



Code Exemptions: Far-Reaching Achievement

The Honorable Robert L. Hughes

Follow this and additional works at: <https://via.library.depaul.edu/law-review>

Recommended Citation

The Honorable Robert L. Hughes, *Code Exemptions: Far-Reaching Achievement*, 28 DePaul L. Rev. 1025 (1979)

Available at: <https://via.library.depaul.edu/law-review/vol28/iss4/6>

This Article is brought to you for free and open access by the College of Law at Via Sapientiae. It has been accepted for inclusion in DePaul Law Review by an authorized editor of Via Sapientiae. For more information, please contact digitalservices@depaul.edu.

CODE EXEMPTIONS: FAR-REACHING ACHIEVEMENT

*The Honorable Robert L. Hughes**

Some of the most significant changes brought about by the new Bankruptcy Code concern its treatment of exempt property. In this Article, Judge Hughes examines the new law of exemptions. He explores the unique election system set out by the Code, the status of exempt property, and the broad avoiding powers extended to the debtor.

Consumers file the majority of the country's bankruptcy cases and no portion of the new Bankruptcy Code¹ (the Code) has changed as much law affecting consumers as its treatment of exempt property. If the draftsmen applied a fresh coat of paint on the law of discharge and remodeled the law of dischargeability, they tore down former section six² and built a brand new structure in section 522.³ The change is quantitative as well as qualitative. The legal principles embraced by section six of the 1898 Bankruptcy Act,⁴ even after its expansion in 1938,⁵ were so sparse as to approach nonexistence. By contrast, section 522 of the Code affirmatively and extensively deals with almost the entire panoply of exemption issues. No other nondefinitional section is as thorough.

Indeed, section 522 is one of the Code's most far-reaching achievements. For the first time since 1877, the bankruptcy statute itself prescribes the amount and kind of property that is not subject to distribution to creditors.⁶ In addition, section 522 provides the debtor with virtually unprecedented

* United States Bankruptcy Judge for the Northern District of California.

1. Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549 (to be codified in 11 U.S.C. and scattered sections of 2, 7, 12, 15, 17-20, 22, 28, 29, 31, 33, 40-43, 46, 48, 49 U.S.C.). The new Bankruptcy Code was enacted on November 6, 1978, and became effective in substantial part on October 1, 1979. Pub. L. No. 95-598, § 402, 92 Stat. 2682. As this article was prepared for publication, the most current codification of the Bankruptcy Code was the 1978 Supplement to the United States Code. U.S.C. tit. 11 is set out in an appendix to the supplement, and the amendments to scattered U.S.C. sections are set forth in the body of the supplement. Throughout this Article, title 11 will be cited as 11 U.S.C. app. § — (Supp. II 1978). Amendments to scattered U.S.C. sections will be cited as — U.S.C. — (Supp. II 1978). Title IV of the new Bankruptcy Code, containing the transition provisions, will be cited to Pub. L. No. 95-598, § —, 92 Stat. —.

2. Bankruptcy Act of July 1, 1898, ch. 541, § 6, 30 Stat. 547 (1897-99), as amended by Act of June 22, 1938, ch. 575, § 6, 52 Stat. 847 (originally codified at 11 U.S.C. § 24 (1976)) (replaced with 11 U.S.C. app. § 522 (Supp. II 1978)).

3. 11 U.S.C. app. § 522 (Supp. II 1978).

4. Act of July 1, 1898, ch. 541, § 6, 30 Stat. 544 (1897-99).

5. Act of June 22, 1938, ch. 575, § 6, 52 Stat. 847, amending Bankruptcy Act of 1898, ch. 541, § 6, 30 Stat. (1897-99) (codified originally at 11 U.S.C. § 24 (1976)) (current version at 11 U.S.C. app. § 522 (Supp. II 1978)).

6. These amounts and kinds of exempt property are set forth at 11 U.S.C. app. § 522(d) (Supp. II 1978). See notes 27-72 and accompanying text *infra*.

avoiding powers over liens on, or involuntary transfers of, exempt property.⁷

An important feature of the new Bankruptcy Code is the provision enabling the debtor to select either the uniform federal system of exemptions provided by the Code, or the state and non-bankruptcy federal exemptions such as were permitted by the 1898 Bankruptcy Act.⁸ In one sense, the Code's specified exemptions are a federal floor or minimum so that the debtor is not denied more favorable non-Code exemptions that may be available.

This Article examines the Code's treatment of exempt property. It first analyzes the debtor's ability to elect between the two exemption systems, and follows with a close look at the federal alternative. Next it examines the status of exempt property. The Article then addresses the broad avoiding powers the Code extends to debtors. Finally, several procedural and constitutional considerations that have significance when exempting property are discussed.

THE ELECTION

A full appreciation of the Code's treatment of exemptions requires acquaintance with section 541.⁹ When a bankruptcy case is filed and an estate created,¹⁰ section 541 determines what interests of the debtor become the property of this estate. Generally, all legal or equitable interests of the debtor, wherever located as of the commencement of the case, are included.¹¹ The provisions of section 541 are indeed broad, with the only apparent property not entering into the estate being the debtor's interest in a spendthrift trust that is valid under state law.¹²

7. 11 U.S.C. app. § 522(f)-(i) (Supp. II 1978).

8. 11 U.S.C. app. § 522(b) (Supp. II 1978). See notes 14, 15, and accompanying text *infra*.

9. 11 U.S.C. app. § 541 (Supp. II 1978). While an analysis of § 541 is beyond the scope of this Article, the significance of this section lies in the fact that many property interests that escape administration under the 1898 Act do not fare as well under the Code. H.R. REP. NO. 595, 95th Cong., 1st Sess. 367-69 (1977).

10. Cases creating such estates may be voluntary, 11 U.S.C. app. § 301 (Supp. II 1978) (any entity that is a debtor), joint, *id.* § 302 (an individual that may be a debtor and such individual's spouse), or involuntary, *id.* § 303 (commenced only under chapter 7 or 11 of Title 11 and only against a person, except a farmer or a corporation that is not a moneyed, business, or commercial corporation, that may be a debtor under the chapter under which the case is commenced).

11. *Id.* § 541(a)(1).

12. *Id.* § 541(c)(2). A spendthrift trust is defined as a trust in which the beneficiary is unable to transfer his or her right to future payments of income or capital and creditors are unable to subject the beneficiary's interest to the payment of their claims. G. G. BOGART & C. T. BOGERT, HANDBOOK OF THE LAW OF TRUSTS 147 (5th ed. 1973). Due to the creditor's inability to reach a debtor's interest in a spendthrift trust, it is arguable that such a trust is not really a property interest of a debtor for bankruptcy purposes. If so, § 541(c)(2) is redundant.

Personal injury causes of action provide an example of the Code's broader inclusion of property in the estate compared to the old Act. For example, state laws sometimes combined with the Bankruptcy Act of 1898, ch. 541, § 70(a), 30 Stat. 565 (1897-99), as amended by Chandler Act, ch. 575, § 70(a), 52 Stat. 879 (1938) (originally codified at 11 U.S.C. § 110 (1976)) (repealed

Once property is part of the estate, the debtor is permitted to claim exemptions.¹³ Section 522(b) provides the debtor with a choice of exemption systems. The debtor may elect the federal alternative and exempt property via the uniform bankruptcy exemptions set forth in section 522(d),¹⁴ or

(1979)), to exclude personal injury causes of action. *See, e.g., In re Schmelzer*, 480 F.2d 1074 (6th Cir. 1973) (title to a cause of action does not pass to the trustee when the state does not subject the claim to judicial process); *In re Buda*, 323 F.2d 748 (7th Cir. 1973) (same). *But see Carmona v. Robinson*, 336 F.2d 518 (9th Cir. 1964) (because California subjects a personal injury action to judicial process once it is pending in court, title to such cause of action passes to the trustee in bankruptcy). Although the Code includes such causes of action in the estate, the new alternative permits an exemption of payment not to exceed \$7,500 due to a personal bodily injury, 11 U.S.C. app. § 522(d)(11)(D) (Supp. II 1978), and payment in compensation of loss of future earnings. *Id.* § 522(d)(11)(E).

13. The statutory concept is first to include all property of the debtor in the estate and then to allow exemptions. H.R. REP. NO. 595, 95th Cong., 1st Sess. 368 (1977).

14. 11 U.S.C. app. § 522(b)(1) (Supp. II 1978). The power to enact uniform federal bankruptcy exemptions is derived from the constitutional provision stating that Congress may establish uniform bankruptcy laws throughout the United States. U.S. CONST. art. I, § 8, cl. 4. The earliest federal bankruptcy statutes, enacted in 1800 and 1841, provided for uniform federal standards for exempting property. These laws, however, were short-lived, with Congress repealing each within three and two years respectively. *See Plumb, The Recommendation of the Commission on the Bankruptcy Laws—Exempt and Immune Property*, 61 VA. L. REV. 1, 5 (1975) [hereinafter cited as *Plumb*]; 68 YALE L.J. 1459, 1460-61 (1951) [hereinafter cited as *Critique*]. The Act of 1867 provided for an election between a uniform federal exemption and local state exemptions. Due to the expense and corruption in its administration, the Act of 1867 was repealed in 1878. *See Plumb, supra* at 5; *Critique, supra* at 1461-62. The Act of 1898, which as amended had force until the effective date of the Code, gave a bankrupt whatever exemptions to which he or she might be entitled under the laws of the state of his or her domicile and to any exemptions that other federal laws made available. Bankruptcy Act of 1898, ch. 541, § 6, 30 Stat. 548 (1897-99), *as amended by Chandler Act*, ch. 575, § 6, 52 Stat. 847 (1938) (originally codified at 11 U.S.C. § 24 (1976)) (replaced with 11 U.S.C. app. § 522 (Supp. II 1978)). *See Plumb, supra* at 5; *Critique, supra* at 1462-63. Thus, for the last 80 years the bankruptcy exemptions have not been uniform.

The policy of deferring to state exemptions was widely criticized. *See, e.g., Countryman, Consumer Bankruptcy—Some Recent Changes and Some Proposals*, 19 U. KAN. L. REV. 165, 167-68 (1971); King, *Proposed Amendments to the Chandler Act*, 45 COM. L.J. 36, 40 (1940); *Critique, supra* at 1510-11. The gist of this criticism was: (1) given the great variety among state exemption laws, the policy promotes unequal treatment of debtors; (2) Congress should not delegate to state legislatures the important task of determining what property bankrupts may retain; (3) there is a state rather than a federal priority for exemptions; and (4) references to non-bankruptcy law results in much litigation. *See Vukowich, The Bankruptcy Commission's Proposal Regarding Bankrupt's Exemption Rights*, 63 CAL. L. REV. 1439, 1441-44 (1975) [hereinafter cited as *Vukowich*]. In light of this criticism, the Commission on Bankruptcy Laws of the United States proposed in 1973 that Congress avoid the unfairness of state exemptions by enacting a uniform system of exemptions in bankruptcy. Thereafter, the National Conference of Commissioners on Uniform State Laws approved the Uniform Exemption Act in 1976. *See Uniform Exemptions Act*, U.L.A. CIVIL PROC. & REM. LAWS 7-9 (Supp. 1978) [hereinafter cited as *UEA*]. *See also* H.R. REP. NO. 595, 95th Cong., 1st Sess. 361 (1977). Although § 522, as enacted by Congress, generally follows the Bankruptcy Commission's proposals, one major departure was the inclusion of the election between the bankruptcy-specified exemptions and the existing state and federal exemptions. This alternative approach was proposed by the National Conference of Bankruptcy Judges in the so-called "Judges' Bill." H.R. 32, 94th Cong., 1st Sess. (1975). *See* H.R. 16643, 93d Cong., 2d Sess. (1974). As a result of a House-Senate compromise

the debtor may exempt property under any federal law other than the uniform exemptions, as well as under state and local law.¹⁵ These alternatives are mutually exclusive. The debtor may not maximize his or her exemptions by applying state and non-Code federal exemptions to certain property and the uniform federal exemptions to other property.¹⁶ Therefore, the debtor must carefully choose the alternative providing the greater advantages. The consequences of selecting the federal alternative exemptions or the non-uniform exemptions are best understood by comparing the two systems.

The non-uniform exemption alternative has two parts. The first part includes non-bankruptcy federal and state exemptions that are applicable on the date the petition is filed at the place in which the debtor's domicile has been located for the 180 days prior to the filing date.¹⁷ The second part extends an exemption to any interest held by the debtor "as a tenant by the entirety or joint tenant to the extent that such interest . . . is exempt from process under applicable non-bankruptcy law."¹⁸ Although many states permit jointly held property to be reached only by joint creditors,¹⁹ such an interest is property of the estate under the Code and is subject to administration for the benefit of creditors unless it is exempt.²⁰ The second part of the non-uniform exemption system provides such an exemption.²¹ There is nothing comparable to this exemption, however, under the federal alternative. Thus, the debtor who elects the federal alternative loses any advantages

during the closing days of the 95th Congress, however, § 522 also gives each state the power to deny the federal alternative to its residents 11 U.S.C. app. § 522(b)(1) (Supp. II 1978). See 124 CONG. REC. 111, 115 (daily ed. Sept. 28, 1978) (remarks of Rep. Butler). Absolute national uniformity, therefore, is frustrated by first giving the debtor a choice between the new and old systems and then giving each state the power to withdraw the opportunity to choose the new system. Some states already have exercised this power. See, e.g., 1979 Fla. Sess. Law Serv. ch. 79-363.

15. 11 U.S.C. app. § 522(b)(2) (Supp. II 1978). This alternative continues the law of the 1898 Act. Bankruptcy Act of 1898, ch. 541, § 6, 30 Stat. 548 (1897-99), as amended by Chandler Act, ch. 575, § 6, 52 Stat. 847 (1938) (originally codified at 11 U.S.C. § 24 (1976)) (repealed 1979).

16. This conclusion is based on the wording of § 522(b). 11 U.S.C. app. § 522(b) (Supp. II 1978) states that a "debtor may exempt from property of the estate either (1) property that is specified under [the uniform exemptions] . . . or, in the alternative, (2) . . . property that is exempt under [other] Federal . . . or state or local law . . ." *Id.* (emphasis added). Even though spouses may file a single joint petition, *id.* § 302(a), the Code assures that the § 522(b) election applies individually to each spouse. *Id.* § 522(m). Therefore, each spouse may elect a different exemption system. H.R. REP. NO. 595, 95th Cong., 1st Sess. 363 (1977).

17. 11 U.S.C. app. § 522(b)(2)(A) (Supp. II 1978).

18. *Id.* § 522(b)(2)(B).

19. See Plumb, *supra* note 14, at 114-18.

20. See 11 U.S.C. app. § 541 (Supp. II 1978). The old bankruptcy law provided that property was not included in the estate if it was immune to sequestration and not transferable under state law. Bankruptcy Act of 1898, ch. 541, § 70(a)(5), 30 Stat. 565 (1897-98), as amended by Chandler Act, ch. 575, § 70(a)(5), 52 Stat. 879 (1938) (originally codified at 11 U.S.C. § 110(a)(5) (1976)) (repealed 1979).

21. For a good discussion in this area, see Plumb, *supra* note 14, at 114-37; Vukowich, *supra* note 14, at 1480-81.

under state law which protect jointly owned property from invasion by creditors.²²

Another consequence of choosing the uniform federal alternative is that the debtor not only waives state exemptions but also waives federal exemptions that often are taken for granted. While many of these exemptions are duplicated in the federal alternative,²³ other important ones are not. For example, the seventy-five percent wage garnishment limitation contained in the Consumer Credit Act²⁴ was not included. Indeed, the federal alternative contains no specific exemption for wages or salaries.

Despite these limitations, the federal alternative provides many advantages to debtors. Within its scope are explicit exemptions for the debtor's interests in a wide variety of specified properties.²⁵ This includes an unprecedented exemption of up to \$7,900 in *any* property.²⁶ Thus, debtors should choose their exemption system only after performing a detailed legal and factual analysis of their property.

THE FEDERAL ALTERNATIVE

The exemptions available to a debtor who elects²⁷ the federal alternative under section 522(d)²⁸ are contained in eleven paragraphs, two of which consist of five parts. Section 522(d) is characterized by a unique, unrestricted \$7,900 grubstake exemption.²⁹ The Code also provides for an assortment of restricted exemptions for which there is a broad, although not universal, consensus among existing exemption statutes. Most of the latter exemptions

22. As explained by Professor Frank R. Kennedy, who served as the Bankruptcy Commission's Executive Director: "If one opts for the federal exemption, he will give up any advantage under state law that protects an estate by the entirety from invasion by creditors of either spouse. If you take the federal exemption, you submit to a termination of the estate by the entirety." Kennedy, *New Bankruptcy Act Impact on Consumer Credit*, 33 *BUS. LAW.* 1059, 1064 (1978). The sale of an estate by the entirety, as well as a non-filing co-owner's interest as a tenant in common or joint tenant with the debtor, is permitted by the Code. 11 U.S.C. app. § 363(h) (Supp. II 1978). Thus, "heretofore inviolable property rights of the debtor's spouse" are exposed to the trustee's reach. Plumb, *supra* note 14, at 137.

23. For example, Social Security payments, 42 U.S.C. § 407 (1976), and veteran benefits, 45 U.S.C. § 352(E) (1976), are duplicated in 11 U.S.C. app. § 522(d)(10) (Supp. II 1978).

24. 15 U.S.C. app. § 1673 (Supp. II 1978).

25. 11 U.S.C. app. § 522(d) (Supp. II 1978).

26. See note 29 *infra*.

27. See notes 14-16 and accompanying text *supra*.

28. 11 U.S.C. app. § 522(d) (Supp. II 1978).

29. The figure of \$7,900 is computed by reading § 522(d)(5) together with § 522(d)(1). 11 U.S.C. app. § 522(d)(5) (Supp. II 1978) provides for an exemption equal to "[t]he debtor's aggregate interest, not to exceed in value \$400 plus any unused amount of the exemption provided under paragraph (1) of this subsection, in any property." 11 U.S.C. app. § 522(d)(1) (Supp. II 1978) provides for the following exemption:

The debtor's aggregate interest, not to exceed \$7,500 in value, in real property or personal property that the debtor or a dependent of the debtor uses as a residence, in a cooperative that owns property that the debtor or a dependent of the debtor uses as a residence, or in a burial plot for the debtor or a dependent of the debtor.

contain value, use, or need limitations that generally are neither as liberal as those in some states, nor as austere as those in others.³⁰ Somewhat surprisingly, personal earnings are not expressly exempt, and a specific exemption for the debtor's residence or burial plot also is missing.³¹

Two terms that have particular relevance to the section 522(d) exemptions are defined in the Code. The first term is dependent, including a nondependent spouse.³² The word "dependent" is employed in the Code, rather than "head-of-family" or "head-of-household" designations, as an element of need and use limitations for exemptions.³³ The second definition is that of value, meaning "fair market value as of the date of filing the petition."³⁴ Section 522(d) further defines value by exempting the debtor's interest³⁵ in property, rather than the property itself.³⁶ It follows that the value of such an interest in property is computed exclusive of liens.³⁷ For example, a \$5,000 automobile that is subject to a \$3,800 security interest is exempt because the debtor's interest does not exceed \$1,200, the amount of the exemption.³⁸

The unrestricted exemption³⁹ permits the debtor to exempt his interest in "any property" to a value of \$400, "plus any unused amount" of the \$7,500 residential exemption.⁴⁰ This provision is unique among exemption statutes and proposals.⁴¹ The primary impact of the unrestricted exemption is to replace the \$400 limitation⁴² with a \$7,900 allowance for all debtors who do

30. See 1A COLLIER ON BANKRUPTCY 867-901 (14th ed. 1978); Vukowich, *supra* note 14, at 1457-67; Vukowich, *Debtor's Exemption Rights*, 62 GEO. L.J. 779, 797-832 [hereinafter cited as *Exemption Rights*]. With respect to the types of property exempted, there are many similarities between § 522(d) and the Uniform Exemption Act. See UEA, *supra* note 14. The Code's exemptions tend to be less generous than those provided for in the Uniform Exemption Act, with the notable exception of the unrestricted grubstake exemption. Compare 11 U.S.C. app. § 522(d)(2)-(4) (Supp. II 1978) with UEA, *supra* note 14, at § 8(a)-(c).

8(a)-8(c).

31. See text accompanying notes 44-46 *infra*.

32. 11 U.S.C. app. § 522(a)(1) (Supp. II 1978).

33. *Id.* §§ 522(d)(10)(D), (E), 522 (d)(11)(B), (C), (E).

34. *Id.* § 522(a)(2).

35. *Id.* § 522(d)(1)-(6), (d)(8). Other paragraphs exempt the debtor's right to receive property. *Id.* § 522(d)(10)-(11).

36. Cf. UEA, *supra* note 14, at § 1(10), which defines "value" as the "fair market value of an individual's interest in property, exclusive of valid liens." Because § 522(d) typically exempts the debtor's interest in property, rather than the property itself, the differences between the Uniform Exemption Act's and the Code's definitions are not significant.

37. Under the Code, the debtor has the power to avoid liens on his or her property. See notes 92, 93, and accompanying text *supra*.

38. 11 U.S.C. app. § 522(d)(2) (Supp. II 1978).

39. *Id.* § 522(d)(5).

40. *Id.* § 522(d)(1).

41. Most existing statutes restrict a debtor's exemptions to types of property that are perceived as necessary to sustain ordinary livelihood in modern society. See, e.g., UEA, *supra* note 14, at § 8(a)-(c). Statutes or proposals that resemble the Code's exemption in kind are much more limited in amount. See, e.g., UEA, *supra* note 14, at § 8(d).

42. 11 U.S.C. app. § 522(d)(5) (Supp. II 1978).

not claim residential exemptions.⁴³ This represents the majority of individuals who file bankruptcy.

An apparently unintended consequence of incorporating "any unused amount" of the \$7,500 residential allowance⁴⁴ into the unrestricted exemption⁴⁵ is the elimination of specific exemptions for residences and burial plots. The language of the residential allowance provision becomes surplusage, and the unrestricted exemption is, in effect, a \$7,900 allowance. This result derives from the fact that the unrestricted allowance provision employs the general term, "any property," which necessarily includes whatever property is specifically described in the exemption section pertaining to residences. Whether a particular piece of property qualifies as "real . . . or personal property that the debtor or a dependent of the debtor uses as a residence"⁴⁶ is immaterial; the property readily qualifies under the unrestricted exemption provision.

The policy implication of the merger of the residential allowance⁴⁷ and the unrestricted exemption⁴⁸ is that highly favored property, such as a homestead or burial plot, receives the same treatment under section 522(d) as less favored property such as country club memberships, ski cabins, gambling casino chips, wine cellars, and yachts. Likewise, departure from the restricted property requirement proposed in the Commission Bill⁴⁹ results in treating earnings no better than lottery tickets. Of course, the unrestricted allowance also may be used to enhance the value of other exemption allowances.

The probable impact of the grubstake exemption⁵⁰ is that, in the majority of cases, the balance will tip toward election⁵¹ of the federal alternative

43. Congress indicated that the unrestricted exemption was included "in order not to discriminate against the non-homeowner." H.R. REP. NO. 595, 95th Cong., 1st Sess. 361 (1977). The bill proposed by the Commission on the Bankruptcy Laws of the United States was the forerunner to the present Act. H.R. 31, 94th Cong., 1st Sess. (1975) [hereinafter cited as Commission Bill]. The Commission Bill exempted "cash, securities, and receivables, including unpaid personal earnings, accrued vacation pay and income tax refunds, to the aggregate value of . . . \$500." Commission Bill, *supra* at § 4-503(c)(3). Earnings, vacation pay, and tax refunds—none of which are expressly exempted under § 522(d)—thus were among the assets sought to be protected early in the evolutionary development of § 522(d)(5).

The unrestricted exemption concept has received criticism. For example, the draftsmen of the Uniform Exemption Act rejected an exemption having the characteristics of the Code provision. The Uniform Exemption Act, therefore, "does not reflect the view that every debtor is entitled to a minimum grubstake for whatever purpose may please him." UEA, *supra* note 14, at 10. Another commentator characterized the unrestricted exemption as "unnecessary and exorbitant." *Exemption Rights*, *supra* note 30, at 1463.

44. 11 U.S.C. app. § 522(d)(1) (Supp. II 1978).

45. *Id.* § 522(d)(5).

46. *Id.* § 522(d)(1).

47. *Id.*

48. *Id.* § 522(d)(5).

49. Commission Bill, *supra* note 43, at § 4-503(c). See *Exemption Rights*, *supra* note 30, at 1460-67.

50. 11 U.S.C. app. § 522(d)(5) (Supp. II 1978).

51. *Id.* § 522(b).

exemption scheme over state and other federal exemptions.⁵² Moreover, to the extent that the section 522(d) exemption system is elected, the unrestricted exemption provision may be expected to curtail substantially the number of cases in which assets are administered for the benefit of creditors.

In addition to the unrestricted allowance, section 522(d) provides for exemptions restricted to particular types of property. The first category of restricted exemptions includes property exempt without regard to value, use, or need of the debtor and dependents.⁵³ The second category consists of the debtor's interests in certain property valued at designated amounts.⁵⁴ Another classification includes property exempt but subject to both value and use limitations.⁵⁵ The final group of restricted exemptions is comprised of property interests exempt to the extent reasonably necessary⁵⁶ for the support of the debtor and dependents.⁵⁷ With the exception of support

52. Of 200 individual bankrupts who commenced cases in the Northern District of California during December, 1978, slightly less than 20% had property that enabled them to take advantage of California's generous homestead exemptions. For most of the balance of bankrupts, the \$7,900 grubstake exemption would have been considerably more attractive. L. Russel, Report of Homestead Claims in Cases Filed in the United States District Court, Bankruptcy Court, Alameda and Contra Costa Counties, in December, 1978 (Jan. 25, 1979) (unpublished study in United States Bankruptcy Court, N.D. Cal., Oakland).

53. 11 U.S.C. app. § 522(d)(7) (Supp. II 1978) (unmatured life insurance policy); *id.* § 522(d)(9) (health aids); *id.* § 522(d)(10)(A) (Social Security benefits, unemployment compensation, local public assistance); *id.* § 522(d)(10)(C) (temporary disability, illness, or unemployment benefits); *id.* § 522(d)(11)(A) (crime victim's award). The insurance policy exemption is designed to prevent the trustee from surrendering a policy on the debtor's life and thereby causing it to lapse. See H.R. REP. NO. 595, 95th Cong., 1st Sess. 361 (1977). The Code further protects against the lapse of a life insurance policy by allowing the insurer, when permitted by contract, to use any value in the policy to pay premiums. 11 U.S.C. app. § 542(d) (Supp. II 1978).

54. 11 U.S.C. app. § 522(d)(2) (Supp. II 1978) (one motor vehicle; \$1,200); *id.* § 522(d)(8) (cash value of life insurance policy; \$4,000); *id.* § 522(d)(11)(D) (personal bodily injury award; \$7,500). The \$4,000 insurance allowance included within this category represents a departure from the virtually unlimited insurance exemptions provided for in many states. See, e.g., ARK. STAT. ANN. § 30-208 (1947); FLA. STAT. ANN. § 222.14 (West 1977); ILL. REV. STAT. ch. 73, § 850 (West 1977). OKLA. STAT. ANN. tit. 36, §§ 2410, 2510, 2720 (West 1976). The injury payments that are exempted under this category are to be distinguished from payments for "pain and suffering or compensation for actual pecuniary loss," which are not exempt. 11 U.S.C. app. § 522(3)(11)(D) (Supp. II 1978). The House Report explained that this provision is "designed to cover payments . . . [for] actual bodily injury, such as loss of a limb, and is not intended to include the attendant costs that accompany such a loss, such as . . . loss of earnings." H.R. REP. NO. 595, 95th Cong., 1st Sess. 362 (1977).

The exemptions with value limitations are not indexed to the cost of living, unlike those in the Uniform Exemption Act. See, *UEA, supra* note 14, at § 2. The Code, however, directs the Judicial Conference of the United States to recommend adjustments in dollar amounts to the Congress and the President every six years, commencing in 1985. 11 U.S.C. app. § 104 (Supp. II 1978).

55. 11 U.S.C. app. § 522(d)(3) (Supp. II 1978) (property held for personal, family, or household use; \$200 per item); *id.* § 522(d)(4) (jewelry); *id.* § 522(d)(6) (property used in the debtor's trade; \$750).

56. See notes 58-62 and accompanying text *infra*.

57. 11 U.S.C. app. § 522(d)(10)(D) (Supp. II 1978) (support and alimony payments); *id.* § 522(d)(10)(E) (stock bonus and pension payments); *id.* § 522(d)(11)(B) (wrongful death award);

payments, the types of property exempted by the latter category generally will involve large amounts of money. The "reasonably necessary" test, therefore, is the battleground upon which debtors holding such assets and their creditors will meet.

Neither the Code nor any legislative history report defines "reasonably necessary." The Commission Bill, first proposing this limitation,⁵⁸ also was silent.⁵⁹ Similar terminology, however, has been construed by various state courts.⁶⁰ Further guidance in defining "reasonably necessary" may be found in the Uniform Exemption Act.⁶¹ In view of the evolutionary relationship

id. § 522(d)(11)(C) (insurance proceeds); *id.* § 522(d)(11)(E) (payment in compensation of loss of future earnings).

The spousal-support-payment exemption is somewhat illusory. For example, it may be difficult to establish a debtor's need with respect to past due support payments. Also, in a case involving a debtor's right to future support payments, an order based on a finding of insufficient need would place the bankruptcy court in a domestic relations stance. Finally, only true support payments are covered; obligations, such as payments representing a division of property, are not exempt. *Adler v. Nicholas*, 381 F.2d 168, 172 (5th Cir. 1967); *In re Fiorio*, 128 F.2d 562, 563 (7th Cir. 1942). See *Plumb*, *supra* note 14, at 32. Child support payments owed to the debtor are not explicitly exempted in the Code. Such amounts due on behalf of a child usually are considered trust funds and are beyond the reach of the bankruptcy trustee. See, e.g., *In re Gardner*, 243 F. Supp. 258 (D. Or. 1965). See also *Plumb*, *supra* note 14, at 32.

A second provision in this category warranting special comment is the exemption for pension payments and other permanent employment benefits. 11 U.S.C. app. § 522(d)(10)(E) (Supp. II 1978). No distinction is drawn between public and private employment benefits. In some instances, private employment benefits based on age or length of service are denied exemption, unless the plan or contract qualifies for tax deferral under the Internal Revenue Code. *Id.* This exception applies only if the debtor is employed by an insider, such as a partnership in which the debtor is a general partner or a corporation in which the debtor is a director, officer, or person in control. *Id.* See 11 U.S.C. app. § 101(25)(A) (Supp. II 1978). Temporary benefits are unlimited in amount, whereas permanent benefits are subject to the "reasonably necessary" test. *Id.* § 522(d)(10)(E). See notes 58-62 and accompanying text *infra*.

58. Commission Bill, *supra* note 43, at § 4-503.

59. See *Plumb*, *supra* note 14, at 94.

60. See, e.g., *In re Brown's Estate*, 35 N.Y.S.2d 646, 648, 650 (Sup. Ct. 1941), *aff'd*, 264 App. Div. 824, 35 N.Y.S.2d 738 (1942) (the court took into consideration the manner of living to which bankrupt beneficiary of trust had been accustomed); *Sillick v. Mason*, 2 Barb. 79 (1847) (defendant brought up with improvident habits and without learning to care for property was not expected to maintain himself and his family as comfortably on same amount as industrious business man). Cf. *Canfield v. Security-First Nat'l Bank*, 13 Cal. 2d 1, 87 P.2d 830 (1939) (creditors are not required to defer to expenditures for excessive entertaining and luxuries); *Tolles v. Wood*, 99 N.Y. 616, 1 N.E. 251 (1885) (creditors need not defer to expenditures for extravagant life style).

61. Section 6(b) of the Uniform Exemption Act defines property reasonably necessary for the support of the debtor and his or her dependents as "property required to meet the present and anticipated needs of the individual and his or her dependents, as determined by the court after consideration of the individual's responsibilities and all the present and anticipated property and income of the individual, including that which is exempt." UEA, *supra* note 14, at § 6(b). The comment to § 6(b) notes that these standards differ from those "generally governing . . . what is . . . allowable . . . as alimony and support or as a distribution to a beneficiary under a support trust." UEA, *supra* note 14, at 25. The comment also indicates that "[r]ather than focusing on the debtor's station in life and the standard of living to which he has been accustomed, the definition requires the court to direct its attention to the individual's needs and responsibilities." *Id.*

between the Commission Bill, the Uniform Exemption Act, and the Code, the Uniform Exemption Act's definition and comments carry great weight.⁶² Once a court has determined that an exemption involving future payments, such as pensions or other permanent employment benefits, exceeds the debtor's reasonable needs, the problem of realizing the excess for the benefit of creditors arises.⁶³

Tracing—the right to preserve an exemption as it changes form—⁶⁴ is greatly restricted under section 522(d). It is expressly permitted only as to one category of property.⁶⁵ It is reasonable to conclude that section 522(d) precludes other tracing. First, the draftsmen's use of the concept in only one section suggests it was deliberately withheld as to all other property interests. Moreover, tracing generally is less important in the static bankruptcy context—where exemption rights are determined as of one point in time—than in the non-bankruptcy context.⁶⁶ Finally, the unrestricted exemption⁶⁷ may be viewed as an alternative to tracing. The denial of tracing is particularly significant with respect to exemptions of the debtor's "right to receive" various benefits or payments.⁶⁸ In the absence of tracing, the received payment no longer is exempt under the Code, and the debtor must utilize the unrestricted exemption⁶⁹ to protect such assets.

It also is noteworthy that section 522(d) contains no exemptions for personal earnings. Wages and salaries, therefore, are exempt only under the unrestricted allowance provision.⁷⁰ According to one commentator, the exemption of earnings is "[t]he most significant exemption for most debtors."⁷¹ The absence of a specific earnings exemption, however, has no consequence

62. In contrast to the Uniform Exemption Act's approach discussed in note 61 *supra*, the California courts have construed a comparable "necessary" limitation in terms of the debtor's social class and customary standard of living. *See, e.g., In re Westhem*, 459 F. Supp. 556 (C.D. Cal. 1978) (bankrupt was permitted to exempt a four carat diamond ring). One commentator advocates that "reasonably necessary" be construed by an objective standard, namely as "reasonably essential to or needed by an average and reasonable person." *Exemption Rights*, *supra* note 30, at 1462. Applying that standard to life insurance proceeds, he assumes they would not be exempt to a debtor "who was able to work since the benefits would not be necessary for such a person's support." *Id.* at 1461.

63. The problem has been assessed as follows: "Apparently, when there is an excess, the trustee may sell the right to it, hold open the estate so as to collect the income, or reach the fund itself." Plumb, *supra* note 14, at 58.

64. For example, tracing allows an exemption to be preserved as it changes form from the exempt right to receive a payment, to payment in the form of a check, to a bank deposit, and ultimately to cash proceeds.

65. 11 U.S.C. app. § 522(d)(11) (Supp. II 1978).

66. *See Exemption Rights*, *supra* note 30, at 836-37.

67. 11 U.S.C. app. § 522(d)(5) (Supp. II 1978).

68. *Id.* § 522(d)(10).

69. *Id.* § 522(d)(5).

70. *Id.*

71. *See Exemption Rights*, *supra* note 30, at 813. Virtually all states protect personal earnings from judicial process to some extent, and some states prohibit any garnishment of wages. *See, e.g.,* FLA. STAT. ANN. § 222.11 (West 1977); OKLA. STAT. ANN. tit. 12, § 1171.1 (West 1976); 42 PA. CONS. STAT. ANN. § 866 (Purdon 1966). The Federal Consumer Credit Protec-

with respect to wages earned subsequent to the commencement of the case.⁷²

STATUS OF EXEMPT PROPERTY

Sections 541(a)(1)⁷³ and 522(b)⁷⁴ of the Code operate together to establish two concepts. First, all of the debtor's property at the commencement of the case comprises an estate, and second, the individual debtor is permitted to exempt certain property interests from the property of the estate.⁷⁵ The removal would appear to be retroactive to the commencement of the case because, with one exception, exempt property "is not liable for payment of any administrative expense."⁷⁶ The converse follows, however, and the estate is not liable for any liens or charges, such as storage costs, that are attributable to exempt property.

Once property has been removed from the estate under either exemption system, it remains free from the subsequent claims of most creditors.⁷⁷ Any property that is exempted under this section "is not liable during or after the case for debt . . . that arose . . . before the commencement of the case."⁷⁸ Without this provision, property set aside to the debtor pursuant to the federal alternative could be vulnerable under state law to creditors holding non-dischargeable claims.

Exceptions to the general rule found in section 522(c) include non-discharged taxes⁷⁹ and family support obligations.⁸⁰ These exceptions are con-

tions Act, 15 U.S.C. §§ 1601-93R (1976), limits garnishment of wages to no more than 25% of disposable earnings. *Id.* § 1673(a)(1).

The forerunner of the unrestricted exemption provision was intended by the Commission to harbor earnings. *See* Commission Bill, *supra* note 43, at § 4-503(c)(3). *See also* Plumb, *supra* note 14, at 27. An approach similar to that adopted by the Commission was followed in the Uniform Exemption Act, which expressly allows the application of the cash exemption to "unpaid earnings not otherwise exempt." *UEA*, *supra* note 14, at § 8(d). The preceding passage refers to the "assumption . . . that personal earnings are now appropriately taken care of by" the Uniform Consumer Credit Code and the Federal Consumer Credit Protection Act. *Id.* at 11. That assumption does not apply to § 522(d) because neither state nor non-bankruptcy federal exemptions are available to the debtor who elects the federal alternative. 11 U.S.C. app. § 522(b) (Supp. II 1978).

72. 11 U.S.C. app. § 541(a)(6) (Supp. II 1978). But see 11 U.S.C. app. § 1306(a)(2) (Supp. II 1978), which provides that earnings from services performed after commencement of the case would be included as property of the estate.

73. *See* notes 9-12 and accompanying text *supra*.

74. *See* notes 13-15 and accompanying text *supra*.

75. Congress stated that § 541(a)(1) "includes as property of the estate all property of the debtor, even that needed for a fresh start. After the property comes into the estate, then the debtor is permitted to exempt it." H.R. REP. NO. 595, 95th Cong., 1st Sess. 368 (1977).

76. 11 U.S.C. app. § 522(k) (Supp. II 1978). The exception is confined to expenses attributable to avoidance or transfers affecting exempt property. *See* note 120 *infra*.

77. 11 U.S.C. app. § 522(c) (Supp. II 1978).

78. *Id.*

79. *Id.* § 522(c)(1).

80. *Id.* § 522(e)(1).

sistent with the general rule that otherwise exempt property is liable for taxes⁸¹ and for spouse and child support obligations.⁸² Also excepted from the provisions of section 522(c) are liens that are not avoided and tax liens that are voided provided notice is properly filed.⁸³ The Code "will not prevent enforcement of valid liens . . . on exempt property."⁸⁴

Section 522(c) thus serves three objectives. First, it protects section 522(d) property after bankruptcy. Second, it creates a uniform policy concerning debts that may be satisfied from exempt property. Finally, it provides that consensual liens, generally, and nonconsensual tax liens, in particular, may be enforced on exempt property.

AVOIDANCE OF LIENS ON EXEMPT PROPERTY

The Code's grant to the debtor of avoiding powers on exempt property rivals the uniform exemption scheme of section 522(d) in importance and its unrestricted grubstake exemption in novelty. There is a paucity of precedent for this in prior bankruptcy laws. The old Act provided limited authority to avoid judicial liens in favor of the debtor.⁸⁵ It also contained a narrow exception to a proviso that expressly denied exemption rights in property transferred or concealed by the bankrupt and recovered by the trustee.⁸⁶ The avoiding powers set out in the Code,⁸⁷ however, go far beyond what-

81. 11 U.S.C. app. § 522(c)(1) (Supp. II 1978).

82. See *Cartledge v. Miller*, 457 F. Supp. 1146 (S.D.N.Y. 1978); *Exemption Rights*, *supra* note 30, at 852-53. California, however, adheres to the minority view and expressly protects exempt property from state taxes. CAL. CIV. PROC. CODE § 690.51 (West Supp. 1978). Furthermore, California courts do not distinguish between support and non-support judgments in applying exemption laws. See, e.g., *Miller v. Superior Court*, 69 Cal. 2d 14, 442 P.2d 663, 69 Cal. Rptr. 583 (1968). Tax collectors and frustrated spousal-support judgment holders in California and similar states can be expected to initiate involuntary bankruptcy actions against debtors with substantial exempt property interests such as homesteads, life insurance, and pensions.

83. 11 U.S.C. app. § 522(c)(2) (Supp. II 1978).

84. H.R. REP. NO. 595, 95th Cong., 1st Sess. 361 (1977). Both the Senate and the House accepted the rule of *Long v. Bullard*, 117 U.S. 617 (1880), which stated that a discharge in bankruptcy did not affect a valid lien on exempt property. *Id.* See S. REP. NO. 989, 95th Cong., 2d Sess. 78 (1978).

85. Under the old Bankruptcy Act, liens obtained against the property of a debtor by an unsecured creditor by legal proceedings within four months before filing the petition could be avoided if the debtor was insolvent when the lien was obtained. Bankruptcy Reform Act of 1898, ch. 541, § 67, 30 Stat. 564 (1897-99), as amended by Chandler Act, ch. 575, § 67, 52 Stat. 875 (originally codified at 11 U.S.C. § 107(a) (1976)) (repealed 1979). See *Chicago, B. & Q. R.R. v. Hall*, 229 U.S. 511 (1913) (property is withdrawn from the estate not for the purpose of being subjected to liens, but on the supposition that it needed no protection because they had been nullified).

86. Bankruptcy Reform Act of 1898, ch. 541, § 6, 30 Stat. 548 (1897-99), as amended by Chandler Act, ch. 575, § 6, 52 Stat. 847 (1938) (originally codified at 11 U.S.C. § 24 (1976)) (repealed 1979).

87. 11 U.S.C. app. § 522(f)-(k) (Supp. II 1978).

ever powers the bankrupt had under the old law in concept and even farther in application.

There are two types of avoiding powers: those directly granted to the debtor⁸⁸ and those the debtor shares with, or derives from, the trustee.⁸⁹ The powers held solely by the debtor are found in section 522(f), allowing the debtor to avoid "the fixing of a lien on . . . property to the extent that such lien impairs an exemption to which the debtor would have been entitled" if the lien is of a specified type.⁹⁰ Two types of liens are specified as qualifying for avoidance. The first, and more important type, is a judicial lien.⁹¹ Because the Code imposes no limitation for avoiding a judicial lien this power is of great practical importance to debtors. This power also is significant because it applies to judicial liens on real as well as personal property.⁹² The second type of lien that can be avoided by a debtor is a non-possessory, non-purchase-money security interest in a particularly favored class of exempt property.⁹³ Only personal property, described generally as household goods, tools of trade, or health aids, qualifies for this avoiding power.⁹⁴

The balance of the debtor's avoiding powers is derived from the trustee under section 522(g)⁹⁵ or shared with the trustee under section 522(h).⁹⁶ In order to avoid a lien under these powers, the property must qualify as exempt except for its transfer or lien; it must not have been concealed; and the lien or transfer must have been involuntary.⁹⁷

88. *Id.* § 522(f).

89. *Id.* § 522(g)-(i).

90. *Id.* § 522(f).

91. The concept of judicial liens on exempt property would appear to be a contradiction of terms. A judicial lien, however, may be obtained on property capable of being transformed from nonexempt into exempt property by means of a mere formality. For example, California homestead property only is exempt from the time the written declaration of homestead is placed on public record. CAL. CIV. CODE § 1244 (West 1954). A judgment lien, therefore, is unaffected by a subsequently recorded homestead declaration. *Id.* §§ 1241(1), 1241(4). Although such factual-legal circumstances are grist for the Code's avoiding powers mill, they are relatively rare. Thus, the more frequent application of these powers will arise as a result of judicial liens on property that is exempt under the federal alternative but is not exempt under state law.

92. 11 U.S.C. app. § 522(f)(1) (Supp. II 1978).

93. *Id.* § 522(f)(2). The nonpossessory exclusion protects a pawnbroker's lien. The non-purchase money qualification limits application of this provision to lenders.

94. *Id.* Because small loan companies tend to take security interests in such personal property, presumably they will be affected more often by § 522(f)(2) of the Code than other groups of lenders.

95. *Id.* § 522(g).

96. *Id.* § 522(h). See also *id.* § 522(i).

97. *Id.* § 522(g)-(h). By restricting the debtor's right under § 522, subsections (g) and (h), to involuntary transfers, the Code departs from a line of cases that permit the debtor to exempt property the trustee has recovered as a preference or a fraudulent conveyance. Vukowich, *supra* note 14, at 1479.

Accordingly, these powers derived under section 522, subsections (g) and (h), are relatively narrow. They only have possible application to involuntary preferences,⁹⁸ statutory liens,⁹⁹ avoidable setoffs,¹⁰⁰ and property held by a non-custodian.¹⁰¹ Further, section 522(f) is a simpler basis for invalidating preferential judicial liens,¹⁰² except to the extent that constitutional considerations make it inapplicable to pre-existing liens.¹⁰³

The derivative powers found in section 522(g) permit the debtor to exempt property that the trustee recovers under various provisions of the Code.¹⁰⁴ The debtor may not exercise these avoiding powers if the trustee fails to act or if there is no trustee in the case. The rights included in section 522(g) are not the traditional avoiding powers. These rights concern equitable subordination,¹⁰⁵ turnover of property by one other than a custodian,¹⁰⁶ turnover of property by a custodian,¹⁰⁷ and setoffs.¹⁰⁸ Section 522(g), however, also provides that the debtor may exempt property the trustee recovers under section 550, establishing the liability of one who receives an avoided transfer,¹⁰⁹ and under section 551, automatically preserving avoided transfers for the benefit of the estate.¹¹⁰ The inclusion of these latter two sections is significant in that through them traditional avoiding powers are incorporated into section 522(g). This occurs because sections 550 and 551 are applicable to avoidance of transfer sections of the Code other than those delineated in section 522(g).¹¹¹

Contra, Gardner v. Johnson, 195 F.2d 717 (9th Cir. 1952). There is an exception to the limitation that a debtor's rights under § 522(g) apply only to involuntary transfers of property that were not concealed. Property subject to a consensual lien that could be avoided under § 522(f)(2) is not subject to these requirements. 11 U.S.C. app. § 522(g)(2) (Supp. II 1978).

98. 11 U.S.C. app. § 547 (Supp. II 1978). This section includes judicial liens that qualify as preferences.

99. *Id.* § 545.

100. *Id.* § 553.

101. *Id.* § 542.

102. See notes 90-94 and accompanying text *supra*.

103. See note 151 and accompanying text *infra*.

104. 11 U.S.C. app. § 522(g) (Supp. II 1978).

105. *Id.* § 510(c)(2).

106. *Id.* § 542.

107. *Id.* § 543.

108. *Id.* § 553.

109. *Id.* § 550. In this way the Code distinguishes the concept of avoiding a transfer and of recovering from the transferee. H.R. REP. NO. 595, 95th Cong., 1st Sess. 375 (1977).

110. 11 U.S.C. app. § 551 (Supp. II 1978).

111. See 11 U.S.C. app. §§ 544, 545, 547-549, 724(a) (Supp. II 1978). For example, even though § 522(g) does not expressly permit exemption of property whose transfer was avoided by the trustee under the preference section of the Code, § 547, such an act is allowed due to the recovery of this property under § 550.

The shared powers found in section 522(h) permit the debtor to exercise the trustee's traditional avoiding powers in the event of the trustee's inaction.¹¹² The specific rights extended to the debtor involve the strong arm powers,¹¹³ statutory liens,¹¹⁴ preferences,¹¹⁵ fraudulent transfers,¹¹⁶ post-petition transactions,¹¹⁷ and liens securing liabilities for other than actual pecuniary loss.¹¹⁸ The trustee's non-traditional powers of avoidance or recovery are not permitted to the debtor under section 522(h) except with regard to setoffs.¹¹⁹ Once a lien or transfer pursuant to section 522(h) has been avoided, the debtor may recover from the transferee or preserve the lien.¹²⁰

Closely associated with the debtor's powers to avoid liens is the debtor's ability to redeem certain tangible personal property from a lien securing a dischargeable consumer debt. Property that is "primarily intended for personal, family, or household use may be redeemed by the debtor under section 722 of the Code by paying the value of the collateral."¹²¹ Section 722, however, is applicable only in liquidation cases.¹²²

A debtor may redeem property that is exempt or abandoned to the debtor by the trustee.¹²³ Even though the language of section 722 may be read to limit the ability to redeem property to the debtor's exempt interest,¹²⁴ it

112. 11 U.S.C. app. § 522(h) (Supp. II 1978). Any limitations on the trustee's avoiding powers that are found in § 546 of the Act apply to the debtor exercising the shared avoidance powers. H.R. REP. NO. 595, 95th Cong. 1st Sess. 363 (1977).

113. 11 U.S.C. app. § 544 (Supp. II 1978).

114. *Id.* § 545.

115. *Id.* § 547.

116. *Id.* § 548.

117. *Id.* § 549.

118. *Id.* § 724(a).

119. *Id.* § 522(h).

120. *Id.* § 522(i). Thus, § 522(i) serves the debtor in the same way that §§ 550 and 551 serve the trustee. *See* notes 109-111 and accompanying text *supra*. It must be emphasized that the property recoverable by the debtor under either § 522(g) or § 522(i) must qualify as exempt property under the Code. 11 U.S.C. app. § 522(j) (Supp. II 1978). The debtor, therefore, may not recover more from the estate than the exempt property quota. The trustee is authorized to charge for expenses incurred in avoiding transfers and in recovering property that is released to the debtor as exempt. The amount chargeable is defined as "the aliquot share of the costs and expenses" incurred. *Id.* § 522(k)(1). The debtor also must pay any costs and expenses personally incurred. *Id.* § 522(k)(2).

121. 11 U.S.C. app. § 722 (Supp. II 1978). This is true whether or not the debtor has waived the right to redeem the property. *Id.*

122. This limitation is due to the fact that § 722 is located in chapter 7 of the Code. In contrast, due to its location in chapter 5 of the Code, § 522 is applicable to cases administered under chapter 7 (liquidation), chapter 11 (reorganization), and chapter 13 (individuals with regular income). *Id.* § 103(a).

123. *Id.* § 722.

124. Section 722 provides that tangible personal property may be redeemed "if such property is exempted under section 522." *Id.*

would appear that section 722 was intended to extend to the whole of the property,¹²⁵ and thus to the debtor's advantage.¹²⁶

Redemption under section 722 contemplates ridding the collateral of the lien upon payment of its value to the secured party.¹²⁷ If the parties are not able to agree on the value, the court will determine the amount of the allowed secured claim.¹²⁸ In the absence of agreement, payment must be cash because section 722 conditions redemption upon payment.¹²⁹ This requirement will limit use of the redemption right by those debtors who are unable to pay cash for more expensive property.¹³⁰

PROCEDURAL AND CONSTITUTIONAL CONSIDERATIONS

The Rules of Bankruptcy Procedure are expected to prescribe the procedure and time constraints for: (1) making the section 522(b) election between exemption systems; (2) specifying the property claimed; and (3) objecting to exemption claims. Although some procedure has been codified,¹³¹ those

125. H.R. REP. NO. 595, 95th Cong., 1st Sess. 380-81 (1977).

126. For example, if a bankrupt owned a \$2,000 car, subject to a \$1,200 lien, the debtor could exempt an \$800 interest in the car under the uniform federal alternative that provides for a \$1,200 motor vehicle exemption. 11 U.S.C. app. § 522(d)(2) (Supp. II 1978). Section 722 now will permit the debtor to pay off the \$1,200 lien and redeem the entire car, not just the remaining \$400 left over from the exemption. See H.R. REP. NO. 595, 95th Cong., 1st Sess. 381 (1977).

127. Payment of only the value of the collateral is provided by the clause in § 722 which states that redemption occurs upon payment of "the amount of the allowed secured claim." 11 U.S.C. app. § 722 (Supp. II 1978). The phrase "allowed secured claim" derives from § 506(a) of the Code, which provides that an "allowed claim . . . is a secured claim to the extent of the value of such creditor's interest . . . in such property." *Id.* § 506(a). Section 506(a) "abolishes the use of terms 'secured creditor' and 'unsecured creditor' and substitutes the terms 'secured claim' and 'unsecured claim.'" H.R. REP. NO. 595, 95th Cong., 1st Sess. 356 (1977).

By providing for redemption upon payment of only the value of the claim, § 722 is the equivalent of the "cram down" provision used in other chapters of the Code. See, e.g., 11 U.S.C. app. §§ 1129(b)(2)(A), 1325(a)(5)(B) (Supp. II 1978). Section 722 redemption differs from the Uniform Commercial Code where collateral may be redeemed only upon payment of the full amount owing plus costs. U.C.C. § 9-506.

128. Because value as used in § 722 is undefined in the Code, "courts will have to determine value on a case-by-case basis." H.R. REP. NO. 595, 95th Cong., 1st Sess. 356 (1977).

129. Section 722 states that redemption may occur only upon "paying the holder of the lien." 11 U.S.C. app. § 722 (Supp. II 1978).

130. One commentator has pointed out that "in cases involving larger assets such as automobiles and in cases involving poorer debtors . . . the right to redeem is either meaningless or the exercise of the right to redeem creates substantial hardship." Vukowich, *supra* note 14, at 471. While § 722 does not provide for deferred payments of the redemption amount, agreements to this effect are contemplated by the Code. See 11 U.S.C. app. § 524(c)(4)(B) (Supp. II 1978). This provision excepts good faith redemption agreements from the general restriction on reaffirmations.

131. A list of property claimed exempt must be filed either by the debtor or by a dependent. 11 U.S.C. app. § 522(i) (Supp. II 1978). It is likely that the rules promulgated will require the list to be filed reasonably soon after commencement of the case. Two provisions, however, mandate opportunities to amend at later dates. Property of the estate that can be exempted

portions of the present rule 403¹³² that are not inconsistent with section 522 will control until new rules are promulgated.

An exemption waiver executed in favor of a creditor who holds an unsecured claim is denied effect.¹³³ Security interests granted in exempt property, however, are unaffected by this provision.¹³⁴ Similarly, any waivers of avoiding or recovery powers are unenforceable.¹³⁵ It should be noted that exemptions are not allowable out of property that is fraudulently obtained,¹³⁶ although conversion of nonexempt property into an exempt interest on the eve of bankruptcy is not in itself fraudulent.¹³⁷

Under the 1898 Bankruptcy Act, the doctrine of *Lockwood v. Exchange Bank*¹³⁸ denied bankruptcy courts jurisdiction over property after it had been exempted to the bankrupt. The broad jurisdiction that Congress has extended to bankruptcy courts in other legislation, however, destroys *Lockwood's* foundation.¹³⁹ Accordingly, there now is statutory authority for the bankruptcy court to determine controversies between the bankrupt and third parties over property the trustee has set apart as exempt.¹⁴⁰ More importantly, bankruptcy courts also have the jurisdiction to enforce the post-bankruptcy status of exempt property.¹⁴¹

Several constitutional issues deserve consideration. The first question raised is whether the Code exemption provisions¹⁴² affect creditors or debtors retrospectively. A second issue presented is whether certain lien avoidance powers¹⁴³ provided for the benefit of the debtor can be applied either prospectively or retrospectively. There also is some question as to whether

by the debtor is defined as certain assets, such as inheritances, property settlements, and life insurance proceeds, acquired within 180 days of the date of filing. *Id.* § 541(a)(5). The recovery and avoiding powers under the Code can be exercised many months, if not years, after the filing date, and it is expressly contemplated that this property may be claimed as exempt. *Id.* § 522(g)-(i).

132. FED. R. BANK. P. 403.

133. 11 U.S.C. app. § 522(e) (Supp. II 1978).

134. *Id.*

135. *Id.*

136. See *Miguel v. Walsh*, 447 F.2d 724 (9th Cir. 1971); *In re White*, 221 F. Supp. 64 (E.D. Cal. 1963).

137. See *Wudrick v. Clements*, 451 F.2d 988 (9th Cir. 1971). Neither of these principles is addressed by the Code, although the House of Representatives did refer to the latter rule in reporting on this legislation. H.R. REP. NO. 595, 95th Cong., 1st Sess. 361 (1977).

138. 190 U.S. 294 (1903).

139. A broad jurisdiction grant is found in 28 U.S.C. § 1471 (1976). Congress stated that "[t]he adjunct bankruptcy court will exercise . . . jurisdiction . . . [over] everything that arises in a bankruptcy case." S. REP. NO. 989, 95th Cong., 2d Sess. 153 (1978).

140. Presumably this will include replevin actions by secured creditors for possession of their collateral or a money judgment for its value.

141. See notes 77-78 and accompanying text *supra*.

142. 11 U.S.C. app. § 522(d) (Supp. II 1978).

143. *Id.* § 522(f)-(i).

the lien redemption provision¹⁴⁴ is applicable either prospectively or retroactively. Finally, it remains to be determined whether one who is not in bankruptcy can be divested of an interest in property on the basis of being a co-owner of the property with a debtor.¹⁴⁵

In the absence of other constitutional constraints, the power granted to Congress under the bankruptcy clause¹⁴⁶ justifies an affirmative answer to each of the preceding questions. The contract clause,¹⁴⁷ interpreted as forbidding retrospective application of new state exemptions to existing debt,¹⁴⁸ is a limitation on state laws only. Thus, the question becomes whether or not the noted provisions amount to depriving a person of property without due process of law, as forbidden by the fifth amendment.¹⁴⁹ In general, the courts have not characterized the expectations of either debtors or creditors that are affected by exemption laws as rising to the level of property interests.¹⁵⁰

Security interests, however, are recognized as property interests,¹⁵¹ and any retrospective application of lien avoidance powers is therefore constitutionally suspect. There is no problem as to security interests created after the effective date of the Code because they are subject to, and limited by, the appreciable avoidance power provision. In summary, it appears that there may be serious constitutional questions only as to the retrospective application of avoidance laws to existing property interests.

144. *Id.* § 722.

145. *Id.* § 363(h).

146. U.S. CONST. art. I, § 8, cl. 4.

147. *Id.* art. I, § 10, cl. 1.

148. See *Cohen v. Beneficial Indus. Loan Corp.*, 337 U.S. 541, 553-54 (1949); *Blount v. Windley*, 95 U.S. 173, 180 (1877); *In re Inland Dredging Corp.*, 61 F.2d 765 (2d Cir. 1932), cert. denied sub nom. *Baker v. Fisher*, 288 U.S. 611 (1933); *Piedmont Memorial Hosp. v. Guilford County*, 221 N.C. 308, 311, 20 N.E.2d 332, 334 (1942). Several courts have held that the contract clause prohibits states from legislating to enlarge exemptions, as this would impair the obligation on contracts with creditors by substantially lessening their value. See *W.B. Worthen Co. v. Thomas*, 292 U.S. 426 (1934); *Bank of Minden v. Clement*, 256 U.S. 126 (1921); *Edwards v. Kearzey*, 96 U.S. 595 (1878); *Gunn v. Barry*, 82 U.S. (15 Wall.) 610 (1837); *In re Rauer's Collection Co.*, 87 Cal. App. 2d 248, 196 P.2d 803 (1948).

Some courts have held that states may eliminate a debtor's previous exemptions of property without impairing contract obligations or depriving the debtor of property without due process. See *Sponger v. Cumpston*, 54 Ga. 355 (1875); *Petrulionis v. Dudek*, 113 Ill. App. 2d 398, 252 N.E.2d 23 (1969); *Leak v. Gay*, 107 N.C. 468, 12 S.E. 312 (1890); *Brearily School v. Ward*, 201 N.Y. 358, 94 N.E. 1001 (1911); *Laird v. Carton*, 196 N.Y. 169, 89 N.E. 822 (1909); *Chandler v. Horne*, 23 Ohio App. 1, 154 N.E. 748 (1926). See also *Plumb*, supra note 14, at 137-43.

149. U.S. CONST. amend. V.

150. See *Plumb*, supra note 14, at 143.

151. See *Louisville Joint Stock Land Bank v. Radford*, 295 U.S. 555, 589-602 (1935); *Tahoe Nat'l Bank v. Philips*, 4 Cal. 3d 11, 480 P.2d 320, 92 Cal. Rptr. 704 (1971); *Greve v. Leger*, 64 Cal. 2d 853, 415 P.2d 824, 52 Cal. Rptr. 9 (1966); *American Mach. Co. v. Fitzpatrick*, 92 Idaho 416, 443 P.2d 1013 (1968).

CONCLUSION

The exemption scheme set forth in section 522 of the Bankruptcy Code is vast and far-reaching. There is the new system of federal exemptions, which the debtor may choose in lieu of existing state and non-federal exemptions. The most distinguishing feature of the federal alternative is the \$7,900 exemption in any property. The debtor is also provided with broad powers to avoid liens on, or involuntary transfers of, exempt property. All of this makes bankruptcy a more attractive alternative than it has been in the past, furthering as it does the principle of a fresh start for the debtor.

