, otherwise the policy shall pass to the trustee as assets; (6) rights of action arising upon contracts, or usury, or the unlawful taking or detention of or injury to his property; (7) contingent remainders, executory devises and limitations, rights of entry for condition broken, rights or possibilities of reverter, and like interests in real property, which were nonassignable prior to bankruptcy and which, within six months thereafter, become assignable interests or estates or give rise to powers in the bankrupt to acquire assignable interests or estates; and (8) property held by an assignee for the benefit of creditors appointed under an assignment which constituted an act of bankruptcy, which property shall, for the purposes of this title, be deemed to be held by the assignee as the agent of the bankrupt and shall be subject to the summary jurisdiction of the court.
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> All property, wherever located, except insofar as it is property which is held to be exempt, which vests in the bankrupt within six months after bankruptcy by bequest, devise or inheritance shall vest in the trustee and his successor or successors, if any, upon his or their appointment and qualification, as of the date when it vested in the bankrupt, and shall be free and discharged from any transfer made or suffered by the bankrupt after bankruptcy.
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> All property, wherever located, except insofar as it is property which is held to be exempt, in which the bankrupt has at the date of bankruptcy an estate or interest by the entirety and which within six months after bankruptcy becomes transferable in whole or in part solely by the bankrupt shall, to the extent it becomes so transferable, vest in the trustee and his successor or successors, if any, upon his or their appointment and qualification, as of the date of bankruptcy.

See also 4 COLLIER ON BANKRUPTCY ¶¶ 541.02, 541.03. (This is a comprehensive comparison between section 541 of the code and section 70a of the Act).

[16] 11 U.S.C. § 522(b) (Supp. V 1981).

[17] 11 U.S.C. § 522(c) (Supp. V 1981).

[18] 11 U.S.C. § 522(c)(2) (Supp. V 1981).

[19] 11 U.S.C. §§ 544, 545, 547, 548 (Supp. V 1981) (These provisions enable the bankruptcy trustee to avoid certain transfers including liens which would be enforceable outside of bankruptcy).

and health aids, if they are exempt property. It is important to understand that only exempt property of the type and kind specified in section 522(f) is protected by the lien avoidance provision. All other liens held by secured creditors are not affected by section 522(f). In addition, avoidable liens can only be avoided to the extent of any allowed exemption, and any excess amount of the lien remains valid.[20]

Congress intended for most creditors who extend credit to debtors on a secured basis to receive the benefits and advantages which naturally accrue to such creditors even though the borrower subsequently becomes a debtor in a bankruptcy proceeding under the Code.[21] However, Congress also recognized the fact that some creditors extending credit on a secured basis have unnecessarily and unfairly harassed debtors in order to coerce them into an unwise reaffirmation of what would otherwise have been a debt dischargeable in bankruptcy.[22] Congress' desire to put a stop to such harassment, plus its belief that bankruptcy proceedings are designed to allow such debtors a "fresh start," resulted in the adoption of section 522, particularly subsection (f).[23] Both common sense and actual experience under the Act make it clear that debtors who cannot avoid the kinds of liens avoidable under section 522(f) are subjected to creditor harassment and denied a meaningful "fresh start." The existence of this harassment has been acknowledged by spokemen for the credit industry who nevertheless have strongly criticized the power of debtors to avoid liens pursuant to section 522(f).[24]

The cases addressing the question of whether or not section 522(f) applies in chapter 13 cases are not in agreement. Section 103(a) of the Code arguably resolves this question in that it clearly states ". . . chapters 1, 3, and 5 . . . apply in . . . chapter . . . 13 . . . ."[25] However, the question is not that easily disposed because it is clear that not *all* provisions found in chapters 1, 3, and 5 apply in chapter 13 cases.[26]

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[20]3 COLLIER ¶ 522.29.

[21]11 U.S.C. § 522(c)(2) (Supp. V 1981).

[22]H.R. REP. No. 595, *supra* note 9, at 6088.

[23]*Id.*

[24]*Bankruptcy Reform Act of 1978: Hearings on S.863 Before the Subcommittee on Courts of the Senate Committee on the Judiciary*, 97th Cong., 1st Sess. 52–75 (1981) (prepared statement of Jonathan M. Landers, Professor, University of Illinois; Claude Rice, Attorney at Law; and Alvin O. Wiese, Jr., Attorney at Law).

[25]11 U.S.C. § 103(a) (Supp. V 1981).

[26]It is elementary in statutory interpretation that if two provisions conflict, the more specific will control. *See, e.g. In re* Aycock, 15 Bankr. 728, 729 (Bankr. E.D.N.C. 1981) (where it is stated "Where a specific provision of Chapter 13 conflicts with a general provision of Chapter 1, 3, or 5, the specific provision controls. . . .) *See also In re* Thornhill Way I, 636 F.2d 1151 (7th Cir. 1980).

III. CASES HOLDING SECTION 522(f) APPLICABLE TO CHAPTER 13

Baldwin v. Avco Financial Services[27] is one of the better reasoned opinions holding that section 522(f) applies to chapter 13 cases. In *Baldwin*, the creditors held nonpossessory, nonpurchase-money security interests in various household goods of the chapter 13 debtors. The debtors filed complaints[28] to avoid the liens. The creditors raised two main contentions: (1) section 522(f) directly conflicts with section 1325(a)(5)(B)(i)'s[29] requirement that a chapter 13 plan can only be confirmed if it provides for the retention of liens held by secured creditors; and (2) since chapter 13 debtors retain possession of all their property, while chapter 7 debtors surrender all nonexempt property to the trustee, it is illogical to allow chapter 13 debtors to avoid liens of any kind.

The court disagreed with the creditors' contentions and reasoned that sections 522(f) and 1325(a)(5)(B)(i) do not conflict. The court reasoned that once a lien has been avoided pursuant to section 522(f) the once secured claim becomes an unsecured claim by definition.[30] As to the creditors' second contention, the court looked to the legislative history of subsection 522(f) to find a clear congressional intent that its lien avoiding powers apply equally in chapters 7 and 13.[31] In finding that the same creditor harassment and pressures are present in chapter 13 proceedings as are present in chapter 7 proceedings, the court quoted at length from the report of the House Judiciary Committee[32] wherein such harassment and pressure were fully discussed and then stated:

> The Court perceives no reason for penalizing a Chapter 13 debtor by subjecting him to this kind of collection tactic when Congress obviously intended to alleviate this pressure. A finance company's threat of seizure of exempt property to force a reaffirmation of a debt gives a hollow

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[27]Baldwin v. Avco Financial Services, 22 Bankr. 507 (Bankr. D. Del. 1982).

[28]*See infra* notes 68–101 and accompanying text for procedures involved in avoiding liens pursuant to section 522(f).

[29]Section 1325(a)(5)(B)(i) provides:

> (5) with respect to each allowed secured claim provided for by the plan – (B)(i) the plan provides that the holder of such claim retain the lien securing such claims;

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

[30]*See In re* Walker, 11 Bankr. 43 (N.D. Ill. E.D. 1981) (Second mortgage secured only to extent that value of realty exceeds first mortgage, remainder would be unsecured claim). *In re* Collins, 24 Bankr. 77 (E.D. Mich. S.D. 1982) (in reference to debt secured by automobile the court held that creditor "would have secured claim up to the value placed on its collateral by the court, and an unsecured claim for allowable amounts in excess of the value of the collateral").

[31]Baldwin v. Avco Financial Services, 22 Bankr. 507, 509–10 (Bankr. D. Del. 1982).

[32]H.R. REP. No. 595, *supra* note 9, at 127.

ring to the "fresh start" promise of the bankruptcy laws.[33]

The court in *Baldwin* further reasoned that a finding that section 522(f) does not apply to chapter 13 proceedings would defeat the efforts of Congress to make chapter 13 the preferred proceeding over chapter 7. This Congressional intent to encourage greater use of chapter 13 is readily apparent in both the legislative history[34] and the specific provisions of the Code itself.[35] The court was also cognizant of the advantages offered to creditors by chapter 13 cases over chapter 7 cases.[36]

In re Bowles[37] also held the creditor's contention that section 1325(a)(5)(B)(i) conflicts with § 522(f) to be incorrect. The court succinctly stated: "If the lien has been successfully avoided pursuant to § 522(f), there will be no allowed secured claim, but the creditor will . . . have an allowed unsecured claim for purposes of distribution in the Chapter 13 proceeding."[38] The court also stated that the lien retention provisions of § 1325(a)(5) simply are not applicable once the lien is avoided.[39] Therefore, the two sections do not conflict.

Other courts have reached the same result.[40] One court concluded that not only are sections 522(f) and 1325(a)(5) not in conflict, but that the underlying policy of both sections is the same, to wit: to free debtors from harassment and pressure by creditors holding a security interest in property that is of no true value to anyone, including the creditor, other than the debtor.[41] Section 1325(a)(5) accomplishes this goal by dividing the claim into secured and unsecured portions, whereas section 522(f) converts the entire debt from secured to unsecured.[42] *In re Drummond*[43] reached the same result

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[33]Baldwin v. Avco Financial Services, 22 Bankr. 507, 509–10 (Bankr. D. Del. 1982).

[34]H.R. REP. No. 595, *supra* note 9, at 6080–82, 6381–82; S. REP. No. 989, *supra* note 9, at 5798–99, 5924–25.

[35]11 U.S.C. § 1301 (Supp. V 1981); 11 U.S.C. 1328(a) (Supp. V 1981). *See also* 11 U.S.C. § 727(a)(9) (Supp. V 1981) limiting a debtor's right to receive a chapter 7 discharge to once every six years. No such limitation is placed on chapter 13 debtors.

[36]Baldwin v. Avco Financial Services, 22 Bankr. 507, 510 (Bankr. D. Del. 1982).

[37]*In re* Bowles, 8 Bankr. 394 (Bankr. S.D. Ohio E.D. 1981).

[38]*Id.* at 397.

[39]*Id.*

[40]*In re* Mattson, 20 Bankr. 382 (Bankr. W.D. Wis. 1982); *In re* Hagerman, 9 Bankr. 412 (Bankr. W.D. Mo. 1981); *In re* Flynn, Case No. 3-80-02362, Adv. No. 3-80-0493 (Bankr. S.D. Ohio December 29, 1980) (on LEXIS, Bkrtcy library, Cases File); *In re* Lantz, 7 Bankr. 77 (Bankr. S.D. Ohio 1980); Transouth v. Paris, 26 Bankr. 184 (W.D. Tenn. W.D. 1982); *In re* Lincoln, 26 Bankr. 14 (Bankr. W.D. Mich. 1982); *In re* Coma, 25 Bankr. 103 (Bankr. W.D. Penn. 1982); *In re* Mitchell, 25 Bankr. 406 (Bankr. N.D. Ga. 1982); *In re* Cameron, 25 Bankr. 410 (Bankr. N.D. Ga. 1982).

[41]*In re* Hagerman, 9 Bankr. 412, 413–14 (Bankr. W.D. Mo. 1981).

[42]*Id.*

[43]*In re* Drummond, 17 Bankr. 494 (Bankr. E.D. Ark. 1981).

but for the wrong reason. The *Drummond* case is discussed here because it is a source of potential confusion. While following the result of *Hagerman*, it did so only for the "sake of uniformity of judgments."[44] Footnote 2 of *Drummond* reveals a misunderstanding of the purpose and function of section 1325(a)(5).[45] Contrary to that court's opinion, a holding that section 522(f) is applicable to chapter 13 proceedings does *not* render section 1325(a)(5)(B)(i) meaningless, redundant, or useless. Section 1325(a)(5)(B)(i) is very obviously of crucial importance to liens which are not avoidable pursuant to section 522(f), such as purchase-money security interests and all other security interests not specifically covered by section 522(f). Otherwise, even these nonavoidable liens could possibly be substantially impaired. This point is so apparent that further discussion would be, in the words of the *Drummond* court itself, meaningless, redundant, or useless.

Some cases have held that section 103 of the Code demands a finding that section 522(f) applies in chapter 13.[46] These cases fail to account for possible conflicts between specific provisions of chapter 13 and the more general provisions of chapters 1, 3 and 5.[47] Others have found the lien avoidance power of section 522(f) applicable in chapter 13 without any significant legal analysis.[48] These cases do not assist one in understanding "why" section 522(f) applies in chapter 13 proceedings.

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[44]*Id.* at 495.

[45]*Id.* at 495 n.2. The court stated:

> The reasoning in the Hagerman decision is to the effect that "[t]he constraint of Section 1325(a)(5) can be dealt with by concluding that, after lien avoidance, the creditor is not secured and there is, therefore, no 'allowed secured claim provided for by the plan.' " But this is only to beg the question of the applicability of lien avoidance in chapter 13 cases, despite the precise and explicit letter of § 1325, then subsection (a)(5)(B)(1) of § 1325 must be regarded as totally surplusage, with the whole lien avoidance matter to be controlled and determined by § 522(f) of the Code. It is a rudiment of statutory construction, however, that each provision of a statutory scheme is to be regarded as having a sensible purpose. "There is a presumption that every word, sentence, or provision was intended for some useful purpose, has some force and effect, and that some effect is to be given to each, and also that no superfluous words or provision were used. Conversely, it will not be presumed that the legislature inserted idle or meaningless, redundant, or useless." 82 C.J.S. Statutes § 316, pp. 551–552.

[46]*In re* Cohen, 13 Bankr. 350 (Bankr. E.D.N.Y. 1981); *In re* Canady, 9 Bankr. 428 (Bankr. D. Conn. 1981); *In re* Pomm, 6 Bankr. 142 (Bankr. D. Kan. 1980); *In re* Jordan, 5 Bankr. 59 (Bankr. D.N.J. 1980); *In re* Ohnstad, 1 COLLIER BANKR. CAS. 2d (MB) 494 (Bankr. D.S.D. 1980).

[47]*Supra* note 26.

[48]*In re* Hitts, 21 Bankr. 158 (Bankr. W.D. Mich. 1982); *In re* McKay, 15 Bankr. 1013 (Bankr. E.D. Pa. 1981); *In re* Graham, 15 Bankr. 1010 (Bankr. E.D. Pa. 1981); *In re* Clayborn, 11 Bankr. 117 (Bankr. E.D. Tenn. 1981); *In re* Snow, 8 Bankr. 113 (Bankr. S.D. Ohio 1980); *In re* Brahm, 7 Bankr. 253 (Bankr. S.D. Ohio 1980).

IV. CASES HOLDING SUBSECTION 522(f) INAPPLICABLE TO CHAPTER 13

One of the leading cases concluding that section 522(f) does not apply in chapter 13 is out of the Middle District of North Carolina.[49] The *Sands* court stressed that chapter 13 debtors do not claim exempt property and are not required to do so.[50] In addition to failing to directly address the real issue, this statement by the court is not entirely correct. It is generally accepted that section 1325(a)(4) makes it necessary for a debtor to file a schedule B-4 entitled "Property Claimed as Exempt"[51] so that the court can determine whether unsecured creditors are receiving at least as much as they would in chapter 7. The *Sands* court also emphasized the lack of economic benefit accruing to a chapter 13 debtor through lien avoidance.[52] Later in this article such reasoning is criticized.[53] However, the *Sands* court itself admits the invalidity of such reasoning in composition plans under chapter 13.[54] Another rationale in *Sands* is that no exemption is impaired in chapter 13 cases since the debtors in such cases retain possession of all of their property.[55]

The primary concern of the *Sands* court is found in its discussion of "the equities of avoidance" in chapter 13 cases.[56] Upon a close reading of the *Sands* case one can easily conclude that the court knows that the Code technically requires a finding that section 522(f) is applicable in chapter 13 proceedings.[57] The court seems very concerned with what it perceives as

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[49]*In re* Sands, 15 Bankr. 563 (Bankr. M.D.N.C. 1981).

[50]*Id.* at 564.

[51]*In re* Aycock, 15 Bankr. 728 (Bankr. E.D.N.C. 1981). Section 1325(a)(4) provides:

> (a) The court shall confirm a plan if – (4) the value, as of the effective date of the plan, of property to be distributed under the plan on account of each allowed unsecured claim is not less than the amount that would be paid on such claim if the estate of the debtor were liquidated under chapter 7 of this title on such date.

11 U.S.C. § 1325(a)(4) (Supp. V 1981).

[52]*In re* Sands, 15 Bankr. 563, 564–65 (Bankr. M.D.N.C. 1981).

[53]*See infra* notes 124–144 and accompanying text. *Also see In re* Lincoln, 26 Bankr. 14 (Bankr. W.D. Mich. 1982).

[54]*In re* Sands, 15 Bankr. 563, 564 (Bankr. M.D.N.C. 1981). The court stated:

> In reaching this conclusion, this Court found it necessary to study the typical plans filed in this District, the plan filed in this case, and the equities of avoidance. Consideration of the latter supports the decision in this case even though there could be a technical interpretation of the code which might support a different result.

[55]*Id.* at 565. *See infra* notes 124–144 and accompanying text for criticism of such reasoning.

[56]*In re* Sands, 15 Bankr. 563 (Bankr. M.D.N.C. 1981).

[57]*Id.* at 564. ("Consideration of the equities of avoidance supports the decision in this case even though there could be a technical interpretation of the Code which might support a different result.")

the basic unfairness of allowing lien avoidance in chapter 13. The court states its concern as follows:

> In the event of dismissal of a Chapter 13 case, a creditor's lien which is wholly or partially avoided under § 522(f) will be reinstated under 11 U.S.C. § 349(b). The affected creditor will be returned to his pre-avoidance status legally. However, dismissal of a debtor's case after 4½ years under a plan and 20% payment to unsecured creditors would be of no practical benefit to the reinstated lien creditor. Such a creditor would probably have no security at the end of such period by reason of depreciation, loss, or other disposition of the property. Fairness and equity do not support this treatment of the secured creditors, especially since there is very little benefit, if any, to the debtor by avoidance of the household goods lien. Even if an interpretation of § 522(f) does allow lien avoidance in Chapter 13 cases, it is not feasible or practical to apply this code provision to the Chapter 13 plans which have been described. Therefore, the security interest in this case should be recognized and paid through the plan according to the confirmation order and not avoided.[58]

Another case holding section 522(f) inapplicable in chapter 13 cases is *In re Aycock*.[59] The *Aycock* case also relies heavily on the assumption that a chapter 13 debtor retains possession of all his property and is not entitled to exemptions.[60] However, unlike *Sands*, *Aycock* recognizes the requirement of filing a list of exemptions even in chapter 13.[61] *Aycock* presents an additional ground for finding section 522(f) inapplicable in chapter 13. The argument that sections 522(f) and 1325(a)(5)(B) conflict was accepted in *Aycock*, wherein the court stated:

> Although section 522(f) provides that the debtor may avoid the fixing of a lien on the debtor's interest in certain property, section 1325 (a)(5)(B) conflicts by mandating that the plan contain a provision for the retention of the lien of a nonaccepting holder of a secured claim, provided for in the plan, in order for the Court to confirm the plan.[62]

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[58]*Id.* at 565. *But see infra* notes 124–144 and accompanying text for criticism of such reasoning.

[59]*In re* Aycock, 15 Bankr. 728 (Bankr. E.D.N.C. 1981).

[60]*Id.* at 730.

[61]*Id.*

[62]*Id.* Section 1325(a)(5)(B) provides:

> (a) The court shall confirm a plan if – (5) with respect to each allowed secured claim provided for by the plan – (B)(i) the plan provides that the holder of such

The case of *In re Morgan*[63] also finds section 522(f) inapplicable in chapter 13 cases. The court emphasized the policy behind exemptions in bankruptcy. It concluded these policy reasons are not needed in chapter 13. The court did admit that *Collier's* appears to disagree, but concluded that the legislative history makes it clear that *Collier's* is wrong.[64]

Another case agreeing with *Sands* and *Aycock* should be briefly mentioned.[65] Even though this case arose in Florida, which has opted out of the exemptions set forth in section 522(d), the court seems to simply rely on *Sands*.[66] The court does not appear to place any reliance on the fact that Florida has opted out of section 522(d), even though other cases have placed considerable emphasis on this fact.[67]

The two immediately preceding sections of this article have attempted to acquaint the reader with cases addressing the issue of whether or not chapter 13 debtors can in fact use section 522(f) to avoid certain kinds of liens on certain kinds of exempt property. The next section of this article briefly addresses the procedure to be followed by debtors who find themselves in courts which allow the use of section 522's lien avoidance provisions in the chapter 13 setting.

V. PROCEDURAL ASPECTS OF LIEN AVOIDANCE

A. Introduction

The reader is forewarned that this section is not intended to be a comprehensive lesson on "how to avoid liens under section 522(f) of the Bankruptcy Reform Act of 1978." Because of the differences in chapter 7, chapter 11,[68] and chapter 13 cases, the actual procedural steps involved in a given case may vary. For example, in a chapter 7 case it is reasonable to require the debtor to file either a motion or a complaint in order to avoid liens pursuant to section 522(f). Such action by the debtor appears to be universally expected. This article is focusing on lien avoidance in chapter 13 and

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> claim retain the lien securing such claim; and (ii) the value, as of the effective date of the plan, of property to be distributed under the plan on account of such claim is not less than the allowed amount of such claim.

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

[63]*In re* Morgan, 18 Bankr. 17 (Bankr. D. Del. 1981).

[64]*Id.* at 17–18.

[65]*In re* Corden, 19 Bankr. 552 (Bankr. M.D.Fla. 1982).

[66]*Id.* at 553; *In re* Sands, 15 Bankr. 563 (Bankr. M.D.N.C. 1981).

[67]*See infra* notes 102–123 and accompanying text where the effect of a state's "opting out" of the federal exemptions on the availability of section 522(f) is discussed.

[68]To date no reported cases have arisen wherein the question of section 522(f)'s applicability to chapter 11 has been analyzed. However, in light of the fact that section 109(d) makes it clear that individual debtors are eligible for chapter 11 proceedings, it is logical for individuals filing chapter 11 petitions to seek lien avoidance pursuant to section 522(f). It is also logical that 11 U.S.C. § 522(f) is applicable in chapter 11 proceedings.

the discussion here will be limited to certain procedural points concerning lien avoidance in chapter 13. In the main, these points are being discussed as a result of the apparent confusion and non-conformity among the courts discovered as a by-product of researching the main topic of this article, to wit: the applicability of 522(f) in chapter 13. The procedural points will only be briefly discussed.

Courts differ not only on the applicability of section 522(f) in chapter 13, but also on how one goes about avoiding liens in chapter 13 once it is determined that section 522(f) is in fact available to a chapter 13 debtor. Because of this lack of uniformity, it is vital to check the procedures normally followed in a particular court. Local rules are often very specific in such matters. Such local rules will often set forth basic procedural information such as time limitations, type of pleading required, notice requirements, etc. Hence, the very first step is to check the local rules, if any exist.

On the question of what one must do in order to avoid a lien in a chapter 13 case, one finds a wide range of approaches. One leading authority states that the debtor can avoid liens under section 522(f) simply by including in the debtor's chapter 13 plan a provision avoiding liens on exempt property.[69] This would include the filing of a proposed chapter 13 plan wherein the creditor would be listed and treated as unsecured.[70] This approach eliminates the debtor's filing of a complaint or motion to avoid such liens. There is also case law consistent with this view.[71] Failure of a creditor to file an objection would result in the lien being avoided.[72] The *DeSimone* court required a specific objection to the lien avoidance provision itself as opposed to a general objection to the overall plan.[73]

Other cases have required the debtor to bring an adversary proceeding.[74] This requires that the debtor file a "Complaint To Avoid Lien Impairing Debtor's Exemptions."[75] Such a requirement appears to be the result of confusing what is necessary to adequately give notice to a creditor in chapter 7 with what would be adequate notice in a chapter 13 case.[76] Such a requirement in chapter 13 cases seems to be a classic case of overkill in that a plan with a specific provision avoiding such liens is seemingly adequate notice to a creditor wishing to challenge such an avoidance of its lien. Additionally, the *DeSimone* approach seems preferable from both a common sense point of view and a judicial efficiency point of view.

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[69]6 COLLIER BANKRUPTCY PRACTICE GUIDE ¶¶ 101.10, 101.12.

[70]*Id.* at ¶ 101.12.

[71]*In re* DiSimone, 17 Bankr. 862 (Bankr. E.D.Pa. 1982).

[72]*Id.* at 863.

[73]*Id.* at 863–4.

[74]*In re* Hoffman, 11 Bankr. 68 (Bankr. D. Mass. 1981).

[75]*See* 4 COLLIER BANKRUPTCY PRACTICE GUIDE ¶ 74.61.

[76]Such a requirement in chapter 7 cases seems designed to provide reasonably adequate notice to creditors who would not otherwise know that a debtor was attempting to avoid their lien.

The "New Bankruptcy Rules" eliminate the necessity of filing an actual complaint for the purpose of avoiding liens even in chapter 7, requiring only the filing of a motion.[77] This makes the procedure simpler and less costly by eliminating filing fees, etc. Nevertheless it still seems that even the filing of a motion should be unnecessary in chapter 13. However, the procedures provided in the new rules are certainly preferable to an adversary proceeding. The new rules also specify the form of the motion and how service is perfected.[78] Hopefully, most courts will apply the motion requirement to lien avoidance in chapter 7 and follow the *DeSimone* procedure in chapter 13.

Must a debtor exercising his section 522(f) power do so within a specified period of time? The cases are again in disagreement. The following discussion sets forth the different approaches on the issue of when a debtor can initiate lien avoidance under section 522(f).

B. No Time Limit Cases

Several cases have concluded that there is no time limit.[79] *Bledsoe v. Household Finance Corporation*[80] is especially interesting. The court held that even though its local rules called for the debtor to file a declaration of intent to avoid any lien not later than thirty days after the date first set for the first meeting of creditors, the debtor, who failed to file such a declaration, could still avoid a lien post discharge. The court stated:

> This court . . . has established a . . . local procedure for . . . uncontested lien avoidances by declaration. The local practice of declaration . . . is only available if the declaration of intent is filed not later than thirty days after the date first set for the first meeting of creditors. . . .
>
> The local practice . . . is not intended to affect a debtor's substantive right to avoid liens. Instead, if a debtor chooses not to file a declaration of intent, the debtor may nevertheless file an avoidance action by complaint, even subsequent to . . . discharge. . . .[81]

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[77]New Bankruptcy Rules, Rule 4003(d) provides:

> A proceeding by a debtor to avoid a lien or other transfer of property exempt under § 522(f) of the Code shall be by motion in accordance with Rule 9014.

(By order of the United States Supreme Court dated April 25, 1983, the new rules take effect on August 1, 1983).

[78]New Bankruptcy Rules, Rule 7004, Rule 9014.

[79]*In re* Tarrant, 19 Bankr. 360 (Bankr. D. Ala. 1982); *In re* Hart, 16 Bankr. 78 (Bankr. D. Neb. 1981); *In re* Newton, 15 Bankr. 640 (Bankr. W.D.N.Y. 1981); *In re* Baskins, 14 Bankr. 110 (Bankr. E.D.N.C. 1981); *In re* Swanson, 13 Bankr. 851 (Bankr. D. Idaho 1981); *In re* Gortmaker, 14 Bankr. 66 (Bankr. D.S.D. 1981); *In re* Bennett, 13 Bankr. 643 (Bankr. W.D. Mich. 1981); *In re* Butler, 5 Bankr. 360 (Bankr. D.Md. 1980); Naples v. London, No. 205-5-80-00794 (Bankr. D. Conn. March 25, 1980).

[80]Bledsoe v. Household Finance Corporation, 28 Bankr. 210 (Bankr. S.D. Ohio W.D. 1983).

[81]*Id.* at 213. *Also see In re* Rheinbolt, 24 Bankr. 167 (Bankr. S.D. Ohio W.D. 1982).

Bankruptcy Judge David L. Crawford of Nebraska concludes that the Code contains no time limits within which a debtor must act in order to avoid a lien pursuant to section 522(f), but that a final judgment in a state court replevin action commenced after the debtors had received a discharge in their chapter 7 case prevents the lien avoidance because of the doctrine of res judicata.[82] *In re Holyst*,[83] while recognizing the absence of any time limit in the Code, indicates that laches may be available as a defense to a debtor's attempt to avoid a lien under section 522(f). Nevertheless, the *Holyst* court allowed the debtor to avoid a lien after closing of the case by filing a motion to reopen his case specifically for the purpose of avoiding the lien. While recognizing that a defense such as laches may enable a lienholder to prevent lien avoidance in the proper case, the court concluded that an action to avoid a lien under section 522(f) is not barred simply because it is brought after the closing of the case. The court relied on section 350[84] of the Code in reaching that conclusion.

The case of *In re Stephenson*[85] out of the Middle District of Tennessee also indicates that section 350 allows a chapter 7 case to be reopened specifically for the purpose of allowing the debtors to avoid a lien pursuant to section 522(f). The court stated that the decision whether or not to allow the case to be reopened rests entirely within the discretion of the court. The *Stephenson* case contains an excellent discussion of why lien avoidance under section 522(f) is not limited by any specific time limitation.[86] For reasons not relevant to the present discussion, the court denied the debtor's attempt to avoid the lien in question. Also see the *Stephenson* case for an extensive list of cases which have held that there is no statutory time limitation on section 522(f) lien avoidance actions.

C. Time Limit Cases

The cases requiring debtors to seek lien avoidance within specified time periods do not establish a uniform time limit. They generally fall into one of the following categories.

1. *Before Discharge Cases*

Some cases under chapter 7 have required the debtor to seek lien

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[82]*In re* Howery, Bankr. No. 80-1145 Slip op. (Bankr. D. Neb., May 26, 1982).

[83]*In re* Holyst, 19 Bankr. 14 (Bankr. D. Conn. 1982).

[84]11 U.S.C. § 350 (Supp. V 1981).

[85]*In re* Stephenson, 19 Bankr. 185 (Bankr. M.D. Tenn. 1982).

[86]*Id.* at 188.

avoidance before discharge is granted.[87] *In re Smiley*[88] acknowledged the absence of any specific time limitations in section 522(f). Nevertheless, the court found that any proceedings by debtors to avoid liens should occur at or before the discharge hearing. The court stated: " . . . to effectively carry out the provisions of the Code and to obtain finality of a determination of the right of the parties, . . . a debtor must file a complaint to avoid a lien under section 522(f) at or before the discharge hearing."[89]

2. *After Discharge But Before Closing of Case*

Another line of cases has concluded that lien avoidance by the debtor under section 522(f) is allowable after discharge but only if done before the administration of the case is completed.[90] In the case of *In re Smart*,[91] Judge Mooreman acknowledged the absence of any specific statutory time limits on section 522(f) lien avoidance rights. However, he also drew proper distinctions between the granting of the discharge and the actual closing of the case.[92] Since the issue in *Smart* involved a fact situation wherein the debtors had filed their lien avoidance action after discharge but before closing of the case, it is unknown whether Judge Mooreman would allow post-closing avoidance under section 522(f). However, the court's distinction between discharge and closing is at least indicative of its unwillingness to allow post-closing avoidance. Likewise, the *Barner*[93] case implies that post-closing avoidance may not be proper.[94]

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[87]*In re* Krahn, 10 Bankr. 770 (Bankr. E.D. Wisc. 1981); *In re* Porter, 11 Bankr. 578 (Bankr. W.D. Okla. 1981); *In re* Atkins, 7 Bankr. 325 (Bankr. S.D. Cal. 1980).

[88]*In re* Smiley, 26 Bankr. 680 (Bankr. D. Kan. 1982).

[89]*Id.* at 686–87. *Also see In re* Andrews, 22 Bankr. 623 (Bankr. D. Del. 1982).

[90]*In re* Barner, 20 Bankr. 428 (Bankr. E.D. Wis. 1982); *In re* Smart, 13 Bankr. 838 (Bankr. D. Ariz. 1981); *In re* Leeman, 25 Bankr. 180 (E.D. Wis. 1982); *In re* Lee, 21 Bankr. 774 (Bankr. E.D. Tenn. 1982).

[91]*In re* Smart, 13 Bankr. 838 (Bankr. D. Ariz. 1981).

[92]*Id.* at 840 where the court states:

> Defendant relies on *In re* Adkins (AVCO Financial), 7 B.R. 325, (Bkrtcy.S.D.Cal. 1980), which held that a debtor's right to commence an action under Sec. 522(f) is cut off at the time of discharge. The Adkins opinion acknowledges that there is no express time limit mentioned in either the Bankruptcy Code itself nor in the accompanying legislative history. However, the California court in Adkins attempts to ascertain a 'clue' from other code sections as to a proper time limit. In particular, the Adkins decision, for interpretation, looks to 11 U.S.C. § 524(c) which provides that a reaffirmation must be made at or before the granting of a discharge and reasons that since a debtor will likely reaffirm a debt only if he is unable to avoid it under Sec. 522(f), that it is proper to infer that the time of discharge was meant also to apply to Sec. 522(f), since after discharge, a reaffirmation agreement cannot be made.

[93]*In re* Barner, 20 Bankr. 428 (Bankr. E.D. Wis. 1982).

[94]*Id.* at 403 where the court states:

> While failure to take advantage of the avoidance powers of § 522(f) prior to discharge may in some instances deprive the debtor from using *reaffirmation* as an *alternative* means of retaining possession of certain property, this factor should not

3. *Chapter 13 Cases*

In re Macias[95] addressed the issue of the timing of lien avoidance in a chapter 13 case. The debtor had filed a plan on February 29, 1980, with the plan being confirmed by the court on April 28, 1980. However, the debtor did not attempt to avoid the lien in question until September 10, 1980. The court held that such a belated effort at lien avoidance was too late. The court based its decision on good practice and basic fairness and stated:

> In a Chapter 13 case good practice requires the filing of such a complaint simultaneously with the Voluntary Petition initiating the case. It strikes this Court as unfair and patently impermissible to permit a debtor to lull a creditor into acceptance of a plan on the basis that he will be treated as secured, then after confirmation transform the secured claim to unsecured. The rights of the parties become fixed on confirmation.[96]

In re Babineau[97] also addressed the issue of the timing of lien avoidance by a debtor in a chapter 13 case. The creditor relied on *In re Macias*[98] for the proposition that post-confirmation lien avoidance in chapter 13 is unfair. The court distinguished the *Macias* case by virtue of the fact that here the debtor's plan had not dealt with the creditor's claim and stated:

> Inasmuch as neither the code nor the Interim Bankruptcy Rules fix a bar date for filing an action under § 522(f) for lien avoidance of non-purchase money and non-possessory liens, there is no valid reason why a Chapter 13 debtor should not be able to seek a lien avoidance so long as the chapter 13 case is pending or at least prior to the expiration of the time allowed for a debtor to file a Chapter 13 plan.[99]

No other chapter 13 case discussing the time limits within which a debtor must seek to avoid liens under section 522(f) has been found. However, it seems that chapter 13 debtors should act prior to confirmation. Secured creditors must be specifically provided for in a chapter 13 case before the

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further serve as a burden on the debtor by preventing the use of § 522(f) itself in a proper case to avoid the effect of a lien on *exempt property* in a timely manner during the continued administration of the debtor's estate.

[95]*In re* Macias, 9 Bankr. 225 (Bankr. N.D. Ill. 1981).

[96]*Id.* at 226.

[97]*In re* Babineau, 22 Bankr. 936 (Bankr. M.D. Fla. 1982).

[98]9 Bankr. 225 (Bankr. N.D. Ill. 1981).

[99]*In re* Babineau, 22 Bankr. 936, 938 (Bankr. M.D. Fla. 1982).

proposed plan can be confirmed.[100] Of course, a secured creditor can defeat a plan by rejecting the plan unless the debtor uses the chapter 13 "cram down" provision of section 1325(a)(5)(B) or, alternatively, surrenders the collateral itself to the secured creditor.[101] Therefore, in all likelihood, the showdown between a chapter 13 debtor and a secured creditor will occur prior to confirmation in most cases. Furthermore, treatment of a creditor as secured under the plan could result in a later attempt to avoid the lien being successfully defeated through equitable defenses such as estoppel or laches. Confirmation of the plan with a provision treating a creditor as secured could also be viewed as res judicata. Therefore, even though the Code contains no express time limitation within which section 522(f) lien avoidance must occur, it seems that confirmation is the logical cut-off point, at least in chapter 13. Therefore, it is recommended that debtors initiate lien avoidance efforts prior to confirmation and preferably prior to or during the proposing of the plan itself.

VI. WHAT IS THE EFFECT OF A STATE'S "OPTING OUT" OF THE SECTION 522(d) EXEMPTIONS ON A DEBTOR'S SECTION 522(f) POWERS?

Section 522(b) of the Code provides in part as follows:

> (b) Notwithstanding section 541 . . ., an individual debtor may exempt from property of the estate . . .
>
> (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.* (Emphasis added)[102]

The last clause quoted clearly gives the states the authority to provide state exemptions in lieu of the specific exemptions given to debtors in bankruptcy proceedings under section 522(d) of the Code. This provision of section 522(b) will be referred to as the "opt out" provision. The validity of this opt out provision is not examined here,[103] even though it is of questionable validity in view of Congress' clear intent to remedy the unequal treatment of debtors which results when widely varying exemptions are adopted from

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[100]Section 1325(a)(5) provides:

> (5) with respect to each allowed secured claim provided for by the plan – (A) the holder of such claim has accepted the plan; (B) (i) the plan provides that the holder of such claim retain the lien securing such claim; and (ii) the value, as of the effective date of the plan, of property to be distributed under the plan on account of such claim is not less than the allowed amount of such claim; or (C) the debtor surrenders the property securing such claim to such holder. . . .

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

[101]11 U.S.C. § 1325(a)(5)(c) (Supp. V 1981).

[102]11 U.S.C. § 522(b) (Supp. V 1981).

[103]The "opt out" provision of 11 U.S.C. § 522(b) has been challenged as unconstitutional on the

state to state.[104] It is undeniable that by virtue of adopting the opt out provision presently found in section 522(b) Congress has, albeit perhaps unknowingly, failed in its attempt to rectify the unequal treatment of debtors from the different states which resulted under the Act.[105] Clearly, Congress needs to reexamine the opt out provision and its effect on the uniformity of treatment of debtors under the Code.

In spite of Congress' stated intent to correct the problems caused by exemption laws on a state by state basis, the fact is that section 522(b) has effectively prevented such remedial gains. In addition to the obvious result of unequal treatment of debtors because of the state in which they happen to live, the opt out provision has caused a problem other than which property the debtor can exempt. Because section 522(f) allows debtors to avoid a lien on specified types of property only to "the extent that such lien impairs an exemption to which the debtor would have been entitled under subsection (b) of this section,"[106] the opt out provision can result in the loss of section 522(f) powers by the debtor.[107] It is difficult, perhaps impossible, to believe that Congress intended to give individual states the power to deny debtors the right to avoid liens under section 522(f). This is especially so when one considers the stated purposes behind the lien avoidance provision, to wit: the prevention of harassment of debtors by certain creditors and the guarantee of a fresh start to the debtor.[108] Nevertheless, the result, at least in some courts, has been to allow states to effectively opt out of the lien avoidance provision of subsection (f) of section 522 as well as the exemption provision of subsection (d) of section 522.[109] While such cases are certainly subject to criticism, they clearly illustrate how some debtors are being treated extremely unequally as a result of section 522(b)'s opt out provision. Even though this author believes that cases such as *Babcock*[110] and *Foster*[111] are wrong, their result is as much due to the existence of the opt out provision as it is to faulty reasoning by the courts.

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grounds that it violates article I, section 8, clause 4 of the Constitution which empowers Congress "to establish uniform laws on the subject of bankruptcies." U.S. Const. Art. I, § 8, c1.4. To date the challenge has failed. *See In re* Sullivan, 680 F.2d 1131 (7th Cir. 1982).

[104]Vukowich, *Debtor Exemption Rights under the Bankruptcy Reform Act*, 58 N.C.L. Rev. 769, 772–74. *See also* H.R. Rep. No. 595, *supra* note 9, at 126–27; Note, *Controversy Surrounding Exemption Uniformity: the Opt Out Provision of Section 522 of the Bankruptcy Reform Act of 1978*, 13 Toledo L. Rev. 1111 (hereinafter cited as *Exemption Uniformity Article*).

[105]11 U.S.C. § 24 (1976) (repealed 1978).

[106]11 U.S.C. § 522(f) (Supp. V 1981).

[107]*See infra* note 109 and accompanying text.

[108]H.R. Rep. No. 595, *supra* note 9, at 116, 117, 126, 127.

[109]*In re* Babcock, 9 Bankr. 475 (Bankr. W.D. La. 1981); Foster v. City Loan and Savings Co., 16 Bankr. 467 (Bankr. N.D. Ohio E.D. 1981).

[110]*In re* Babcock, 9 Bankr. 475 (Bankr. W.D. La. 1981).

[111]Foster v. City Loan and Savings Co., 16 Bankr. 467 (Bankr. N.D. Ohio E.D. 1981).

The vast majority of the courts which have considered the question of whether a state can opt out of subsection 522(f)'s lien avoidance provisions (either directly or indirectly) have held that it is not possible to do so.[112] The cases of *Rodgers*,[113] *Barto*,[114] *Strain*,[115] *Meadows*[116] and *McKelvey*[117] are especially well reasoned on why a state cannot opt out of subsection 522(f) and the reader is encouraged to read them for an analysis of this problem, which is beyond the scope of this article. The only purpose here is to alert one to the problem, which itself is substantial enough to comprise an article. The correct answer to the question of the effect of a state's "opting out" of section 522(d) exemptions on a debtor's section 522(f) powers appears to be: "none." However, as pointed out, the mere presence of the section 522(b) opt out provision has resulted in cases where debtors have been denied a fresh start in clear contravention of stated Congressional intent.[118] This is in addition to the frustration of the more immediate goal originally sought to be accomplished by section 522(d), to wit: equal treatment of all debtors regardless of where they might live.[119] Section 522(b) in its final form was passed into law clearly as a result of a compromise between the House and the Senate,[120] despite the recommendation from the Commission on Bankruptcy Laws of the United States that uniformity of exemptions was needed.[121] Perhaps the fear of absolute uniformity in exemption laws because of differing conditions in the economies of the various states could be overcome by allowing states to adopt more liberal exemption laws but not less liberal exemption laws than those provided by subsection 522(d). Of course, such a suggestion is far from original. As early as 1867, Congress actually passed an act with such a provision.[122] Yes, we seem to have gone backward since the enactment of the Bankruptcy Act of 1867. For further

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[112]*In re* Maddox, 27 Bankr. 592 (N.D. Ga. 1983); *In re* McKelvy, 20 Bankr. 405 (Bankr. D. Ariz. 1982); *In re* Strain, 16 Bankr. 797 (Bankr. D. Id. 1982); *In re* Lausch, 16 Bankr. 162 (Bankr. M.D. Fla. 1981); *In re* Davis, 16 Bankr. 62 (Bankr. D. N.Y. 1981); *In re* Redin, 14 Bankr. 727 (Bankr. D. Colo. 1981); *In re* Phillips, 13 Bankr. 811 (Bankr. N.D. Ohio 1981); *In re* Frederickson, 12 Bankr. 506 (Bankr. D. S.D. 1981); *In re* Meadows, 9 Bankr. 882 (Bankr. N.D. Ga. 1981); *In re* Barto, 8 Bankr. 145 (Bankr. E.D. Va. 1981); *In re* Rodgers, 5 Bankr. 761 (Bankr. W.D. Va. 1980); *In re* Curry, 5 Bankr. 282 (Bankr. N.D. Ohio 1980); *In re* Hill, 4 Bankr. 310 (Bankr. N.D. Ohio 1980); *See also* 3 COLLIER ON BANKRUPTCY ¶ 522.29(1).

[113]*In re* Rodgers, 5 Bankr. 761 (Bankr. W.D. Va. 1980).

[114]*In re* Barto, 8 Bankr. 145 (Bankr. E.D. Va. 1981).

[115]*In re* Strain, 16 Bankr. 797 (Bankr. D. Id. 1982).

[116]*In re* Meadows, 9 Bankr. 882 (Bankr. N.D. Ga. 1981).

[117]*In re* McKelvy, 20 Bankr. 405 (Bankr. D. Ariz. 1982).

[118]*See supra* note 109.

[119]*Supra* note 104.

[120]*Exemption Uniformity Article*, *supra* note 104, at 1114.

[121]REPORT OF THE COMMISSION ON THE BANKRUPTCY LAWS OF THE UNITED STATES, H.R. DOC. NO. 137, 93rd Cong., 1st Sess., pt. 2, § 4–503, note 3 (1973).

[122]Act of Mar. 1, 1867, Ch. 176 § 33, 13 Stat. 517 (1867) (Repealed 1878).

discussion of the opt out provision of section 522 see the Exemption Uniformity Article.[123]

VII. POLICIES FAVORING THE APPLICABILITY OF SECTION 522(f) IN CHAPTER 13 CASES

The majority of cases addressing the question of the applicability of the debtor's rights or power to avoid liens pursuant to section 522(f) of the Code in chapter 13 cases have concluded that it does in fact apply. This writer agrees with those cases' holdings, and they represent the favored view. Particularly disturbing is the idea expressed in the *Sands*[124] case that a chapter 13 debtor obtains no economic benefit through lien avoidance. Anyone who has ever counselled a potential chapter 13 debtor realizes such reasoning to be invalid. Perhaps the easiest and most effective method to refute such reasoning is by using a simple hypothetical case:

> Dan Debtor has a take-home income of four hundred dollars per week. His family's basic living expenses are three hundred fifty dollars per week. Therefore Dan has a maximum of fifty dollars per week to devote to a chapter 13 plan. Dan's debts are as follows: (assume 1, 2, and 3 are one hundred percent secured).
>
> 1. Six thousand two hundred fifty dollars to E.Z. Loan Company, which has obtained a judgment against Dan in that amount and has recorded the judgment, thereby obtaining a valid judgment lien on Dan's equity in his home.[125]
> 2. Five thousand dollars to ABC Loan Company, secured by a validly perfected consensual nonpurchase-money security interest in household goods owned by Dan. Assume no one item is worth more than two hundred dollars.
> 3. Seven hundred fifty dollars to Big Bank, secured by a validly perfected consensual nonpurchase-money security interest in tools used by Dan in his trade.
> 4. One hundred dollars to Little Bank, which is unsecured.
>
> Assume Dan has no non-exempt assets. Therefore, in a chapter 7 liquidation, Dan's unsecured creditors would

[123]*Supra* note 104.

[124]*In re* Sands, 15 Bankr. 563 (Bankr. M.D.N.C. 1981).

[125]*See* 11 U.S.C. § 101 (27) (Supp. V 1981).

receive zero.[126]

Remember the point being refuted here: "The avoidance of a . . . lien is of no financial benefit to the debtor. . . ."[127] In the above illustration, admittedly oversimplified for purposes of illustration only, Dan's ability to propose a chapter 13 plan is dependent on his section 522(f) lien avoidance power. If not available, E.Z., ABC and Big Bank must be treated as secured in a total amount of twelve thousand dollars. Section 1325(a)(5) would require payments in excess of that amount over the life of the plan.[128] The result would be a minimum requirement of paying approximately one hundred dollars per week under a three-year plan. Dan cannot do that. However, if Dan can use section 522(f) to avoid the liens, E.Z., ABC, and Big Bank are obviously unsecured. This would result in Dan now having to comply with section 1325(a)(4), which only requires that unsecured creditors receive at least as much as they would receive in a chapter 7 liquidation case,[129] which here is zero dollars.

The "financial benefit" is obvious. If Dan now proposes a plan offering to pay fifty dollars a week (clearly all he *can* pay), this would appear to more than satisfy section 1325(a)(4) and also be in good faith.[130] Such a plan would result in approximately seven thousand dollars plus being distributed to Dan's creditors over the three-year life of the plan. The reasoning of *Sands*[131] on this point is wrong.

The immediately preceding discussion also refutes Judge Reynolds' concern with the "equities of avoidance" of such liens in chapter 13 cases.[132] Apparently the concern being that it is just not fair to allow such liens to be avoided in chapter 13. Well, how much "fairer" or "more equitable" is it in chapter 7? No one claims that section 522(f) is not applicable to chapter 7 proceedings. If Dan Debtor cannot use lien avoidance in chapter 13, what will

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[126]Since it is universally accepted that section 522(f) applies in chapter 7 cases, each of the debts used in the hypothetical would be unsecured in bankruptcy. Therefore each of these claim holders would receive zero dollars if this were a chapter 7 case.

[127]*In re* Sands, 15 Bankr. 563 (Bankr. M.D.N.C. 1981). *Contra In re* Lincoln, 26 Bankr. 14 (Bankr. W.D. Mich. 1982).

[128]The language of section 1325(a)(5)(b)(ii) makes it clear that holders of secured claims must receive the equivalent of the present cash value of that claim. 11 U.S.C. § 1325(a)(5)(b)(ii) (Supp. V 1981).

[129]Section 1325(a)(4) states:

> the value, as of the effective date of the plan, of property to be distributed under the plan on account of each allowed unsecured claim is not less than the amount that would be paid on such claim if the estate of the debtor were liquidated under chapter 7 of this title on such date;

11 U.S.C. § 1325(a)(4) (Supp. V 1981).

[130]11 U.S.C. § 1325(a)(3) (Supp. V 1981) requires that the debtors' plan be proposed in good faith.

[131]*In re* Sands, 15 Bankr. 563 (Bankr. M.D.N.C. 1981).

[132]*Id.* at 564.

happen? Often he will simply convert to chapter 7. In chapter 7, Dan's four creditors will receive zero dollars.[133] In the chapter 13 plan illustrated above, they will share pro rata in proceeds of more than seven thousand dollars. If the "equities of avoidance" is a legitimate basis for refusing to allow chapter 13 debtors use of section 522(f), the court adopting such a rule could never allow use of section 522(f) in a chapter 7 case, where it is arguably "more inequitable." Seriously, the *Sands*[134] case has simply missed the whole idea behind section 522(f) and the policy reasons involved in its passage by Congress.

Courts holding section 522(f) inapplicable in chapter 13 have also expressed concern because many chapter 13 plans are not carried out to completion and the former collateral has since been destroyed or become unavailable.[135] In light of the fact that the creditor is certainly no worse off than it would have been had the debtor filed a chapter 7 proceeding to begin with, this concern seems to be irrelevant to the issue. As law professors are wont to say, "such a concern is a red herring." Additionally, under section 349[136] if the debtor fails to carry out the plan, the creditor's claim becomes nondischargeable and the lien is reinstated. This again brings one to the conclusion that there is no additional prejudice or unfairness towards creditors by virtue of lien avoidance in chapter 13 which does not also exist in chapter 7. Furthermore, the creditor who receives money under a chapter 13 plan is certainly better off than a creditor whose lien is avoided in a chapter 7 case.[137]

By refusing to apply section 522(f) in chapter 13 cases, courts are not only failing to follow a Congressional mandate for more filings under chapter 13, they are also forcing debtors into chapter 7 with the unavoidable result being harsher treatment of the very creditors they are seeking to protect. Since the lien is avoidable in chapter 7, the creditor ends up being an unsecured creditor in a chapter 7 case, which normally means no payment or

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[133]*Supra* note 126.

[134]*In re* Sands, 15 Bankr. 563 (Bankr. M.D.N.C. 1981).

[135]*Id. In re* Babcock, 9 Bankr. 475 (Bankr. W.D. La. 1981).

[136]Section 349 states:

> (a) Unless the court, for cause, orders otherwise, the dismissal of a case under this title does not bar the discharge, in a later case under this title, of debts that were dischargeable in the case dismissed. (b) Unless the court, for cause, orders otherwise, a dismissal of a case other than under section 742 of this title – (1) reinstates – (A) any proceeding or custodianship superseded under section 543 of this title; (B) any transfer avoided under section 522, 544, 545, 547, 548, 549, or 724(a) of this title, or preserved under section 510(c)(2), 522(i)(2), or 551 of this title; and (C) any lien voided under section 506(d) of this title; (2)vacates any order, judgment, or transfer ordered, under section 522(i)(1), 542, 550, or 553 of this title; and (3) revests the property of the estate in the entity in which such property was vested immediately before the commencement of the case under this title.

11 U.S.C. § 349 (Supp. V 1981).

[137]*Supra* note 126.

a very small payment. In chapter 13, the creditor is unsecured but normally receives some payment.[138]

In both chapter 7 and chapter 13, the debtor would keep the property, but in chapter 13 the debtor usually pays something to the creditor, unlike the situation in chapter 7. The logical conclusion being that if the courts are really concerned about the well-being of creditors, they should allow debtors to use section 522(f) in chapter 13 cases. Fortunately, most do.

Congress has indicated a clear preference for chapter 13 proceedings over chapter 7 liquidations.[139] One of the more obvious reasons is illustrated by the foregoing hypothetical case of Dan Debtor, to wit: Creditors will usually receive more money in a chapter 13 case than they will in a chapter 7 case. Another reason stated by Congress for preferring chapter 13 over chapter 7 is the psychological advantage to debtors trying to pay these creditors rather than simply filing "straight bankruptcy."[140] To accomplish increased use of chapter 13 by debtors, Congress provided certain "carrots" or inducements to debtors who file chapter 13 cases which again illustrate Congress' clear preference for chapter 13 over chapter 7. These are: (1) a broader discharge for debtors who successfully complete their chapter 13 plan;[141] (2) no limitation on the frequency or time periods within which additional chapter 13 plans may be filed;[142] (3) a broader definition of those who are eligible to file chapter 13 than was allowable under old Chapter XIII;[143] and (4) a broader automatic stay.[144]

VIII. CONCLUSION

In light of Congress' preference for chapter 13 over chapter 7 for the

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[138]This is true even though some "zero payment" chapter 13 plans have been confirmed. *See In re* Bellgraph, 4 Bankr. 421 (Bankr. W.D.N.Y. 1982). Even in a zero plan, such creditors are not treated any differently than they are under most chapter 7 cases.

[139]S. REP. No. 989, *supra* note 9, at 12, 13; H.R. REP. No. 595 *supra* note 9, at 426-32.

[140]H.R. REP. No. 595, *supra* note 9, at 118.

[141]11 U.S.C. § 1328(a) (Supp. V 1981).

[142]11 U.S.C. 727(a)(8) (Supp. V 1981) prevents a debtor from receiving a discharge under chapter 7 more than once every six years. There is no such limitation on discharges in chapter 13 cases.

[143]Section 109(e) states:

> Only an individual with regular income that owes, on the date of the filing of the petition, noncontingent, liquidated, unsecured debts of less than $100,000 and noncontingent, liquidated, secured debts of less than $350,000, or an individual with regular income and such individual's spouse, except a stockbroker or a commodity broker, that owe, on the date of the filing of the petition, noncontingent, liquidated, unsecured debts that aggregate less than $100,000 and noncontingent, liquidated, secured debts of less than $350,000 may be a debtor under chapter 13 of this title.

11 U.S.C. § 109(e) (Supp. V 1981).

[144]11 U.S.C. § 1301 (Supp. V 1981) (extends the automatic stay to certain co-debtors as well as the debtor.)

above stated reasons, it seems clear that the cases holding section 522(f) to be inapplicable in chapter 13 proceedings are not only wrong but have also failed to recognize this Congressional preference. The question for the courts is not whether lien avoidance should be allowed in chapter 13 or not.[145] The question is whether or not allowing lien avoidance in chapter 13 will further the Congressional intent and be in compliance with the Code. The answer is an obvious "yes."

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[145]The author expresses no opinion on the wisdom of Congress' decision to make chapter 13 the preferred chapter under the Code. Congress has spoken very clearly on this point. If this is to be changed it must be done through the legislative branch, not the judicial branch.