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## I. Introduction

Exemption statutes are designed to protect debtors against total divesture of their real and personal estates.[1] Such statutes insulate debtors from abject poverty by preserving a minimum amount of property free from the claims of creditors.[2] The protection afforded by exemption statutes, however, is often more illusory than real. In most jurisdictions, while prospective exemption waivers are prohibited, creditors can nonetheless obtain a security interest even in the most basic exempt necessity.[3] The current state of the law has undesirable effects on debtor-creditor relations[4] and may frustrate the objectives of federal bankruptcy legislation.[5] This article examines the purpose and operation of exemption statutes as a part of state debtor-creditor law and suggests possible statutory and judicial reforms.

## II. Background

An exemption has been defined as "a right given by law to a debtor to retain portions of his property free from the claims of creditors."[6] A right of exemption can be created by statute[7] or constitutional provision.[8] At common law virtually all of a debtor's estate

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1 *See* notes 12-13 *infra* and accompanying text.

2 *See* note 18 *infra* and accompanying text.

3 *See* section IV *infra*.

4 *See* section IV D *infra*.

5 Under the Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549 (codified in 11 U.S.C.), state law governing debtors' exemptions is applicable in bankruptcy either at the debtor's option or by state legislative mandate. *See* 11 U.S.C. § 522(b) (1978) and note 26 *infra*.

6 Hertz, *Bankruptcy Code Exemptions: Note on the Effect of State Law*, 54 AM. BANKR. L.J. 339 (1980). The exemption insulates designated property from attachment or execution by creditors. *Id.*

7 *See* Mayhugh v. Coon, 460 Pa. 128, 133, 331 A.2d 452, 454-55 & n.4 (1975).

8 Many state constitutions provide for legislative enactment of exemption laws. *E.g.*, LA. CONST. art. 12, § 9; N.C. CONST. art X, §§ 1, 2; OKLA. CONST. art. XII, §§ 1, 2, 3. One

was subject to appropriation and sale to satisfy his debts.[9] Early statutes shielded only the barest essentials—wearing apparel and bedding[10]—from the claims of creditors. By the mid-nineteenth century, however, exemption statutes extended protection to a wider range of personal property and realty.[11]

The motivating forces behind the historical enlargement of exemption rights are varied.[12] Uniformly, however, exemption statutes reflect a legislative judgment that the need to preserve basic necessities for debtors and their families outweighs the benefit society derives from the strict enforcement of debtors' obligations. Exemption statutes are intended to enable debtors and their families to continue to function as independent economic units[13] during periods of financial embarassment.

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state's constitutional exemption provisions are entirely self-executing. ARK. CONST. art. 9, §§ 1-5.

9 Indeed, at early common law, the debtor's body itself was subject to seizure and incarceration if sufficient property could not be found to satisfy his indebtedness. *See* Note, *Body Attachment and Body Execution: Forgotten But Not Gone*, 17 WM. & MARY L. REV. 543 (1976).

10 Vukowich, *Debtors' Exemption Rights*, 62 GEO. L.J. 779, 782 (1974) [hereinafter cited as Vukowich].

11 COLEMAN, DEBTORS AND CREDITORS IN AMERICA 257-58 (1974). According to Coleman, the expansion of debtors' exemption rights led to restrictions on creditors' rights to enforce payment through imprisonment. These developments were part of a broader social movement toward a commercial and legal system that fostered individual freedom and independence. *Id.* *See* Mayhugh v. Coon, 460 Pa. 128, 134, 331 A.2d 452, 455 (1975) ("freedom from imprisonment for debt would be meaningless if the debtor could, nevertheless, be stripped of all belongings and deprived of all means of regaining a modicum of economic stability").

12 *See* text accompanying notes 17-22 *infra*.

13 One noted commentator explained:

> While variety characterizes even the objectives of exemption legislation, a persistent theme is the protection of the family of the debtor from penury. Exemption legislation embodies a deliberate choice of policy to prefer the social interest in providing a minimum of economic security and other benefits to debtors and their families-over the economic interests to be served by assuring creditors the maximum availability of their debtor's property for the satisfaction of their claims.

Kennedy, *Limitation of Exemptions in Bankruptcy*, 45 IOWA L. REV. 445, 447-48 (1959) (footnotes deleted). *See also* Note, *Bankruptcy Exemptions: Critique and Suggestions*, 68 YALE L.J. 1459 (1959) [hereinafter cited as Bankruptcy Note] ("[I]n a community which is concerned with the well-being of its individual members, the social cost of leaving a debtor and his family without resources may outweigh the economic disadvantage of immunizing property from the claims of creditors.").

Exemption statutes were enacted to protect debtors' families against destitution. Many states provide more generous exemptions for debtors with dependents, *e.g.* ARK. CONST. art. 9, § 2 (personal property); GA. CODE ANN. § 51-101 (1979) (real and personal property); HAWAII REV. STAT. § 651-92 (Supp. 1980) (real property); MASS. GEN. LAWS ANN. ch. 188, § 1 (West 1981) (real property); MO. ANN. STAT. §§ 435, 440, 513 (Vernon Supp. 1980) (specific items of personal property or a mix of real and personal property). *See also* In re Perry, 225 F. Supp. 481, 482 (N.D. Ohio 1963) (purpose of exemption statutes is to protect debtor's

The proper balance between debtor protection and creditors' rights has long been the subject of debate.[14] Similarly, the degree to which exemption rights are vested indefeasibly in the debtor and the relative ease with which such rights may be forfeited are matters of some controversy.[15] As a result, debtor exemption statutes vary greatly from state to state.[16]

The diversity of debtor exemption provisions has also been attributed to: (1) traditional notions of debtor culpability;[17] (2) concern for the plight of the families of spendthrifts;[18] (3) a desire to limit welfare payments by preventing indigency;[19] (4) a desire to provide minimal property with which a debtor can start anew;[20] (5) rural distrust of urban merchants;[21] and, (6) a desire to encourage frontier settlement.[22] Today exemption statutes remain widely disparate in the amount[23] and categories[24] of property they protect. The variety of debtor exemption provisions is of significance not only to the determination of state debtor-creditor rights,[25] but also to the

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family); National Bank v. Chapman, 212 Iowa 561, 234 N.W. 198 (1931). *See* text accompanying notes 69-75 *infra*.

14 An early commentator considered the legislative purpose of exemption statutes to be "to afford to the debtor, and to his family the prime necessities of life, and to furnish the insolvent a nucleus wherewith to begin life anew." G. PENDLETON, DEBTORS' EXEMPTIONS IN PENNSYLVANIA 18 (1886). During the same period, however, others were criticizing exemption statutes as unduly generous. J. GRAY, RESTRAINTS ON THE ALIENATION OF PROPERTY § 263 at 247 n.1 (2d ed. 1895). Over the years, "legislative sympathy with the debtor class has fluctuated with the economic barometer." Bankruptcy Note, *supra* note 13, at 1459.

15 *See* section IV *infra*. These issues have been resolved in a variety of ways. *See* sections III and IV *infra*; *compare* Mayhugh v. Coon, 460 Pa. 128, 331 A.2d 452 (1975), *with* Case v. Dunmore, 23 Pa. 93 (1854).

16 *See generally* Vukowich, *supra* note 10; Joslin, *Debtors' Exemption Laws: Time for Modernization*, 34 IND. L.J. 355 (1959) [hereinafter cited as Joslin].

17 Case v. Dunmore, 23 Pa. 93, 94-95 (1854); Bowman v. Smiley, 31 Pa. 225, 226 (1858). *See* Rombauer, *Debtor's Exemption Statutes—Revision Ideas*, 36 WASH. L.REV. 484 (1961).

18 J. SMYTH, HOMESTEAD AND EXEMPTIONS § 1 at 49 (1875); THOMPSON, A TREATISE ON HOMESTEAD AND EXEMPTION LAWS § 1 (1878).

19 *See* Bankruptcy Note, *supra* note 13.

20 G. PENDLETON, DEBTORS' EXEMPTIONS IN PENNSYLVANIA 18 (1886).

21 Vukowich, *supra* note 10, at 783 & n.19.

22 *Id.*

23 *Compare* TEX. CIV. CODE ANN. tit. 57 §§ 3833 (200 acre exempt rural family homestead), 3836 ($30,000 family personal property exemption) (Vernon Supp. 1980) *with* ARK. CONST. art. 9, § 2 ($500 personal property exemption for head of family), §§ 3-5 ($2,500 homestead exemption for head of family).

24 *E.g.*, CAL. CIV. PROC. CODE § 690.25 (West 1980) (church pews); CONN. GEN. STAT. ANN. § 52-352c(b) (West Supp. 1980) (wedding rings); GA. CODE ANN. § 51-1301(2) (1979) (horse or mule or one yoke of oxen); IDAHO CODE § 11-605(6) (1979) (water right used for irrigation); KY. REV. STAT. § 427.010 (Supp. 1980) (spare tire for motor vehicle); ME. REV. STAT. ANN. §§ 4401(7), (10) (1980) (sled, fishing boat).

25 *See* Joslin, *supra* note 16, at 355-60; Kennedy, *Limitation of Exemptions in Bankruptcy*, 45

administration of federal bankruptcy laws.[26]

Notwithstanding the diversity of exemption statutes, near total harmony exists in the treatment of prospective exemption waivers.[27] With few exceptions,[28] prospective waivers[29] have been declared void, either by the express language of an exemption statute[30] or by judicial interpretation of statutory policy.[31] The vast majority of states, however, have permitted debtors to waive their rights to retain

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IOWA L. REV. 445, 446-47 (1959); Countryman, *For a New Exemption Policy in Bankruptcy*, 14 RUTGERS L. REV. 678, 681 (1960).

26 The Bankruptcy Act of 1898, *as amended by* Ch. 541, 30 Stat. 544 (1897-98) (codified in 11 U.S.C. (1976)) (repealed Pub. L. 95-598, tit. IV, §§ 401(a), 402(a), 92 Stat. 2682, *eff.* October 1, 1979), expressly incorporated the exemption laws of the state of a debtor's domicile for the six months preceding filing of the petition. 11 U.S.C. § 24 (1976) (repealed 1979). Reformers lobbied for a federal bankruptcy exemption provision which would eliminate reference to state law for determination of a debtor's exemption rights. *See* Countryman, *For a New Exemption Policy in Bankruptcy*, 14 RUTGERS L. REV., 678, 746 (1960); Bankruptcy Note, *supra* note 13, at 1507-14; Vukowich, *The Bankruptcy Commission's Proposals Regarding Bankrupts' Exemption Rights*, 63 CAL. L. REV. 1439 (1975). A uniform federal exemption scheme, however, was not without scholarly opposition. *See* Kennedy, *Limitation of Exemptions in Bankruptcy*, 45 IOWA L. REV. 445, 485-86 (1959). The Bankruptcy Reform Act of 1978 permits the debtor to select either the exemption rights available to him under the law of his state of domicile for the 180 days preceding the filing of the petition or the exemptions set forth in the Bankruptcy Reform Act itself. 11 U.S.C. § 522(b), (d) (1978). States may by statute require domiciliary debtors to use only state law and non-bankruptcy federal law exemptions. 11 U.S.C. § 522(b) (1978). This article considers consensual liens in exempt property as a matter of state law, but the reforms proposed will have significance in federal bankruptcy law by operation of § 522(b).

27 *See, e.g.*, Mayhugh v. Coon, 460 Pa. 128, 137, 331 A.2d 452, 456 & n.6 (1975) (holding that exemption waivers are void as contrary to public policy). *See* Section III *infra*.

28 *See* notes 53-55 *infra* and accompanying text.

29 A "prospective waiver" of exemption rights is a promise, given by the debtor, that he will not assert his exemption rights against the creditor's efforts to collect the debt. The waiver is given as consideration for credit or forebearance. Such waivers are executory and do not create liens in specific property contemporaneously with their execution. Thus they can be distinguished from security interests, chattel mortgages and conditional sales contracts. *See* Celco, Inc. v. Davis Van Lines, 226 Kan. 366, 369, 598 P.2d 188, 190 (1979). Exemption waivers may also be created when a tenant-debtor grants a landlord-creditor the right to enter his premises, seize property, and sell it in satisfaction of the debt for accrued rent. Curtiss v. Ellenwood, 59 Ill. App. 110 (1894).

30 *E.g.*, MONT. REV. CODES ANN. § 93-5813.1 (1981); UTAH CODE ANN. § 78-23-11 (Supp. 1981); W. VA. CODE § 38-8-15 (Cum. Supp. 1981); PA. CONS. STAT. ANN. tit. 12, § 8122 (Purdon Pamph. 1981); *But see* ALA. CODE § 6-10-2 (1975); DEL. CODE ANN. tit. 10, § 4912 (1975); VA. CODE § 34-22 (1976 & Cum. Supp. 1981).

31 *E.g.*, Sherbill v. Miller Mfg. Co., 89 So. 2d 28, 30-31 (Fla. 1956); Maloney v. Newton, 85 Ind. 565, 566 (1882); Morgan Plan Co. v. Ates, 8 La. App. 806, 809 (1928); Teague v. Weeks, 89 Miss. 360, 42 So. 172 (1906); Kneettle v. Newcomb, 22 N.Y. 249, 250-51 (1860); Maxwell v. Reed, 7 Wis. 493, 498-99 (1859). *But see* Broadway v. Household Fin. Corp., 351 So. 2d 1373 (Ala. Civ. App. 1977); Lawrence v. Commercial Banking Corp., 165 Md. 559, 560, 169 A. 69, 70 (1933).

exempt property either through creation of nonpossessory,[32] nonpurchase-money[33] security interests,[34] or by granting mortgages[35] in ex-

32 Security interests created through pledges of personal property, i.e. where possession of personalty is transferred to a creditor, present problems distinct from nonpossessory security interests. *See* 1 G. GILMORE, SECURITY INTERESTS IN PERSONAL PROPERTY § 1.1 (1965).

33 Purchase money security interests are those:

> (a) taken or retained by the seller of the collateral to secure all or part of its price;
> (b) taken by a person who by making advances or incurring an obligation gives value to enable the debtor to acquire rights in or the use of collateral if such value is in fact so used.

U.C.C. § 9-107 (1976). States routinely provide that purchase money security interests in personal property will take precedence over claims of exemption in such property. *See* ALASKA STAT. § 09.35.080(a)(7) (Cum. Supp. 1980); ARIZ. REV. STAT. ANN. § 33-1122 (Supp. 1980); ARK. CONST. art. 9, § 1; COLO. REV. STAT. § 13-54-103 (1974); GA. CODE ANN. § 51-101 (1979); HAWAII REV. STAT. § 651-122 (Supp. 1980); IDAHO CODE § 11-607(1)(b)(1) (1979); ILL. ANN. STAT. ch. 52, § 3 (Smith-Hurd Supp. 1981); IOWA CODE ANN. § 627.5 (West 1950); LA. REV. STAT. ANN. § 13:3885 (West Supp. 1981); MINN. STAT. ANN. § 550.37(4) (West Cum. Supp. 1980); NEV. REV. STAT. § 21.090(2) (1979); N.J. STAT. ANN. § 2A-17-19 (West Supp. 1981); N.M. STAT. ANN. § 42-10-6 (1978); N.Y. CIV. PRAC. LAW § 5205(a) (McKinney 1978 & Supp. 1980); N.D. CENT. CODE § 28-22-14 (1978); OHIO REV. CODE ANN. § 2329.661(A) (Page 1981); S.D. COMP. LAWS ANN. § 43-45-8 (1967); TENN. CODE ANN. § 26-2-103(b) (1980); UTAH CODE ANN. § 78-23-10(1)(b)(i) (Supp. 1981); VT. STAT. ANN. tit. 12, § 2740 (1973); VA. CODE § 34-23 (Cum. Supp. 1981); WASH. REV. CODE ANN. § 6.16.020 (Supp. 1981); W. VA. CODE § 38-8-11 (Supp. 1981).

Although a number of the foregoing provisions merely dictate that exemptions may not be asserted against purchase-money security interests, *e.g.*, ARIZ. REV. STAT. ANN. § 13-1122 (Supp. 1980); GA. CODE ANN. § 51-101 (1979); VA. CODE § 34-23 (Cum. Supp. 1981), many states provide that debtors' exemptions may not be asserted against secured or unsecured creditors in actions to recover the purchase price of the personalty, *e.g.*, ALASKA STAT. § 09.35.080(a)(7) (Cum. Supp. 1980); COLO. REV. STAT. 13-54-103 (1974); NEV. REV. STAT. § 21.090(2) (1979); N.J. STAT. ANN. § 2A-17-19 (West Supp. 1981); N.Y. CIV. PRAC. LAW § 5205(a) (McKinney 1978 & Supp. 1980); N.D. CENT. CODE § 28-22-14 (1974); S.D. COMP. LAWS ANN. § 43-45-9 (1969); UTAH CODE ANN. § 78-23-10(1)(b)(i) (Supp. 1981); VT. STAT. ANN. tit. 12, § 2740 (1973); WASH. REV. CODE ANN. § 6.16.020 (Supp. 1981); W. VA. CODE § 38-8-11 (Supp. 1980).

The rationale supporting such provisions is self evident; a debtor should not be able to claim an exemption against the creditor whose extension of credit enabled the debtor to acquire the property.

34 "Security interest" is defined in U.C.C. § 1-201 as "an interest in personal property or fixtures which secures payment or performance of an obligation." 1 UNIFORM LAWS ANN. (1976). The creation and perfection of security interests is governed by U.C.C. Article 9, a version of which has been enacted in every state but Louisiana. 3 UNIFORM LAWS ANN. at 1 (Supp. 1980). The Article 9 security interest comprehends nearly all devices by which creditors obtain rights in personal property of the debtor as security for a debt or obligation. *See* U.C.C. §§ 9-102, 9-202.

35 The chattel mortgage, an historical predecessor of the security interest, was a statutory device by which a creditor could obtain a nonpossessory interest in a debtor's personal property. *See generally* 1 G. GILMORE, SECURITY INTERESTS IN PERSONAL PROPERTY §§ 2.1-2.8 (1965). The chattel mortgage has been replaced by the U.C.C. Article 9 security interest, *see* note 34 *supra*. Many of the early cases considering exemption "waivers" focused on the

empt assets.[36]

Traditional notions of property law[37] and freedom of contract[38] inspired the distinction between prospective exemption waivers and

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debtor's power to encumber his exempt assets through execution of a chattel mortgage or similar device. *See* text accompanying note 128 *infra*.

Debtors are generally permitted to grant creditors nonpurchase-money mortgages in exempt real property. *See, e.g.*, ALASKA STAT. § 09.35.090 (Cum. Supp. 1980); ARIZ. REV. STAT. ANN. §§ 33-1101(c), 33-1102 (Supp. 1980); ARK. CONST. art. 9, § 3; CAL. CIV. PROC. CODE § 690.31(b)(3)(ii) (West Supp. 1981); COLO. REV. STAT. § 38-41-201 (Supp. 1980); HAWAII REV. STAT. § 651-92 (Supp. 1980); IDAHO CODE § 55-1005(3) (1979); ILL. ANN. STAT. ch. 52, § 4 (Smith-Hurd Supp. 1979); IND. CODE ANN. § 34-2-28-13 (Burns 1973 & Supp. 1980); IOWA CODE ANN. § 561.13 (1950 & Supp. 1980); KY. REV. STAT. ANN. § 427.060 (Baldwin 1972 & Cum. Supp. 1980); ME. REV. STAT. ANN. ch. 14, § 4552(1) (1980); MASS. ANN. LAWS ch. 188, § 7 (Michie/Law. Co-op 1981); MICH. STAT. ANN. § 27A.6023(a)(8) (1977); MISS. CODE ANN. § 85-3-21 (1973 & Supp. 1980); MO. ANN. STAT. § 40-103 (1979 & Supp. 1980); NEV. REV. STAT. § 21.090(2) (1979); N.H. REV. STAT. ANN. § 480.4 (1968 & Supp. 1979); N.M. STAT. ANN. § 42-10-11 (1978 & Supp. 1980); N.Y. CIV. PRAC. LAW § 5206(a) (McKinney 1978 & Supp. 1980); OHIO REV. CODE ANN. § 2329.661(A)(1) (Page 1980); S.C. CONST. art. III, § 28; S.D. COMP. LAWS ANN. § 43-31-17 (1969 & Supp. 1980); TENN. CIV. CODE ANN. § 26-2-301(b) & (c) (1980); TEX. CIV. CODE ANN. tit. 57, § 3835 (Vernon 1966 & Supp. 1980); UTAH CODE ANN. § 78-23-4(4) (Supp. 1981); VT. STAT. ANN. § 103 (1975 & Supp. 1980); VA. CODE § 34-23 (Cum. Supp. 1981); WASH. REV. CODE ANN. § 6.12.100 (1963); W. VA. CODE § 38-9-6 (1966 Supp. 1980); WIS. STAT. AN. § 815.20 (West 1977).

A debtor's equity in residential real property subject to a homestead exemption is often substantial. Thus, permitting the debtor to encumber the homestead through execution of a second mortgage or similar instrument is economically justified. *See* Vukowich, *supra* note 10, at 852. *See also* Wyoming County Bank & Trust Co. v. Kiley, 75 A.D.2d 477, 430 N.Y.S.2d 900, 903-04 (1980) (practical reasons for enforcing a second mortgage against a claim of homestead exemption).

This article is limited to consideration of the reasons supporting or recommending against the enforcement of nonpossessory, nonpurchase-money security interests in exempt personal property.

36 States have permitted this type of "waiver" either by statute, *e.g.*, ARIZ. REV. STAT. ANN. § 13-1122 (Supp. 1980); ARK. CONST. art. 9, § 3; GA. CODE ANN. § 51-101 (1979); HAWAII REV. STAT. § 651-122 (Supp. 1980); IDAHO CODE § 11-607(2) (1979); LA. REV. STAT. ANN. § 13:3885 (West Supp. 1980); MICH. STAT. ANN. § 27A.6023(b) (1977); NEV. REV. STAT. § 21.090(2) (1979); N.M. STAT. ANN. § 42-10-6 (1978 & Supp. 1980); OHIO REV. CODE ANN. § 2329.661 (Page 1981); TENN. CODE ANN. § 26-2-103(b) (1980); TEX. CIV. CODE ANN. tit. 57, art. 3836(a) (Vernon 1980); UTAH CODE ANN. § 78-23-10(2) (Supp. 1981), or by judicial decision, In Re Rade, 205 F. Supp. 336 (D. Colo. 1962); Carter's Adm'rs. v. Carter, 20 Fla. 558, 51 Am. Rep. 618 (1884); Kay v. Furlow, 178 La. 637, 152 So. 315 (1934); Aetna Fin. Co. v. Antoine, 343 So.2d 1195 (La. App. 1977); Hernandez v. S.I.C. Fin. Co., 79 N.M. 673, 448 P.2d 474 (1968); State v. AVCO Fin. Servs., 50 N.Y.2d 383, 406 N.E.2d 1075, 429 N.Y.S.2d 181 (1980); Congress Candy Co. v. Farmer, 73 N.D. 174, 12 N.W.2d 796 (1944); Montford v. Grohman, 37 N.C. App. 71, 245 S.E.2d 219 (1978); Frost v. Shaw, 3 Ohio St. 270, 272-73 (1854); City Loan & Sav. Co. v. Keenan, 136 Ohio St. 125, 24 N.E.2d 452 (1939); Mutual Loan & Thrift Corp. v. Corn, 182 Tenn. 554, 188 S.W.2d 345 (1945); Sparkman v. First State Bank, 246 S.W. 724 (Tex. Civ. App. 1981); Cammarano v. Longmire, 99 Wash. 696, 169 P. 806 (1918).

37 *See* Mutual Loan & Thrift Corp. v. Corn, 182 Tenn. 554, 556, 188 S.W.2d 345, 346 (1945); and text accompanying note 103 *infra*.

the creation of security interests in exempt personalty. Creditors have exploited this distinction through the use of "catch-all" or "dragnet" collateral clauses[39] and other security agreements.[40] Dragnet collateral clauses subject all the debtor's personal property, even the most basic instruments of comfort and support,[41] to the threat of

38 *See* State v. AVCO Fin. Servs., 50 N.Y.2d 383, 406 N.E.2d 1075, 429 N.Y.S.2d 181 (1980); and text accompanying note 101 *infra*.

39 An example of a catch-all collateral clause is set forth in State v. AVCO Fin. Servs., 50 N.Y.2d 383, 406 N.E.2d 1075, 1078, 429 N.Y.S.2d 181, 183 (1980):

> This loan is secured by . . . all household goods, furniture, appliances, and consumer goods of every kind and description owned at the time of the loan secured hereby, or at any refinance or renewal thereof, or cash advanced under the loan agreement secured hereby, and located about the premises at the debtor's residence (unless otherwise stated) or at any other location to which the goods could be removed.

*See also* Hernández v. S.I.C. Fin. Co., 79 N.M. 673, 448 P.2d 474 (1968); Montford v. Grohman, 37 N.C. App. 71, 245 S.E.2d 219 (1978).

40 A "security agreement" is an agreement which "creates or provides for a security interest." U.C.C. § 9-105(h).

41 Although some states, by statute or constitutional provision, permit debtors to designate any personal property up to a stated value as exempt, *e.g.* ALA. CODE § 6-10-2; ARK. CONST. art. 9, §§ 1, 2; GA. CODE ANN. § 51-101 (1979) (alternative exemption); ILL. ANN. STAT. ch. 52, § 13 (Smith-Hurd 1979); IND. CODE ANN. § 34-2-28-1(a) & (b) (Burns Cum. Supp. 1980); NEB. REV. STAT. § 25-1552 (Cum. Supp. 1980); N.J. STAT. ANN. § 2A-17-19 (West Supp. 1981); N.C. CONST. art. X, § 1; N.C. GEN. STAT. § 1-369 (1969); N.D. CENT. CODE § 28-22-03 (1978 & Supp. 1979) (alternative exemption); PA. CONS. STAT. ANN. tit. 42, § 8123 (Purdon Pamph. 1981); S.C. CODE § 15-41-310 (1977); S.D. COMP. LAWS ANN. § 43-45-4 (1969 & Supp. 1980) (alternative exemption); TENN. CODE ANN. § 26-2-102 (1980); VA. CODE § 38-8-1 (Supp. 1981) (alternative exemption), the majority of jurisdictions exempts specified values of household goods or household furnishings, ALASKA STAT. § 09.35.080(5) (Cum. Supp. 1973); ARIZ. REV. STAT. ANN. § 13-1123 (Supp. 1980); CAL. CIV. PROC. CODE § 690.1 (Deering 1973 & Supp. 1981); COLO. REV. STAT. § 13-54-102(e) (1974 & Supp. 1980); CONN. GEN. STAT. ANN. § 52-352b(a) (West Supp. 1980); D.C. CODE ANN. § 15-5011(2) (1973 & Supp. 1975); GA. CODE ANN. §§ 51-1301(5), 1301.1(4) (1979 & Supp. 1980) (alternative exemptions); HAWAII REV. STAT. § 651-121 (1976 & Supp. 1980); IDAHO CODE § 11-605(a) (1979); IOWA CODE ANN. § 627.6(13) (West 1950 & Supp. 1980); KY. REV. STAT. ANN. § 427.010 (Baldwin 1972 & Cum. Supp. 1980); LA. REV. STAT. ANN. § 3881(4) (West 1968 & Supp. 1980); ME. REV. STAT. ANN. tit. 14, § 4401(1) (1980); MASS. GEN. LAWS ANN. ch. 235, § 34 (West 1974 & Supp. 1980); MICH. STAT. ANN. § 27A.6023(2) (1977); MINN. STAT. ANN. § 550.37(4) (West Cum. Supp. 1980); MISS. CODE ANN. § 85-3-1(r) (Cum. Supp. 1980); MO. ANN. STAT. § 513.435(3) (Vernon Supp. 1980); NEV. REV. STAT. § 21.090(b) (1979); N.H. REV. STAT. ANN. § 511.2 (Supp. 1979); N.Y. CIV. PRAC. LAWS § 5205(5) (McKinney 1978 & Supp. 1980); N.D. CENT. CODE § 28-22-04(2) (1978 & Supp. 1979) (alternative exemption); OHIO REV. CODE ANN. § 2329.66(a)(4)(b) (Page 1981); OKLA. STAT. ANN. tit. 31 § 1(A)(3) (West Supp. 1980); R.I. GEN. LAWS § 9-26-4 (1969); S.D. COMP. LAWS ANN. § 43-45-5(2) (1969) (alternative exemption); TEX. CIV. CODE ANN. § 3836(a)(1) (Vernon 1966 & Supp. 1980); UTAH CODE ANN. §§ 78-23-5, 78-23-8 (Supp. 1981); VT. STAT. ANN. tit. 12 § 2740 (1973); WASH. REV. CODE § 6.16.020(3) (Supp. 1980); W. VA. CODE § 38-10-4 (Cum. Supp. 1981) (alternative exemption); WIS. STAT. ANN. § 815-18(5) (West 1977 & Supp. 1980 & Pamph. 1981).

Nearly all states that specifically exempt household goods and furnishings, *see* note 24

repossession and sale upon default.[42]

The remainder of this article examines the law of debtors' personal property exemptions in light of public policy, and the rationale supporting legislative and judicial disapproval of prospective exemption waivers. The creation and enforcement of nonpossessory, nonpurchase-money security interests in exempt property will be discussed, followed by an examination of possible legislative and judicial reforms which would restrict the enforcement of security interests in exempt property.

## III. Waivers[43] of Exemption Rights: Public Policy[44]

Exemption laws reduce the pool of debtors' assets from which

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*supra*, also provide an exemption for debtors' tools of trade or professional libraries. *E.g.*, ALASKA STAT. § 09.35.080(4) (Cum. Supp. 1980); CONN. GEN. STAT. ANN. § 52-352(b) (West Supp. 1980); D.C. CODE § 15-501(5), (6) (1973 & Supp. 1975); HAWAII REV. STAT. § 651.121(3) (Supp. 1980); N.Y. CIV. PRAC. LAW § 5205(a)(7) (McKinney 1978 & Supp. 1980). For a thoughtful critique of occupational exemptions, see Joslin, *supra* note 16, at 365-68.

The exemption for wearing apparel predates most other specific category exemptions. Historically, even during the period when virtually all of a debtor's assets could be seized to satisfy his debts, his wearing apparel remained exempt. It was feared that seizure of wearing apparel would lead to breaches of the peace and would offend common notions of decency. *See* Vukowich, *supra* note 10, at 782. Most jurisdictions, including those which do not otherwise categorize personal property exemptions, expressly exempt from seizure the necessary wearing apparel of the debtor and his family. *E.g.*, ALA. CODE § 6-10-2 (Supp. 1980); ALASKA STAT. § 09.35.080(3) (Cum. Supp. 1980); ARK. CONST. art. 9 § 1; D.C. CODE ANN. § 15-501(1) (1973 & Supp. 1975); ILL. ANN. STAT. ch. 52, § 13 (Smith-Hurd Supp. 1979); ME. REV. STAT. ANN. tit. 14, § 4401(1) (1980); N.J. STAT. ANN. § 2A:17-19 (West Supp. 1981); N.D. CENT. CODE § 28-22-02(5) (1978 & Supp. 1979); PA. CONS. STAT. ANN. tit. 42, § 8124(a)(1) (Purdon Pamph. 1981); S.C. CODE § 15-41-310 (1977); WASH. REV. CODE ANN. § 6.16.020(1) (Supp. 1980); WIS. STAT. ANN. § 815.18(5) (West 1977 & Supp. 1981).

42 Under U.C.C. Article 9, when a debtor defaults a secured creditor is entitled to take possession and to sell the property subject to the security interest. U.C.C. §§ 9-503, 9-504. The secured party may take possession peacefully without first initiating judicial proceedings, U.C.C. § 9-503, or he may resort to non-Code judicial procedures to obtain possession. *Id. See, e.g.*, Platte Valley Bank v. Kracl, 185 Neb. 168, 174 N.W.2d 724 (1970); Associates Discount Corp. v. Harris, 87 Misc. 2d 839, 386 N.Y.S.2d 982 (1976).

43 This discussion only concerns contractual waivers of exemption rights in personal property. Exemption rights have been deemed "waived" for a number of other reasons, including: (1) failure to file a required exemption schedule, Andrews v. Briggs, 203 Ark. 714, 715, 158 S.W.2d 269, 270 (1942); (2) failure to timely claim the exemption, Ferrara v. Polito, 167 So. 120 (La. App. 1936); Blaylock v. J. Rubel & Co., 119 So. 503 (Miss. 1928); (3) failure to specifically identify the property in which the exemption is claimed, Barfield & Reynolds Banking Co., 40 Ga. App. 305, 149 S.E. 302 (1929); (4) failure to claim exemptions in debtor's answer or at trial, Bow v. Hodges, 101 S.W.2d 1043 (Tex. Civ. App. 1937); (5) failure to assert the exemption prior to sale under levy, Barnhart Bros. & Spindler v. Dollarhide, 186 S.W. 564 (Mo. 1916); or (6) voluntarily placing exempt chattels on rented premises where the landlord

unsecured creditors[45] can obtain satisfaction upon default. In the nineteenth century, state exemption statutes greatly expanded debtor protections.[46] This expansion prompted creditors to condition the extension of credit upon the debtor's waiver of exemption rights.[47] From an early date prospective exemption waivers were challenged as repugnant to public policy.[48] Many of the early exemption waiver decisions[49] struggled with the conflict between freedom of contract

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is entitled to distrain personal property of the tenant as security for payment of back rent, Howard v. Calhoun, 155 Fla. 689, 21 So. 2d 361 (1945).

In addition, several states expressly make the benefits of exemption statutes unavailable to a debtor who is leaving the state or who has absconded. OKLA. STAT. ANN., tit. 31, § 3 (West 1976); WASH. REV. CODE ANN. § 6.16.070 (1963 & Supp. 1980). Debtors who have purchased potentially exempt assets with funds obtained by fraud may not claim the benefit of the exemption against the defrauded parties. Vukowich, *supra* note 10, at 865-66.

Finally, there are categories of indebtedness which in every state may be collected from otherwise exempt property. Family support obligations, the purchase price of exempt goods, mechanics' and materialmen's liens on exempt property and taxes most often may be collected in spite of exemption claims. For a comprehensive discussion of debts exempted from the application of exemption statutes, see Vukowich, *supra* note 10, at 853-63. Cases and authorities regarding the validity of prospective exemption waivers are collected in Annot., 94 A.L.R.2d 967 (1964).

44 The purpose of the present discussion is to examine the rationales which lead courts to hold exemption waivers unenforceable and to demonstrate that state exemption policies are frustrated by permitting the enforcement of security interests in all exempt property.

45 This section examines exemption waivers received by creditors who at the time of the initial transaction obtained no security interest in specific assets of the debtor. *See* note 29 *supra*. Exemption statutes insulate assets from attachment and execution, *supra* note 6. These remedies are available to creditors after initiation of judicial proceedings. Absent extraordinary circumstances, however, a court will grant these remedies only after judgment. *See* North Georgia Finishing, Inc. v. Di-Chem, Inc., 419 U.S. 601 (1975); Mitchell v. W.T. Grant Co., 416 U.S. 600 (1974); Fuentes v. Shevin, 407 U.S. 67 (1972); Sniadach v. Family Fin. Corp., 395 U.S. 337 (1967).

46 *See* note 11 *supra* and accompanying text.

47 Most often, at the time of the extension of credit the creditor obtained a promise from the debtor not to assert exemption rights through a clause contained in the body of a promissory note or other instrument. *See* Industrial Loan & Inv. Co. v. Superior Court, 189 Cal. 546, 209 P. 360 (1922); Brenau College v. Mincey, 68 Ga. App. 137, 22 S.E.2d 322 (1942); Curtis v. O'Brien & Sears, 20 Iowa 376 (1866).

48 *See, e.g.*, Carter's Adm'rs v. Carter, 20 Fla. 558, 563-71, 51 Am. Rep. 618, 619-23 (1894). Teague v. Weeks, 89 Miss, 360, 42 So. 172 (1906); Weaver v. Lynch, 79 Colo. 537, 246 P. 789 (1926); Howell v. Robertson, 197 N.C. 572, 150 S.E. 32 (1929); Dennis v. Smith, 125 Ohio St. 120, 180 N.E. 638 (1932).

49 The early cases in this area were decided before the enactment of statutes proscribing enforcement of prospective exemption waivers. These decisions were based solely upon the courts' interpretation of the policy behind the exemption laws. *E.g.*, Wallingford v. Bennett, 1 Mackey 303 (D.C. 1881); Moxley v. Ragan, 73 Ky. (10 Bush) 156, 19 Am. Rep. 61 (1874); Kneettle v. Newcomb, 22 N.Y. 249, 78 Am. Dec. 186 (1860); Slyfield v. Willard, 43 Wash. 179, 86 P. 392 (1906); Maxwell v. Reed, 7 Wis. 493 (1859). Some states later enacted statutes invalidating prospective exemption waivers. *E.g.*, ALA. CODE § 6-10-126 (1977) (as to specified personalty); ARIZ. REV. STAT. ANN. § 33-1132 (Supp. 1980); GA. CODE ANN. § 51-1101 (1979) (limiting right to waive exemption); ME. REV. STAT. ANN. tit. 14, § 4401 (1980);

and this peculiar brand of social welfare legislation. In challenging waivers, debtors sought more than the enforcement of their statutory rights;[50] they sought to be protected from the consequences of their own bargains.[51]

Most courts concluded that enforcement of prospective waivers would frustrate the policies underlying debtors' exemptions.[52] Pennsylvania was the only jurisdiction in which prospective exemption waivers enjoyed the enduring approval of the courts in the absence of a constitutional[53] or legislative[54] mandate.[55] In *Case v. Dunmore*[56] the Pennsylvania Supreme Court held prospective waivers of debtors rights enforceable under freedom of contract principles.[57] Notwithstanding expressions of doubt as to the wisdom of this decision,[58] Pennsylvania courts followed the rule of *Case v. Dunmore* for more

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MINN. STAT. ANN. § 550-37(4), (19) (West Cum. Supp. 1980) (limiting waiver availability and requiring explicit disclosures prior to executing waivers); MONT. REV. CODES ANN. § 93-5813.1 (1981); OHIO REV. CODE ANN. § 2329.661(B) (Page 1981); PA. CONS. STAT. ANN. § 8122 (Purdon Supp. 1981); P.R. LAWS ANN. tit. 31, § 1851 (Supp. 1979); S.C. CONST. art. III, § 28 (fifth proviso); UTAH CODE ANN. § 78-23-11 (Supp. 1981); VA. CODE § 34-22 (1976 & Cum. Supp. 1981) (limiting extent of permissible waivers); W. VA. CODE § 38-8-15 (Cum. Supp. 1980).

50 Exemption statutes merely protect certain assets from attachment and execution. They do not purport to limit debtors' freedom to bargain away exemption rights in return for valuable consideration. *See* note 49 *supra*.

51 In several cases debtors have challenged the consensual character of transactions diminishing their exemption rights. Hernandez v. S.I.C. Fin. Co., 79 N.M. 673, 448 P.2d 474 (1968); State v. AVCO Fin. Servs., 50 N.Y.2d 383, 406 N.E.2d 1075, 429 N.Y.S.2d 181 (1980). *See* notes 238-44 *infra* and accompanying text.

52 *See* notes 69-88 *infra* and accompanying text.

53 Alabama's constitution expressly provides for recognition and enforcement of prospective waivers. *See* ALA. CONST. art. X, §§ 204, 205, 210.

54 A few states by statute permit prospective waivers. ALA. CODE §§ 6-10-120, 6-10-121, 6-10-126 (1977 & Cum. Supp. 1981) (supplementing constitutional provision); DEL. CODE ANN. tit. 10, § 4912 (1975) (spouses must execute jointly); GA. CODE ANN. § 51-1101 (1979) (providing for partial waiver of state's constitutional homestead exemption); MD. COURTS AND JUDICIAL PROCEEDINGS CODE ANN. § 11-506 (1980); VA. CODE § 34-22 (1976) (limited right of waiver).

55 *See, e.g.*, Front and Huntingdon Bldg. & Loan Ass'n v. Berzinski, 130 Pa. Super. 297, 196 A. 572 (1938); Case v. Dunmore, 23 Pa. 93 (1854). *See generally* Graubart, *Waiver of Debtors' Exemptions in Pennsylvania*, 48 DICK. L. REV. 130 (1943). Case v. Dunmore and its progeny were overruled by Mayhugh v. Coon, 460 Pa. 128, 331 A.2d 452 (1975).

56 23 Pa. 93 (1854).

57 Notwithstanding the benevolent provisions of the statute in favor of unfortunate and thoughtless debtors, it was far from the intention of the legislature to deprive the free citizens . . . of the right, upon due deliberation, to make their own contracts in their own way, in regard to securing the payment of debts honestly due. Creditors are still recognized as having some rights: and it was not the intention of the legislature to destroy them by impairing the obligation of contracts.

*Id.* at 93-95. *See also* Bowman v. Smiley, 31 Pa. 225, 226-27 (1858).

58 In Shelly's Appeal, 36 Pa. 373 (1860), the court commented:

than one hundred years. As judicial enthusiasm for enforcing waivers declined,[59] however, Pennsylvania appellate courts refused to analyze exemption waivers as matters of pure contract law. Instead the courts viewed waivers as the surrender of rights based in a strong public interest. As a result waivers were strictly construed[60] and enforced only if shown to be voluntary and knowing.[61]

In 1975, in *Mayhugh v. Coon*[62] the Pennsylvania Supreme Court overruled *Case v. Dunmore* and its progeny.[63] The court held that the provisions of Pennsylvania's debtor exemption statute[64] "may not be waived either expressly or by implication."[65] After discussing exemption policy,[66] the court concluded that enforcement of exemption waivers made retention of debtors' exemption rights the exception rather than the rule.[67] The court found this to be an "unreasonable and absurd" result. In 1976 the holding of *Mayhugh v. Coon* was codified by the Pennsylvania legislature.[68]

Early decisions disapproving prospective exemption waivers

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Perhaps it would have been well, if the court had set out by denying the capacity of the debtor to waive the statutory exemption in favor of any creditor.

36 Pa. at 380, *quoted in* Mayhugh v. Coon, 460 Pa. 128, 136, 331 A.2d 452, 456 n.5 (1975) (emphasis deleted). *See also* O'Nail v. Craig, 56 Pa. 161, 162 (1867); Firmstone v. Mach, 49 Pa. 387, 393 (1865).

59 The Pennsylvania appellate court's dissatisfaction with the precedent enforcing waivers was apparent in Resolute Ins. Co. v. Pennington, 423 Pa. 472, 224 A.2d 757 (1966). In that case the court refused to enforce a prospective waiver of exemption rights conferred by a separate statutory exemption provision for proceeds of an insurance policy.

60 Front & Huntingdon Bldg. & Loan Ass'n v. Berzinski, 130 Pa. Super. 297, 302, 196 A. 572, 574 (1938).

61 Transnational Consumer Discount Co. v. Kefauver, 224 Pa. Super. 475, 477, 307 A.2d 303, 305 (1973). This view of waivers was not limited to Pennsylvania, *e.g.*, Flaxman v. Capitol City Press, 121 Conn. 423, 185 A. 417 (1936). *But see* Broadway v. Household Fin. Corp., 351 So.2d 1373, 1377 (Ala. Civ. App. 1977) (refusing to require clear and convincing proof of waiver).

62 460 Pa. 128, 331 A.2d 452 (1975).

63 *See id.* at 132, 331 A.2d at 454 n.3.

64 PA. CONS. STAT. ANN. tit. 42, § 8123 (Purdon Supp. 1981).

65 460 Pa. at 138, 331 A.2d at 457.

66 *Id.* at 133, 331 A.2d at 454.

67 *Id.* at 135, 331 A.2d at 455.

68 PA. CONS. STAT. ANN. tit. 42, § 8122 (Purdon Supp. 1981) provides: "Exemptions from attachment or execution granted by statute may not be waived by the debtor by express or implied contract before or after the commencement of the matter, the entry of judgment or otherwise."

The Pennsylvania statute protects the debtor more comprehensively than most other statutes. By forbidding waivers "before or after . . . judgment" the Pennsylvania statute proscribes even those waivers made after levy or execution. *Cf.* notes 78-80 *infra* and accompanying text. The prohibition of "implied" waivers extends to grants of security interests in exempt property. *See* Beneficial Consumer Discount Co. v. Hamlin, 263 Pa. Super. 393, 398 A.2d 193, 202 (1979).

generally stressed legislative concern for the plight of debtors' families.[69] Permitting the debtor to bargain away rights intended to protect his dependents would arguably base the statutory protections upon an undependable foundation. In *Kneettle v. Newcomb*,[70] the New York Court of Appeals commented:

> Every honest man who contracts a debt expects to pay it, and believes he will be able to do so without having his property sold on execution. No one worthy of credit would, therefore, be apt to object to a clause subjecting all of his property to levy an execution in case of nonpayment. It was against the consequences of this overconfidence, and the readiness of men to make contracts which may deprive them and their families of articles indispensible to their comfort, that the legislature has undertaken to interpose.[71]

The Florida Supreme Court commented that if prospective waivers were enforced, "thoughtless and improvident" debtors might waive their exemption benefits to obtain credit, "thus placing the last blanket and bed of their own and their children's clothing at the mercy of a hard creditor."[72]

Contemporary exemption statutes continue to stress family pro-

69 *See, e.g.*, Recht v. Kelley, 82 Ill. 147, 148 (1876); Moxley v. Ragan, 73 Ky. (10 Bush) 156, 157, 19 Am. Rep. 61-62 (1874); Dean v. McMullen, 109 Ohio St. 309, 315-19, 142 N.E. 683, 685-86 (1924).

70 22 N.Y. 249, 78 Am. Dec. 186 (1860).

71 *Id.* at 250, 78 Am. Dec. at 186-87.

72 Carter's Adm'rs v. Carter, 20 Fla. 558, 570, 51 Am. Rep. 618, 623 (1884). The court stated that a debtor would be less likely to place himself and his family in financial straits through execution of chattel mortgages granting creditors interests in specific items of exempt personalty. *Id.* *See* note 74 *infra*.

Not every court has focused on family welfare. Language in a number of opinions characterize exemption rights as "personal" to the debtor and, therefore, waivable by him. *See, e.g.*, Andrews v. Briggs, 203 Ark. 714, 716, 158 S.W.2d 269, 270 (1942); Lawrence v. Commercial Banking Corp., 165 Md. 559, 561, 169 A. 69, 70 (1933); Barnhardt Bros. & Spindler v. Dollarhide, 186 S.W. 564 (Mo. 1916); Sorensen v. City Nat'l Bank, 293 S.W. 638 (Tex. Civ. App. 1927). Most statements concerning the personal nature of exemption rights, however, have been made in opinions considering: (1) waivers given at the time of levy or thereafter, *e.g.*, *Barnhardt Bros. & Spindler v. Dollarhide*; (2) failures to comply with statutory procedures to claim exemptions, *e.g.*, *Andrews v. Briggs*; (3) waivers as to specific articles executed by chattle mortgage or security agreement, *e.g.*, Aetna Fin. Co. v. Antoine, 343 So. 2d 1195 (La. App. 1977); or (4) state statutory or constitutional provisions permitting executory waivers, *e.g.*, Lawrence v. Commercial Banking Corp., 165 Md. 559, 169 A. 69 (1933).

In Virginia, executory waivers are expressly permitted by statute except as to certain specified property. VA. CODE § 34-22 (1976). Waivers have been considered to further the goal of family protection. "The true interests and the real benefit to the family is . . . to utilize the property exempted and make it the basis of credit." Reed v. Union Bank, 70 Va. (29 Gratt) 719, 727 (1878), *quoted in* Barbarossa v. Beneficial Fin. Co., 438 F. Supp. 840, 841 (E.D. Va. 1977).

tection.[73] Recent cases invalidating prospective exemption waivers cite family protection as an interest of paramount importance in state exemption schemes.[74] Indeed, jurisdictions that have otherwise disapproved prospective exemption waivers have enforced them when a debtor without family or dependents has waived the benefit of the exemption laws for himself alone.[75]

Another concern evident in decisions striking down prospective exemption waivers is the ease with which such waivers can be obtained. If waivers were enforceable, exemption rights would routinely be defeated by the addition of a few simple words to every contract or promissory note.[76] The New York Court of Appeals commented:

> A few words contained in any note or obligation would operate to change the law between those parties and so far disappoint the intentions of the legislature. If effect is given to such provisions, it is likely that they will generally be inserted in obligations for all small demands, and in that way the policy of the law will be completely overthrown.[77]

While the courts generally agreed on the policy reasons supporting non-enforcement of exemption waivers, the legal rationales developed to justify their non-enforcement decisions varied greatly. Several early opinions held that exemption rights could be waived by executory contract because the right to claim exemptions did not arise until a writ of attachment had been issued and levy had been attempted.[78] In dictum these opinions indicated that an exemption waiver would be effective if given at the time of levy.[79] Upon levy the exemption right becomes presently assertable and, therefore, ca-

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73 *See* note 13 *supra*.

74 *See* Anaconda Fed. Credit Union v. West, 157 Mont. 175, 179-80, 483 P.2d 909, 912 (1971); Mayhugh v. Coon, 460 Pa. 128, 134, 331 A.2d 452, 455 (1975); Iowa Mut. Ins. Co. v. Parr, 189 Kan. 475, 370 P.2d 400 (1962).

75 *Compare* Iowa Mut. Ins. Co. v. Parr, 189 Kan. 475, 370 P.2d 400 (1962) *with* Schloss v. Unsell, 114 Kan. 69, 216 P. 1091 (1923) *and* Curtis v. O'Brien & Sears, 20 Iowa 376, 89 Am. Dec. 543 (1866) *with* In re Kline's Estate, 237 Iowa 1086, 24 N.W.2d 481 (1946).

76 *See* Carter's Adm'rs v. Carter, 20 Fla. 558, 570 (1884) ("by the mere scratch of a pen the whole policy of the exemption laws would become nugatory"); Wallingsford v. Bennett, 1 Mackey 303, 310 (D.C. 1881) ("If the legislature had not intended this law to be observed in the interest of public welfare, it never would have been enacted, and parties would have been left where the law found them, to exercise their personal discretion in the disposition of the subject by contract.").

77 Kneettle v. Newcomb, 22 N.Y. 249, 250, 78 Am. Dec. 186, 187-88 (1860).

78 *E.g.*, Harper v. Leal, 10 How. Pr. 276 (N.Y. 1854); Branch & Co. v. Tomlinson, 77 N.C. 388 (1877).

79 Harper v. Leal, *id.* at 283-84; Branch & Co. v. Tomlinson, *id.* at 390-91. *See also* Maloney v. Newton, 85 Ind. 565, 566, 44 Am. Rep. 47, 47 (1882) ("where the right of exemption

pable of being relinquished. Additionally, when the sheriff has asserted dominion over the property, at the time of levy, the debtor can immediately perceive the consequences of waiving his exemption rights.[80]

Another line of early decisions indicated that the character of the debtor's ownership rights in exempt assets precluded him from bargaining away his rights by prospective waiver. In some cases, the debtor was characterized as a trustee holding property for the benefit of his family.[81] In other cases, the court considered that the statutory exemption deprived the debtor of the power to dispossess his family of basic assets by agreeing with a creditor to make exempt property available upon execution.[82]

Nineteenth century courts were uncomfortable with outright restrictions upon an individual's right to freely enter commercial contracts. As a result, some courts described their refusal to enforce exemption waivers as a restriction on creditors' ability to collect their debts.[83] Courts were more comfortable with this characterization than with an express limitation on freedom of contract. The rationale, however, overlooked the essence of the policy behind exemption statutes. Stated simply, the law would not permit debtors to bargain away their exemption rights. Rarely did an opinion straightforwardly acknowledge that exemption policies resulted in a direct restraint on both freedom of contract and debtors' property rights.[84]

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exists it cannot be waived by contract prior to the issuing of the execution"); Maxwell v. Reed, 7 Wis. 493, 498 (1859).

80 *See* Kneettle v. Newcomb, 22 N.Y. 249, 78 Am. Dec. 116 (1860). The *Kneettle* court held an exemption waiver contained in a promissory note void as contrary to public policy. The court expressly distinguished a prospective waiver from a waiver given at the time of levy when the debtor relinquishes an identified asset as part of the transaction. *Id.* at 251, 78 Am. Dec. at 188. *See also* Curtis v. O'Brien, 20 Iowa 376, 377, 89 Am. Dec. 543, 544 (1866).

Other courts have alluded to the same distinction in comparing prospective waivers with sales or mortgages of exempt property. *See* Carter's Adm'rs v. Carter, 20 Fla. 558, 570-71, 51 Am. Rep. 618, 623-24 (1884); Moxley v. Ragan, 73 Ky. (10 Bush) 156, 157-58, 19 Am. Rep. 61, 62-63 (1873); Morgan Plan Co. v. Ates, 8 La. App. 806, 809 (1928).

81 *See, e.g.*, In re Trammel, 5 F.2d 326, 328 (N.D. Ga. 1925).

82 Kneettle v. Newcomb, 22 N.Y. 249, 252-53, 78 Am. Dec. 186, 189-90 (1860).

83 *See, e.g.*, Industrial Loan & Inv. Co. v. Superior Court, 189 Cal. 546, 209 P. 360 (1922); Carter's Adm'rs v. Carter, 20 Fla. 558, 570, 51 Am. Rep. 618, 623 (1884); Kneettle v. Newcomb, 22 N.Y. 249, 251, 78 Am. Dec. 186, 187 (1860).

84 In Kneettle v. Newcomb, 22 N.Y. 249, 78 Am. Dec. 186 (1860), the court recognized that exemption laws deny the debtor the power to make certain agreements disposing of family assets. *Id.* at 252-53, 71 Am. Dec. at 189-90. In Carter's Adm'rs v. Carter, 20 Fla. 558, 51 Am. Rep. 618 (1884) the court stated:

> The object of the exemption laws is to protect people of limited means and their families in the enjoyment of so much property as may be necessary to prevent absolute pauperism and want, and against the consequences of ill advised promises

In refusing to enforce exemption waivers the courts were concerned with the impact of waivers on debtors, their families, and society. Unfortunately the courts' concern focused on the form rather than the substance of the transactions in question. At the same time that the courts were refusing to enforce prospective waivers, debtors were consistently held to be fully capable of granting security interests in exempt property.[85] Full realization of the public policy behind exemption statutes, however, requires that the courts analyze transactions which diminish debtors' exemption rights in light of their practical effect.

A review of the waiver cases fails to reveal a consistent judicial viewpoint regarding either the nature of the debtors' exemption rights or the restrictions which should be imposed on the debtors' ability to bargain them away.[86] The courts, while preventing loss of exemption rights by contractual waiver, have repeatedly held that exemption laws do not prevent the debtor from selling, encumbering, or otherwise disposing of exempt property. The "no-waiver" doctrine has encouraged the use of arrangements creating security interests in debtors' exempt property.[87] The results, in many cases, are no more consonant with public policy than those reached when prospec-

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which their lack of judgment and discretion may have led them to make, or which they may have been induced to enter into by the persuasions of others.

*Id.* at 569, 51 Am. Rep. at 623-24. *See also* Mayhugh v. Coon, 460 Pa. 128, 135, 331 A.2d 452, 455 (1975) (legislative intention to protect debtors against their own "thoughtlessness" and "extravagence").

85 *See* cases cited in note 83 *supra*.

86 Even jurisdictions that continue to enforce exemption waivers recognize that full freedom to waive exemption rights is undesirable. Alabama, by express constitutional provision, permits prospective waivers. The waivers, however, may not extend to designated household goods, wearing apparel, essential business property used by the debtor and the debtor's personal library. ALA. CONST. art. 10, §§ 204, 205, 210; ALA. CODE § 6-10-126 (1977). Georgia has enacted three separate exemption schemes for real and personal property, the "constitutional homestead," GA. CODE ANN. § 51-101 (1979); an alternative "statutory or short homestead," *id.* § 51-1301; and a special bankruptcy exemption, *id.* § 51-1301.1 (Cum. Supp. 1981). The "constitutional homestead" exempts $5,000 of realty and personalty and may be waived as to all exempt assets except $300 worth of household and kitchen furniture and provisions." *Id.* § 51-1101 (1979). The "statutory or short homestead" exemption may be waived before, but not after exempt property has been set apart (by application to probate court and publication of a schedule of assets claimed as exempt under *id.* § 51-1401). In re Trammel, 5 F.2d 326 (N.D. Ga. 1925). The Georgia bankruptcy exemption contains no express language concerning waivers, but such waivers will not be enforced in bankruptcy proceedings. *See* 11 U.S.C. § 522(e).

87 *See* COLEMAN, DEBTORS AND CREDITORS IN AMERICA (1974):

> After 1800 the chattel mortgage, a method of lending on the security of personal property became increasingly common. By the [1850's] it was being supplemented by the conditional sales contract, which gave the seller the right to repossess the goods if the buyer failed to meet all of the installment payments.

tive waivers were enforced.[88]

## IV. Nonpossessory Nonpurchase-money Security Interests In Exempt Personal Property

### A. *Introduction*

Early interpretations of exemption statutes made it clear that most jurisdictions intended to restrict the debtor's ability to dispose of his exemption rights by contractual waiver.[89] The debtor was not permitted to waive his exemption rights because: (1) the waiver might be given without a full appreciation of its consequences;[90] and (2) waivers have a detrimental impact upon the welfare of debtors' families[91] and the state.[92] The "no-waiver" rule meant that public policy imposed restrictions on freedom of contract and a concomittant diminution of the debtor's right to dispose of exempt property.[93]

The courts, however, generally permitted debtors to bargain away the rights protected by the "no-waiver" rule through the execution of chattel mortgages or security agreements granting nonpossessory, nonpurchase-money security interests in exempt assets.[94] Today by statutory or constitutional provision, most states enforce security interests in exempt property.[95] The next section examines the historical rationale leading to the distinct treatment accorded exemption waivers as opposed to chattel mortgages or security agreements. The extent to which nonpossessory, nonpurchase-money

*Id.* at 261. Such devices permitted creditors to reach exempt assets while avoiding the enforcement problems of exemption waivers.

88 *See* text accompanying note 111 *infra*.

89 Some decisions disapproved exemption waivers on the ground that they would "change the law between those parties." These courts recognized that exemption policy imposed limits on freedom of contract. Kneettle v. Newcomb, 22 N.Y. 249, 250, 78 Am. Dec. 186, 187-88 (1860). *See also* Carter's Adm'rs v. Carter, 20 Fla. 558, 570-71, 51 Am. Rep. 618, 623-24 (1884). The essence of any contract is a consensual agreement by which the parties alter the legal rights and obligations existing between them.

90 *See* notes 78-80 *supra* and accompanying text.

91 *See* notes 69-76 *supra* and accompanying text.

92 Exemption laws were intended to prevent the addition of debtors' families to the welfare rolls. *See* text accompanying note 19 *supra*.

93 The "no waiver" rule reduces the debtor's borrowing power by limiting the types of assets to which a creditor may look for repayment. *See* note 45 *supra*. This diminution of property rights and borrowing power can be overcome in part by granting security interests in exempt property. The impact of enforcing security interests in exempt property, however, may be equally at odds with exemption policy.

94 The most striking example of the frustration of exemption policy through such devices is the "catch-all" collateral clause, *supra* note 39. *See* notes 218-19, 229 *infra* and accompanying text.

95 *See* authorities cited in note 36 *supra*.

security interests in exempt personalty can be enforced without contravention of the policy behind debtor exemption statutes is also considered.

### B. *Prospective Waiver Versus Security Interest*

Although courts refuse to enforce exemption waivers, their opinions consistently state that exemption laws do not restrict the debtor's right to dispose of his property.[96] A debtor's right to sell[97] or give away[98] exempt personalty has never been seriously questioned. For many courts, the debtor's right to sell exempt assets logically implies that exempt assets may also be freely encumbered.[99] While the logic is appealing, the result is inconsistent with exemption policy.[100]

The opinions that discuss the distinction between the encumbrance of exempt assets and exemption waivers consider exemption statutes not to be so "paternalistic" as to impose restrictions upon debtors' rights to dispose of their property as they choose.[101] For example, the Washington Supreme Court stated that "[t]o deny the

96 *See* notes 37 & 38 *supra* and accompanying text.

97 *See, e.g.*, Knight v. Addison, 49 Ga. App. 54, 56, 174 S.E. 145, 146 (1934); Kay v. Furlow, 178 La. 637, 152 So. 315 (1934) ("No one would think of saying that the owner of these exempted things could not sell them."); United States Bldg. & Loan Ass'n v. Stevens, 93 Mont. 11, 17-18, 17 P.2d 62, 65 (1933); Hernandez v. S.I.C. Fin. Co., 79 N.M. 673, 675, 448 P.2d 474, 476 (1968); State v. AVCO Fin. Servs., 50 N.Y.2d 383, 388, 406 N.E.2d 1075, 1077, 429 N.Y.S.2d 181, 183-84 (1980); Montford v. Grohman, 37 N.C. App. 733, 736, 245 S.E.2d 219, 222 (1978); Congress Candy Co. v. Farmer, 73 N.D. 174, 12 N.W.2d 796, 803 (1944); Frost v. Shaw, 3 Ohio St. 270, 272-73 (1854); Mutual Loan & Thrift Corp. v. Corn, 182 Tenn. 554, 556 188 S.W.2d 345, 345-46 (1945). Sales of exempt property, assuming they are made at a fair price, do not immediately reduce the net worth of the debtor's assets.

98 Muntford v. Grohman, 36 N.C. App. 733, 736, 245 S.E.2d 219, 222 (1978). Gifts of exempt property have been challenged by creditors who have alleged them to be fraudulent. Courts have held gifts of exempt property permissible because unencumbered exempt property would not be available to satisfy indebtedness on execution. *E.g.*, New Amsterdam Cas. Co. v. Waller, 323 F.2d 20 (4th Cir. 1963). It is difficult to imagine a challenge to a gift of exempt property arising in other circumstances.

99 *E.g.*, State v. AVCO Fin. Servs., 50 N.Y.2d 383, 406 N.E.2d 1075, 429 N.Y.S.2d 181 (1980).

> No statute precludes exempt property from being sold; nor is there any which expressly interdicts a less drastic step of encumbering such property. So, for example, while contractual waivers of a debtor's statutory exemption are usually held to be void . . . the law has not forbidden a debtor to execute a mortgage upon the property so protected and thus create a lien which may be foreclosed despite the property's exempt status . . . .

*Id.* at 388, 406 N.E.2d at 1077, 429 N.Y.S.2d at 184. *See also* cases cited in note 97 *supra*.

100 *See* note 13 *supra* and accompanying text.

101 State v. AVCO Fin. Servs., 50 N.Y.2d 383, 388, 406 N.E.2d 1075, 1077, 429 N.Y.S.2d 181, 183-84 (1980); Montford v. Grohman, 36 N.C. App. 733, 736, 245 S.E.2d 219, 222-23 (1978).

right to mortgage exempt property would be to deny its right of sale or other disposition."[102] The Tennessee Supreme Court opined that limiting a debtor's power to encumber exempt assets presented a greater threat to sound public policy than did enforcement of agreements encumbering such assets.[103] Thus, enforcement of chattel mortgages and security interests in exempt assets is considered necessary to preserve debtors' rights to alienate their property.

In addition to upholding alienation rights, the courts have developed other rationales supporting the enforcement of security interests in exempt property. In the past some courts considered the creation of security interests less threatening to debtors than exemption waivers.[104] It was assumed that a debtor would be more likely to consider the potential loss of exempt personalty if he renounced exemption rights specifically by security agreement rather than generally by waiver.[105] The conclusion that the implied exemption waiver contained in a chattel mortgage or security agreement was undertaken knowingly by the debtor was fostered by the courts' perception that the debtor had bargained for specific credit rights in exchange for specific ownership and exemption rights in identified items of personal property.[106] Whatever may be said about the nature of debtor-

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102 Cammarano v. Longmire, 99 Wash. 360, 362, 169 P. 806, 807 (1918). *See also* Kay v. Furlow, 178 La. 637, 642, 152 So. 315, 317 (1934).

103 Mutual Loan & Thrift Corp. v. Corn, 182 Tenn. 554, 188 S.W.2d 345 (1945).

> [S]ound public policy would rather be defeated by an invasion of the right of the absolute owner to alienate his property and . . . it is sound public policy to provide that the thrift and responsible head of a family shall have the right to borrow in an emergency, funds for the support of his family, than that the improvident should be protected."

*Id.* at 557, 188 S.W.2d at 346. *See also* Mynatt v. Magill, 71 Tenn. 72, 74 (1879).

104 *See, e.g.*, Industrial Loan & Inv. Co. v. Superior Court, 189 Cal. 546, 209 P. 360 (1922); Carter's Adm'rs v. Carter, 20 Fla. 558, 570, 51 Am. Rep. 618, 623 (1884); Kneettle v. Newcomb, 22 N.Y. 249, 251, 78 Am. Dec. 186, 187 (1860).

105 Morgan Plan Co. v. Ates, 8 La. App. 806, 809 (1928). *See also* Carter's Adm'rs v. Carter, 20 Fla. 558, 569-70, 51 Am. Rep. 618, 623 (1884); Kneettle v. Newcomb, 22 N.Y. 249, 251, 78 Am. Dec. 186, 188 (1860).

106 *See, e.g.*, Morgan Plan Co. v. Ates, 8 La. App. 806 (1928):

> Without reviewing them in detail, we think [the cases disapproving prospective waivers] all either depend on the particular provisions of the statute law which they interpret, or if they formulate a doctrine, simply teach that a general renunciation of the right to claim the benefit of homestead or exemption laws cannot be enforced. . . . [I]t does not meet the instant issue, which is not whether a general renunciation of the right to claim the benefit of . . . exemption laws is binding, but whether a special renunciation as to particular property can be enforced. The difference between the two cases is self evident; the one being a divestiture on the part of the debtor of his right to claim the benefits of the laws of the land as to his present and future property, the other being simply the exercise of his power of ownership over the particular property the subject of a particular contract.

creditor relations at the time this view was enunciated, it no longer comports with commercial reality.[107] Today credit transactions commonly include catch-all or "dragnet" collateral clauses making the debtor's exempt and nonexempt personalty subject to the creditor's security interest.[108] Moreover, the courts have consistently enforced security interests in exempt property even under circumstances indicating that the debtor had no appreciation of the legal significance of his acts.[109]

Another reason the courts have given for upholding security interests in exempt personalty is a concern for potential fraud on creditors. It is argued that debtors, having bargained away their exemption rights, should not be able to avoid the consequences of their contracts to the detriment of unsuspecting creditors.[110] Such concerns seem inapposite when the creditor, rather than the debtor, is the party more likely to understand the exemption statute. This continuing devotion to notions of formal contractual obligation is inappropriate where competing policies demand that exemption rights be given due consideration.[111]

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*Id.* at 809 (emphasis deleted). *See also* Congress Candy Co. v. Farmer, 73 N.D. 174, 190, 12 N.W.2d 796, 803 (1944); State v. AVCO Fin. Servs., 50 N.Y.2d 383, 388, 406 N.E.2d 1075, 1077, 429 N.Y.S.2d 181, 183-84 (1980); City Loan & Sav. Co. v. Keenan, 136 Ohio St. 125, 129, 24 N.E.2d 452, 454 (1939).

107 *See* Mayhugh v. Coon, 460 Pa. 128, 137, 331 A.2d 452, 456 (1975).

108 *See* note 39 *supra* and notes 218-19, 228 *infra* and accompanying text.

109 Howard v. Calhoun, 155 Fla. 689, 21 So. 2d 361 (1945), examined the statutory landlord's lien. The lien attaches to a tenant's personal property to secure a claim for back rent. The court concluded that a tenant could waive exemption rights in personalty by merely moving into rental property protected by the statutory lien. A similar result was reached in Tomson v. Lerner, 37 N.M. 546, 25 P.2d 209 (1933), which held that "[w]hen a tenant moves into the premises of his landlord, by his own act he creates the lien in favor of the landlord, and thereby waives his exemption as effectively as though he had granted a mortgage." *Id.* at 547-48, 25 P.2d at 210. *See also* Swan v. Bournes, 47 Iowa 501 (1877) (holding otherwise exempt coat subject to innkeeper's common law lien, the act of renting a room being tantamount to creating a chattel mortgage).

These cases consider the lien to have been created when the premises was rented and personalty moved in. Thus, an implied waiver was given for all personalty on the premises prior to default. If this was the case, the operation of the waiver was essentially indistinguishable from prospective contractual waivers condemned in other cases. *See* Section III *supra*. In some jurisdictions, however, the landlord's lien does not attach to the tenant's exempt chattels. *E.g.*, Huebsch Mfg. Co. v. Coleman, 113 S.W.2d 639 (Tex. Civ. App. 1938); Ray v. Cox, 83 Utah 499, 30 P.2d 1062 (1934).

110 *See, e.g.*, Kay v. Furlow, 178 La. 637, 642, 152 So. 315, 317 (1933). This attitude has had an influence on the development of debtor exemption law and was cited by Pennsylvania courts enforcing prospective exemption waivers prior to Mayhugh v. Coon, 460 Pa. 128, 331 A.2d 452 (1975). *See* Graubart, *Waiver of Debtors' Exemptions in Pennsylvania*, 48 DICK. L. REV. 130 (1944).

111 Resolute Ins. Co. v. Pennington, 423 Pa. 472, 224 A.2d 757 (1966):

### C. *Existing Limitations Upon Nonpossessory, Nonpurchase-Money Security Interests in Exempt Personalty*

The majority of jurisdictions enforce nonpossessory, nonpurchase-money security interests in exempt personalty.[112] A few states, however, limit their enforceability by statute[113] or judicial decision.[114] This section examines the various ways in which states have limited a debtor's ability to waive his exemption rights through the creation of security interests.

#### 1. Joint Execution Requirements

Among the jurisdictions that enforce security interests in exempt personalty many have required that the debtor, if married, obtain the consent of his spouse before any encumbrance will be considered valid.[115] The requirement that both spouses must consent to create a

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> The argument that parties have a right to make their own contracts is not apposite where a matter of sufficient public policy is at stake. Further, it is simplistic in the instant situation. Provisions waiving the protection of all exemption laws customarily appear as part and parcel as the printed form in notes, bonds, mortgages, and the like. It is unrealistic to say that the parties have bargained at arm's length in such cases, where the creditor enjoys an almost impregnable position.

*Id.* at 478 n.2, 224 A.2d at 760 n.2. The same may be said of many clauses by which debtors grant creditors security interests in exempt chattels. *See, e.g.*, Hernandez v. S.I.C. Fin. Co., 79 N.M. 673, 448 P.2d 474 (1968); State v. AVCO Fin. Servs., 50 N.Y.2d 383, 406 N.E.2d 1075, 429 N.Y.S.2d 181 (1980); Montford v. Grohman, 36 N.C. App. 71, 245 S.E.2d 219 (1978).

112 *See* note 36 and Section IV B *supra*.

113 *E.g.*, ME. REV. STAT. ANN. tit. 14, § 4401 (1980) (setting forth specific items in which the "right of exemption may not be waived, pledged or given as security or collateral," except for their purchase price or for agricultural crop loans); MINN. STAT. ANN. §§ 550.37(4) (West. Supp. 1980) (proscribing nonpossessory nonpurchase-money security interests as well as exemption waivers in specified articles but providing for grants of security interests in limited situations after disclosure) and 550.37(19) (proscribing exemption waivers in specified chattels unless disclosure is made and the debtor signs a statement reflecting knowledge of the waiver's consequences); N.H. REV. STAT. ANN. § 399-A:7 (Supp. 1979) (prohibiting small loan companies from taking security interests in exempt household furniture, and declaring void any agreement creating a security interest in exempt property); VA. CODE § 34-28 (1976) (voiding deeds of trust or other instruments granting security interests in specified types of personalty).

114 *E.g.*, Beneficial Consumer Discount Co. v. Hamlin, 263 Pa. Super. Ct. 393, 398 A.2d 193 (1979) (refusing enforcement of a security interest in property set aside as exempt in prior bankruptcy); South Hill Prod. Credit Ass'n v. Hudson, 174 Va. 284, 6 S.E.2d 668 (1940) (extending application of VA. CODE § 6564 (1919), now VA. CODE § 34-28) to exemptions granted to households engaged in agriculture).

115 *E.g.*, Welty v. Burks, 76 Colo. 365, 231 P. 660 (1924); Bruce v. Frame, 39 Idaho 29, 225 P. 1024 (1924); National Bank v. Chapman, 212 Iowa 561, 234 N.W. 198 (1931); Emporia Wholesale Coffee Co. v. Rehrig, 173 Kan. 841, 252 P.2d 590 (1953); Tri-State Fin. Corp. v. Surry, 139 So. 2d 100 (La. App. 1961); Schaub v. Welfare Fin. Corp., 65 Ohio App. 68, 29 N.E.2d 223 (1939); Parsons v. Kimmell, 206 Mich. 676, 173 N.W. 539 (1919); Opitz v. Brawley, 10 Wis. 2d 93, 102 N.W.2d 117 (1960). In the foregoing cases the courts enforced the statutory requirement that spouses jointly execute instruments creating nonpossessory, non-

security interest in exempt property is consistent with the family protection policy which prompted the enactment of exemption statutes.[116] This requirement imposes both substantive and procedural limitations on a debtor's ownership rights in exempt property. The limitation is substantive in that the married owner of exempt property is recognized as the trustee for his spouse and family.[117] The owner is required to obtain the consent of his spouse, a primary beneficiary of the exemption laws, before relinquishing exemption rights. The restrictions are also procedural in that they require the spouse to join in the execution of the instrument creating the security interest.

Joint execution requirements cannot be expected to adequately safeguard exemption rights. Security interests in exempt personalty are often granted under circumstances where the full impact of the transaction is not apparent to the debtor.[118] The requirement that a second party join the transaction is unlikely to prevent the unwise release of exemption rights. In addition, the credit pressures felt by one spouse will undoubtedly be felt by the other. It is unlikely that the second spouse will be much more circumspect regarding the wisdom of the implied exemption waiver.

The object of exemption statutes is to preserve certain essential assets for the debtor and his family. Permitting the creation of security interests in exempt property, with or without a spouse's concurrence, is inconsistent with that purpose.[119]

### 2. The New Hampshire Small Loan Company Act

The New Hampshire Small Loan Company Act prohibits loan companies from securing loans of $2,000 or less by accepting as col-

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purchase-money encumbrances on exempt chattels. Joint execution was not required for creation of purchase-money security interests because the household was not relinquishing exempt equity through the transaction. *See* Simpson v. McConnell, 228 Iowa 412, 291 N.W. 862 (1940). Today joint execution requirements are not generally found in state personal property exemption laws. They are, however, numerous in real property exemption provisions. *E.g.*, N.H. REV. STAT. ANN. § 480:5-a (1968); S.D. COMP. LAWS ANN. § 43-31-17 (1969 & Supp. 1981); TENN. CODE ANN. § 26-2-301(b) & (c) (1980); UTAH CODE ANN. § 78-23-4(4) (1977 & Supp. 1981); WASH. REV. CODE ANN. § 6.12.100 (1963); WIS. STAT. ANN. § 815.20 (West 1977). Statutory provisions requiring joint spousal execution of agreements granting security interests in exempt personalty are sometimes included in laws regulating the conduct of only one group of potential secured creditors, such as small loan companies. *E.g.*, ARIZ. REV. STAT. ANN. § 6-630(A) & (B); VA. CODE § 6.1-289 (1979) (Small Loan Act).

116 National Bank v. Chapman, 212 Iowa 561, 234 N.W. 198, 199 (1931); Dean v. McMullen, 109 Ohio St. 309, 315, 142 N.E. 683, 685-86 (1924).

117 *See* notes 81 & 82 *supra* and accompanying text.

118 *See* notes 108 & 111 *supra*.

119 *See* note 116 *supra* and accompanying text.

lateral "household furniture" used by the debtor.[120] The Act renders security interests in household furniture created in connection with small loans "null and void."[121]

The New Hampshire statute provides only limited protection to debtors. First, the state exemption statute narrowly defines the term "household furniture."[122] Thus, the restriction on small loan collateral fails to protect exempt necessities such as wearing apparel, provisions, fuel, books and tools of the debtor's trade.[123] Second, since small loan companies are permitted to extend credit up to $5,000 a large number of their transactions fall without the statutory restriction on collateral.[124] On loans larger than $2,000, even when the outstanding balance falls below $2,000, household furniture remains subject to the security interest.[125] Finally, limiting the types of collateral that small loan companies can accept fails to protect debtors

120 N.H. REV. STAT. ANN. § 399-A: 7 (Supp. 1979) provides in pertinent part:

I. No licensee shall be permitted to accept as collateral on a loan under this chapter:

(a) Real estate, or

(b) Household furniture presently in use on loans of $2,000 or less.

II. Any agreement purporting to convey to a licensee a security interest in the property listed in paragraph I shall be null and void.

121 *Id.* at § 399-A: 7(II).

122 N.H. REV. STAT. ANN. § 511:2 (Supp. 1979) provides:

*Exemptions*. The following goods and property are exempted from attachment and execution:

I. The wearing apparel necessary for the use of the debtor and his family.

II. Comfortable beds, bedsteads and bedding necessary for the debtor, his wife and children.

III. Household furniture to the value of one thousand dollars.

IV. One cooking stove and the necessary furniture belonging to the same.

V. One sewing machine, kept for use by the debtor or his family.

VI. Provisions and fuel to the value of two hundred dollars.

VII. The uniform, arms and equipments of every officer and private in the militia.

VIII. The Bibles, school books and library of any debtor, used by him or his family, to the value of four hundred dollars.

IX. Tools of his occupation to the value of six hundred dollars.

X. One hog and one pig, and the pork of the same when slaughtered.

XI. Six sheep and the fleeces of the same.

XII. One cow; a yoke of oxen or a horse, when required for farming or teaming purposes or other actual use; and hay not exceeding four tons.

XIII. Domestic fowls not exceeding one hundred and fifty dollars in value.

XIV. The debtor's interest is one pew in any meeting-house in which he or his family usually worship.

XV. The debtor's interest is one lot or right of burial in any cementery.

123 *Id.*

124 *Id.* at § 399-A: 3.

125 *See* note 42 *supra*.

against similar security interests taken by other lenders.[126]

### 3. Uniform Commercial Code

Article 9 of the Uniform Commercial Code[127] provides debtors very limited protection against enforcement of security interests in exempt chattels. Section 9-204 states that "a security agreement may provide that collateral, whenever acquired, shall secure all obligations covered by the security agreement."[128] Although the Code generally permits after-acquired property clauses, a creditor is prohibited from acquiring a security interest in "consumer goods . . . when given as additional security unless the debtor acquires rights in them within ten days after the secured party gives value."[129]

The Code defines "consumer goods" as goods "used or bought for use primarily for personal, family or household purposes."[130] Consumer goods include a substantial number of items generally protected by exemption laws, such as wearing apparel,[131] household furniture,[132] professionally prescribed health aids,[133] and sewing machines.[134] Under the Code, creditors are permitted to take security interests in exempt property possessed by the debtor on the date of the transaction or acquired within ten days thereafter, but are not permitted to extend such security interests to exempt consumer goods later acquired by the debtor. These provisions merely place a temporal limit on the acquisition of security interests in some exempt property. The Code fails to comprehensively or effectively shield basic necessities from the reach of pressing creditors in a way consonant

126 The New Hampshire statute regulating small loan companies does not regulate the operation of banks, credit unions and savings and loan associations. N.H. REV. STAT. ANN. § 399A: 2 (Supp. 1979).

127 3 UNIFORM LAWS ANN. 103 (1976).

128 U.C.C. § 9-204(1).

129 U.C.C. § 9-204(2).

130 U.C.C. § 9-109(1).

131 *See, e.g.*, ALASKA STAT. § 09.35.080(3) (Cum. Supp. 1980); ARIZ. REV. STAT. ANN. § 33-1125(1) (Supp. 1980); CONN. GEN. STAT. ANN. § 52-352b(a) (West Supp. 1981); HAWAII REV. STAT. § 651-121(1) (Supp. 1979); MO. ANN. STAT. § 513.435(2) (Vernon Supp. 1981).

132 *See, e.g.*, ARIZ. REV. STAT. ANN. § 33-1123 (Supp. 1980); CAL. CIV. PRO. CODE § 690.1 (West 1980); IDAHO CODE § 11-605(1)(a) (1979); KY. REV. STAT. § 427.010 (Cum. Supp. 1980).

133 *See, e.g.*, CAL. CIV. PRO. CODE § 690.5 (West 1980); CONN. GEN. STAT. ANN. § 52-352b(f) (West Supp. 1981); IDAHO CODE § 11-603(2) (1979); UTAH CODE ANN. § 78-23-5(2) (Supp. 1981).

134 *See, e.g.*, IOWA CODE ANN. § 627.6(15) (West 1950); MASS. ANN. LAWS ch. 235, § 34(12) (Michie/Law. Co-op. 1974 & Supp. 1981); UTAH CODE ANN. § 78-23-5(7) (Supp. 1981).

with the basic aims of exemption laws.[135]

### 4. Statutory Protection of Exempt Chattels Against Consensual Liens

The Maine exemption statute provides that specified categories of personalty are exempt up to certain value limitations. The debtor's "right of exemption may not be waived, pledged or given as security or collateral other than for the purchase thereof . . . ."[136]

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135 Items such as tools of the debtor's trade are generally protected by exemption statutes as essential to debtor rehabilitation. *See* G. PENDLETON, DEBTORS' EXEMPTIONS IN PENNSYLVANIA 18 (1886), *supra* note 14; Mayhugh v. Coon, 460 Pa. 128, 134, 331 A.2d 452, 455 (1975). Tools of trade fall outside the Code's definition of consumer goods. Arguably, tools of trade could be considered goods purchased for personal use; however, the U.C.C. defines "equipment" as goods "used or bought for use primarily in business . . . ." U.C.C. § 9-109(2). The Official Comment to § 9-109 states that the categories of equipment and consumer goods are mutually exclusive. 3 UNIFORM LAWS ANN. 197 (1981).

136 ME. REV. STAT. ANN. tit. 14, § 4401 (1980) provides as follows:

> The following personal property is exempt from attachment and execution and such right of exemption may not be waived, pledged or given as security or collateral, except as security for the purchase thereof and except for agricultural crop loans on produce of farms until harvested:
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> 1. Apparel, household furniture and goods, bed. The debtor's apparel; the debtor's interest, not to exceed $1,000, in household furniture and goods necessary for himself, his spouse and children; one bed, bedstead and necessary bedding for each such person; one radio and one television not exceeding $200 in total values and the debtor's interest, not to exceed $1,000, in one motor vehicle, as defined in Title 29, section 1, subsection 7;
>
> 2. Bibles, statutes, watch, ring. All family portraits, Bibles and school books in actual use in the family; one copy of the statutes of the State, a library not exceeding $150 in value, a watch not exceeding $50 in value and a wedding ring and an engagement ring not exceeding $200 in value;
>
> 3. Pew. All his interest in one pew in a meeting house where he and his family statedly worship;
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> 4. Stoves, coal, wood. One cooking stove; all iron stoves used exclusively for warming buildings; charcoal, and not exceeding 12 cords of wood conveyed to his house for the use of himself and family; all anthracite coal, not exceeding 5 tons; all bituminous coal, not exceeding 50 bushels; $50 worth of lumber, wood or bark; all heating gas, fuel oil and kerosene, not exceeding $200 in value, for use of the debtor and his family for heating and cooking purposes;
>
> 5. Farm procedure. All produce of farms until harvested; one barrel of flour; 50 bushels of oats; 50 barrels of potatoes; corn and grain necessary for himself and family, not exceeding 30 bushels; all other food provisions raised or bought and necessary for himself and family; and all flax raised on a half acre of land and all articles manufactured therefrom for the use of himself and family;
>
> 6. Trade tools, sewing machine, refrigerator, washing machine, musical instruments. The debtor's interest, not to exceed $1,000, in the tools necessary for his trade or occupation, including power tools, materials and stock designed and procured by him and necessary for carrying on his trade or business and intended to be used or wrought therein; one sewing machine, one refrigerator and one washing machine not exceeding $200 each in value for actual use by himself or family; the

Simply stated, Maine debtors and creditors are precluded from using certain categories of personal property as collateral other than for its purchase price.[137] Exempt personalty, therefore, is no longer a factor in assessing a debtor's creditworthiness.[138]

The Maine exemption statute could be criticized as a paternalistic exercise in social welfare legislation.[139] The statute inhibits freedom of contract, strips debtors of property rights,[140] and deprives

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musical instruments used by him in his profession as a professional musician, not exceeding $200 in value;

7. Cattle, mules, horses, harness, sled. One pair of working cattle, or instead thereof one pair of mules or one or 2 horses not exceeding in value $400, and a sufficient quantity of hay to keep them through the season. If he has more than one pair of working cattle or mules, or if the 2 horses exceed in value $400, he may elect which pair of cattle or mules or which horse shall be exempt. If he has a pair of mules or one or 2 horses so exempt, he may also have exempt for each of said horses or mules, one harness not exceeding $40 in value; and one horse sled not exceeding the same value; but if he has at the same time an ox sled, he may elect which sled shall be exempt;

8. Domestic fowl, cow, swine, sheep. Domestic fowl not exceeding $100 in value, 2 swine, one cow and one heifer under 3 years old and the calves raised from them until they are one year old, or if he has no oxen, horse or mule, 2 cows, and he may elect the cows or cow and heifer, if he has more than are exempt, 10 sheep and the wool from them and the lambs raised from them until they are one year old, and a sufficient quantity of hay to keep said cattle, sheep and lambs through the winter season;

9. Farm equipment. One plough, one cart or truck wagon or one express wagon, one harrow, one yoke with bows, ring and staple, 2 chains, one ox sled and one mowing machine, one corn planter, one potato planter, one cultivator, one horse hoe, one horse rake, one sprayer or duster, one grain harvester and one potato digger;

10. Boat. One boat not exceeding 5 tons burden, usually employed in fishing business, belonging wholly to an inhabitant of the State.

The exception provided for agricultural crop loans is not directly related to the subject under discussion and will not be expressly treated.

137 *See* ME. REV. STAT. ANN. tit. 14, § 4101, *supra* note 136. The vulnerability of exempt property to attachment and execution in actions for its purchase price is discussed in note 33 *supra*.

138 Exempt property is generally not considered by creditors in evaluating creditworthiness. Jurisdictions that permit creditors to take nonpossessory, nonpurchase-money security interests in exempt property allow it to become a factor by agreement of the parties. *See* COLEMAN, DEBTORS AND CREDITORS IN AMERICA 257 (1974):

> These [exemption statutes] did not impair the obligation of contracts because, by implication, all loans were conditioned on the exclusion of specified types and amounts of property from execution. The lender gave up in advance some of his attachment rights.

139 *See, e.g.*, State v. AVCO Fin. Servs., 50 N.Y.2d 383, 388, 406 N.E.2d 1075, 1077, 429 N.Y.S.2d 181, 183-84 (1980); Montford v. Grohman, 36 N.C. App. 733, 737, 245 S.E.2d 219, 223 (1978).

140 *See, e.g.*, Mutual Loan & Thrift Corp. v. Corn, 182 Tenn. 554, 557, 188 S.W.2d 345, 346 (1945).

debtors of the full value of their assets.[141] If, however, one accepts the legislature's judgment that the property protected by the statute represents the "necessities of life,"[142] the prohibition against creating enforceable security interests in these necessities is consistent with the policy underlying exemption legislation. The Maine legislature has declared that such property is not only beyond the reach of unsecured creditors, but that the debtor may not agree to sacrifice his exemption in such property.[143]

The practical impact of the statute restricts the debtor's ability to obtain credit, but the severity of this restriction is *de minimis*.[144] The statute furthers the policy underlying exemption law in the same manner as prohibitions on exemption waivers.[145] The Maine exemption statute simply eliminates the formalistic distinction the courts have recognized between security interests in exempt personalty and exemption waivers.[146]

A Pennsylvania statute provides that debtors may not waive exemption rights by "express or implied contract."[147] The statute prohibits prospective waivers, implied waivers and waivers given at the time of levy pursuant to execution.[148] The proscription appears to be

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141 *But see* Barbarossa v. Beneficial Fin. Co., 438 F. Supp. 840, 842 (E.D. Va. 1977).

142 G. PENDLETON, DEBTORS' EXEMPTIONS IN PENNSYLVANIA 18 (1886). *See* Mayhugh v. Coon, 460 Pa. 128, 134, 331 A.2d 452, 455 (1975).

143 If a debtor owns property within the exempt categories valued in excess of the exemption, the property may be subject to forced sale. The proceeds will be distributed: first, to the debtor in the amount of the exemption; second, to the creditor in the amount of his claim; and third, any surplus to the debtor. ME. REV. STAT. ANN. tit. 14, § 4402 (1980).

144 *Cf.* Mayhugh v. Coon, 460 Pa. 128, 137, 331 A.2d 452, 456 (1975) (holding prospective waivers unenforceable and rejecting the argument that this result would damage the credit industry). *See also* Vukowich, *supra* note 10, at 852; NATIONAL COMMISSION ON CONSUMER FINANCE, CONSUMER CREDIT IN THE UNITED STATES 26-27 (1973).

145 *See* Section III *supra*.

146 For a discussion of the operation of the Maine statute in the context of bankruptcy proceedings, *see* Hertz, *Bankruptcy Code Exemptions: Notes on the Effect of State Law*, 54 AM. BANKR. L.J. 339 (1980).

147 PA. CONS. STAT. ANN. tit. 42, § 8122 (Purdon Pamph. 1981), provides as follows:

> Exemptions from attachment and execution granted by statute may not be waived by the debtor by express or implied contract before or after the commencement of the matter, the entry of judgment or otherwise.

Exemptions granted by statute in Pennsylvania include an exemption of $300 in bank notes, money, securities, real property, judgments or other indebtedness owed to the debtor, PA. CONS. STAT. ANN. tit. 42, § 8123 (Purdon Pamph. 1981); and specific property exemptions in wearing apparel, Bibles and school books, sewing machines, uniforms, certain pension benefits, and certain insurance proceeds, PA. CONS. STAT. ANN. tit. 42, § 8124 (Purdon Pamph. 1981); property on display at international exhibitions, PA. CONS. STAT. ANN. tit. 42, § 8125 (Purdon Pamph. 1981); and wages, salaries and commissions in the hands of an employer, PA. CONS. STAT. ANN. tit. 42, § 8127 (Purdon Pamph. 1981).

148 The conclusion that waivers given at the time of levy are ineffective is drawn from the

absolute.[149] Mortgages of exempt chattels and nonpossessory, nonpurchase-money security interests are subordinate to exemption rights.[150] Although the statute is silent on this point, it is reasonable to assume that possessory, nonpurchase-money security interests, as well as purchase money security interests, will continue to take precedence over exemption rights.[151]

Minnesota is another jurisdiction in which exemption rights may not be overcome by consensual liens.[152] Apart from purchase-

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statutory language indicating that a waiver may not be given "after judgment or otherwise." PA. CONS. STAT. ANN. tit. 42, § 8122 (Purdon Pamph. 1981).

149 PA. CONS. STAT. ANN. tit. 42, § 8122 (Purdon Pamph. 1981), *supra* note 147.

150 The statute expressly prohibits implied waivers. *Id.*

151 *Id. See* note 153 *infra*.

152 MINN. STAT. ANN. § 550.37 (West Cum. Supp. 1981) establishes categories and amounts of exempt personal property and sets forth limitations on the creation of nonpossessory, nonpurchase-money security interests. The same statutory section permits prospective exemption waivers under certain circumstances, but only as to specified categories of exempt property. The statute provides:

> Property exempt:
>
> Subdivision 1. The property mentioned in this section is not liable to attachment, garnishment, or sale of any final process, issued from any court.
>
> Subd. 2. The family bible, library, and musical instruments.
>
> Subd. 3. A seat or pew in any house or place of public worship and a lot in any burial ground.
>
> Subd. 4. All wearing apparel, one watch, household furniture, utensils, household appliances, phonographs, radio and television receivers, and foodstuffs on the debtor and his family, not exceeding $3,000 in value. The exemption provided by this subdivision may not be waived with regard to purchase money security interests. Except for a pawnbroker's possessory lien, a nonpurchase-money security interest in the property exempt under this subdivision is void.
>
> Provided however, if a debtor has property of the type which would qualify for the exemption under this subdivision, of a value in excess of $3,000, an itemized list of the exempt property, together with the value of each item listed, shall be attached to the security agreement at the time a security interest is taken, and a creditor may take a nonpurchase-money security interest in the excess over $3,000 by requiring the debtor to select his exemption in writing at the time the loan is made.
>
> Subd. 5. Farm machines and implements used in farming operations by a debtor engaged principally in farming, livestock, farm produce, and standing crops, not exceeding $5,000 in value.
>
> Subd. 6. The tools, implements, machines, instruments, office furniture, stock in trade, and library reasonably necessary in the trade, business, or profession of the debtor, not exceeding $5,000 in value.
>
> Subd. 7. The total value of property selected by a debtor pursuant to subdivisions 5 and 6 shall not exceed $5,000.
>
> Subd. 8. The library and philosophical and chemical or other apparatus [sic]

money security interests and pawnbrokers' possessory liens,[153] the

belonging to, and used for the instruction of youth in, any university, college, seminary of learning, or school which is indiscriminately open to the public.

Subd. 9. All money arising from any claim on account of the destruction of, or damage to, exempt property.

Subd. 10. All money received by, or payable to, a surviving wife or child from insurance upon the life of a deceased husband or father, not exceeding $10,000.

Subd. 11. All money, relief, or other benefits payable or to be rendered by any police department association, fire department association, beneficiary association, or fraternal benefit association to any person entitled to assistance therefrom, or to any certificate holder thereof or beneficiary under any such certificate.

Subd. 12. A mobile home, as defined in section 168.011, subdivision 8, which is actually inhabited as a home by the debtor.

Subd. 12a. One motor vehicle to the extent of a value not exceeding $2,000.

Subd. 13. [Wage garnishment limitation.]

Subd. 14. [Welfare and similar relief payments; wages of welfare recipients.]

Subd. 15. The earnings of the minor child of any debtor or the proceeds thereof, by reason of any liability of such debtor not contracted for the special benefit of such minor child.

Subd. 16. The claim for damages recoverable by any person by reason of a levy upon sale under execution of his exempt personal property, or by reason of the wrongful taking or detention of such property by any person, and any judgment recovered for such damages.

Subd. 17. All articles exempted by this section shall be selected by the debtor, his agent, or legal representative.

Subd. 18. The exemptions provided for in subdivisions 3 to 15 extend only to debtors who are natural persons.

Subd. 19. The exemption of the property listed in subdivisions 2, 3, 5 to 11, and 12a may not be waived except by a statement in substantially the following form, in bold face type of a minimum size of 12 points, signed and dated by the debtor at the time of the execution of the contract surrendering the exemption, immediately adjacent to the listing of the property: "I understand that some or all of the above property is normally protected by law from the claims of creditors, and I voluntarily give up my right to that protection for the above listed property with respect to claims arising out of this contract."

Subd. 20. [Application of exemptions to funds in bank accounts].

Subd. 21. For the purpose of this section "value" means current fair market value.

Subd. 22. Rights of action for injuries to the person of the debtor or of a relative whether or not resulting in death.

Subd. 23. The debtor's aggregate interest not to exceed in value $4,000 in any accrued dividend or interest under or loan value of any unmatured life insurance contract owned by the debtor under which the insured is the debtor or an individual of whom the debtor is a dependent.

Subd. 24. The debtor's right to receive a payment under a stock bonus, pension, profit sharing, annuity, or similar plan or contract on account of illness, disability, death, age, or length of service, to the extent reasonably necessary for the support of the debtor and any dependent of the debtor.

153 The pledge of property entails parting with possession, and therefore loss of use at the time the lien is created. Thus, pledges present less of a threat to exemption policies than do nonpossessory, nonpurchase-money liens. Pledges and possessory liens represent transactions in which debtors are aware of the consequences of their actions from the outset. *See* notes 80

Minnesota statute does not permit the enforcement of consensual liens in household property with an aggregate value[154] of $3,000 or less.[155] If a Minnesota debtor wishes to grant a nonpossessory, nonpurchase-money security interest in household property with value in excess of $3,000 a property schedule of the debtor must be appended to the security agreement.[156] In the property schedule the debtor designates property worth $3,000 in which the exemption is claimed. The creditor is free to take a security interest in the excess.[157]

The Minnesota statute, like the Maine statute,[158] removes from the reach of creditors a limited amount of exempt property.[159] Although the statutes differ in detail,[160] they both reflect a legislative judgment that effective implementation of exemption policy requires that exemptions be given preference over traditional notions of freedom of contract and property rights.[161]

In addition to its substantive limitations on creditors' rights, the

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& 90 *supra* and accompanying text. In addition, most states extensively regulate the activities of pawnbrokers. A discussion of possessory liens in exempt property is therefore beyond the scope of this article.

154 "Value" means the current fair market value. MINN. STAT. ANN. § 550.37(21) (West Cum. Supp. 1981), *supra* note 152. "Current" fair market value apparently means value on the date that the security interest was created. *See id.* at § 550.37(4).

155 MINN. STAT. ANN. § 550.37(4) (West Cum. Supp. 1981), *supra* note 152.

156 *Id.*

157 *Id.*

158 *See* notes 135-144 *supra* and accompanying text.

159 MINN. STAT. ANN. § 550.37(4) (West Cum. Supp. 1981), *supra* note 152.

160 The Maine statute exempts from execution ten separate categories of goods. The statute also prohibits nonpurchase-money security interests in such goods. See ME. REV. STAT. ANN. tit. 14, § 4401 (1980), *supra* note 136. As to each category a certain dollar value, e.g., $1,000 worth of wearing apparel, or amount, e.g., one fishing boat, is protected. *Id.* Under the Minnesota provision, twenty-one categories of property are exempted either up to a certain quantity, e.g., one seat or pew in a church or meeting house, or value, e.g., farm implements and tools of trade up to $5,000. MINN. STAT. ANN. § 550.37 (West Cum. Supp. 1981), *supra* note 152. Minnesota, unlike Maine, permits consensual possessory liens in items in which nonpurchase-money security interests otherwise may not be taken. *Id.*

The Maine statute prohibits nonpurchase-money security interests in all categories of exempt property up to the amount or value of the exemption. The Minnesota statute voids nonpossessory, nonpurchase-money security interests in only one category of exempt goods. *See* text accompanying note 152 *supra*. Maine's statute protects only $1,000 worth of wearing apparel and household goods and furnishings but extends like protection to the other exemption categories. ME. REV. STAT. ANN. tit. 14, § 4401 (1980), *supra* note 136. Minnesota shields from execution and consensual lien $3,000 worth of wearing apparel and household goods and furnishings, but permits nonpossessory, nonpurchase-money consensual liens in other exempt property. MINN. STAT. ANN. § 550.37 (West Cum. Supp. 1981), *supra* note 152.

The differences in the statutes are attributable to divergent legislative judgments as to the importance of the categories of exempt property to the debtor and his family and the degree of protection necessary for each category.

161 Minnesota's statutory restrictions on the creation of consensual liens in exempt assets

Minnesota statute contains several beneficial procedural safeguards not found in the Maine statute. Nonpossessory, nonpurchase-money security interests in otherwise exempt personalty of a value in excess of $3,000 are permitted,[162] provided the debtor's property schedule designates the items which will remain exempt.[163] This procedure reminds the debtor at the time of the transaction that he has exemption rights.[164] It requires the debtor to consider the value of each item of exempt property and to select those items that will remain outside the security interest. The debtor makes a conscious choice to bargain away his exemption rights in exchange for an extension of credit.[165] The Maine statute lacks this attribute, and permits the "forced sale"[166] of exempt personalty valued above the exemption limits.[167] Finally, under the Minnesota statute, in the event of default the debtor's property schedule provides an efficient means of determining which items are available to satisfy the creditor's claims.[168]

5. The Uniform Consumer Credit Code[169]

Both the 1968 and 1974 versions of the Uniform Consumer

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are open to the same criticisms as the restrictions contained in the Maine statute, *supra* note 139-46 and accompanying text.

162 MINN. STAT. ANN. § 550.37(4) (West Cum. Supp. 1981), *supra* note 152.

163 *Id.*

164 In states like Minnesota, where exemptions may not be impliedly waived by security agreement, disclosure of exemption rights is less critical than in states which permit either security agreements in exempt property or prospective exemption waivers. *Cf.* MINN. STAT. ANN. § 550.37(19) (West Cum. Supp. 1981), *supra* note 152.

165 One historical justification for permitting implied exemption waivers through chattel mortgages and security agreements was that the debtor could more fully appreciate the implications of his actions. *But see* note 80 *supra* and accompanying text and discussion *infra* at Section IV.D.1.

166 ME. REV. STAT. ANN. tit. 14, § 4401 (1980), *supra* note 136.

167 *See id.* The wording of the statute is unclear, but it appears that a security interest created in exempt property would attach only to the value in excess of the amount of the exemption. Upon default the creditor could take possession and sell the property, provided the debtor receives proceeds in the amount of the exemption "off the top." *Id.* *See* note 143 *supra*. This conclusion is drawn from the statute's use of the term "forced sale" in § 4402 rather than the narrower terms "attachment and execution" found in § 4401. Forced sale would seem to include a creditor's sale under U.C.C. § 9-504. In this regard, Maine debtors would benefit from a procedure, such as Minnesota's, notwithstanding the protection already afforded them.

168 In regard to household goods and furnishings and wearing apparel the schedule would establish what items constituted after-acquired property. Such property cannot be made the subject of a security interest if no later advances are made under the security agreement. *See* U.C.C. § 9-204(2) and notes 128-35 *supra* and accompanying text.

169 7 UNIFORM LAWS ANN. 223 (1978). The Uniform Consumer Credit Code [hereinafter cited as U.C.C.C.] was approved in Final Draft by the National Conference of Commissioners

Credit Code (U.C.C.C.) restrict the use of debtor's property as collateral. Indebtedness arising out of "consumer credit sales" and "consumer leases"[170] may be secured by a debtor's property only if a

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on Uniform State Laws on July 30, 1968, and by the American Bar Association on August 7, 1968. *Id.* at 240. The U.C.C.C. was revised and the revision approved by the National Conference in 1974. *Id.* at 583. [The 1974 revision of the U.C.C.C. will hereinafter be cited as U.C.C.C. (1974)]. The U.C.C.C. was drafted to provide uniform statutory provisions furthering the following policies:

> (a) to simplify, clarify and modernize the law governing retail installment sales, consumer credit, small loans and usury;
>
> (b) to provide rate ceilings to assure an adequate supply of credit to consumers;
>
> (c) to further consumer understanding of the terms of credit transactions and to foster competition among suppliers of consumer credit so that consumers may obtain credit at a reasonable cost;
>
> (d) to protect consumer buyers, lessees, and borrowers against unfair practices by some suppliers of consumer credit, having due regard for the interests of legitimate and scrupulous creditors;
>
> (e) to permit and encourage the development of fair and economically sound consumer credit practices;
>
> (f) to conform the regulation of consumer credit transactions to the policies of the Federal Consumer Credit Protection Act; and
>
> (g) to make uniform the law, including administrative rules, among the various jurisdictions.

U.C.C.C. § 1.102(2). For information regarding the impact and operation of the U.C.C.C., *see* Robertson, *Comparison of the Code with the Federal Consumer Credit Protection Act*, 41 MISS. L.J. 36 (1969); Miller & Warren, *The 1974 Uniform Consumer Credit Code*, 23 KAN. L. REV. 619 (1975).

170 U.C.C.C. § 2.104 defines "consumer credit sale" as follows:

> (1) Except as provided in subsection (2), "consumer credit sale" is a sale of goods, services, or an interest in land in which
>
> (a) credit is granted by a person who regularly engages as a seller in credit transactions of the same kind,
>
> (b) the buyer is a person other than an organization,
>
> (c) the goods, services, or interest in land are purchased primarily for a personal, family, household, or agricultural purpose,
>
> (d) either the debt is payable in installments or a credit service charge is made, and
>
> (e) with respect to a sale of goods or services, the amount financed does not exceed $25,000.
>
> (2) Unless the sale is made subject to this Act by agreement (Section 2.601), "consumer credit sale" does not include
>
> (a) a sale in which the seller allows the buyer to purchase goods or services pursuant to a lender credit card or similar arrangement, or
>
> (b) except as provided with respect to disclosure (Section 2.301) and debtors' remedies (Section 5.201), a sale of an interest in land if the credit service charge does not exceed 10 percent per year calculated according to the actuarial method on the unpaid balances of the amount financed on the assumption that the debt will be paid according to the agreed terms and will not be paid before the end of the agreed term.
>
> (3) The amount of $25,000 in subsection (1) is subject to change pursuant to the provisions on adjustment of dollar amounts (Section 1.106).

purchase-money security interest is created or if the property purchased becomes "closely connected" with the debtor's other property and the debt secured is "substantial."[171] A lessor in a consumer lease transaction may not take a security interest in the debtor's property unless the lease is primarily agricultural.[172] Security interests taken in contravention of U.C.C.C. provisions are void.[173]

The U.C.C.C. permits consumer sellers and lessors to use "cross-collateral" in securing indebtedness.[174] This provision permits a seller engaging in multiple sales to a single buyer to secure the indebtedness arising from a later sale with existing security interests in

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*Cf.* U.C.C.C. (1974) § 1.301(12) (substantially similar definition). U.C.C.C. § 2.106 defines a consumer lease as follows:

> (1) "Consumer lease" means a lease of goods
>
> (a) which a lessor regularly engaged in the business of leasing makes to a person, other than an organization, who takes under the lease primarily for a personal, family, household, or agricultural purpose,
>
> (b) in which the amount payable under the lease does not exceed $25,000, and
>
> (c) which is for a term exceeding four months.
>
> (2) "Consumer lease" does not include a lease made pursuant to a lender credit card or similar arrangement.
>
> (3) The amount of $25,000 in subsection (1) is subject to change pursuant to the provisions on adjustment of dollar amounts (Section 1.106).

*Cf.* U.C.C.C. (1974) § 1.301(14).

171 Official Comment to U.C.C.C. § 2.407, 7 UNIFORM LAWS ANN. 367 (1978). A "substantial" debt is defined as $300 in regard to a security interest in closely connected goods, and $1,000 in the case of closely connected realty. *Id.* U.C.C.C. § 2.407 provides as follows:

> (1) With respect to a consumer credit sale, a seller may take a security interest in the property sold. In addition, a seller may take a security interest in goods upon which services are performed or in which goods sold are installed or to which they are annexed, or in land to which the goods are affixed or which is maintained, repaired or improved as a result of the sale of the goods or services, if in the case of a security interest in land the debt secured is $1,000 or more, or, in the case of a security interest in goods, the debt secured is $300 or more. The seller may also take a security interest in any property of the buyer to secure the debt arising from a consumer credit sale primarily for an agricultural purpose. Except as provided with respect to cross-collateral (Section 2.408), a seller may not otherwise take a security interest in property of the buyer to secure the debt arising from a consumer credit sale.
>
> (2) With respect to a consumer lease other than a lease primarily for an agricultural purpose, a lessor may not take a security interest in property of the lessee to secure the debt arising from the lease.
>
> (3) A security interest taken in violation of this section is void.
>
> (4) The amounts of $1,000 and $300 in subsection (1) are subject to change pursuant to the provisions on adjustment of dollar amounts (Section 1.106).

*Cf.* U.C.C.C. (1974) § 3.301 (substantially similar provision expressly permitting the lessor to take a lease deposit).

172 U.C.C.C. § 2.407(2), *id.*; U.C.C.C. (1974) § 3.301(2).

173 *See* note 171 *supra*.

174 *See* U.C.C.C. §§ 2.407(1), 2.408; U.C.C.C. (1974) §§ 3.301(1), 3.302.

property previously sold.[175] Property sold later may also be used as security for previous debts.[176]

In addition to the U.C.C.C. restrictions upon sellers' and lessors' use of security interests in consumers' property, the 1974 version restricts lenders' enforcement of nonpossessory, nonpurchase-money security interests in exempt property.[177] Lenders making secured "supervised loans" may not, without prior notice and hearing or consent of the debtor, enforce security interests in exempt property.[178] If the debtor refuses to surrender possession of exempt collateral and a court finds that retention of the property is necessary to avoid undue hardship on the debtor or his family, the lender will be unable to enforce the security interest in the property.[179]

The 1974 version of the U.C.C.C. provides comprehensive pro-

175 U.C.C.C. § 2.408; U.C.C.C. (1974) § 3.303.

176 U.C.C.C. § 2.409 and U.C.C.C. (1974) § 3.303 establish methods for crediting payments and releasing security interests in the multiple-debt, cross-collateral context. Some states that have not adopted the U.C.C.C. have enacted similar provisions regulating cross-collateral financing. *E.g.*, FLA. STAT. ANN. § 516.31(4) (West 1972 & Supp. 1980).

177 U.C.C.C. (1974) § 5.116, *infra* note 178.

178 *See* U.C.C.C. (1974) § 5.116, which provides as follows:

> (1) Except as to a purchase money security interest, this section applies to a security interest in an item of goods other than a motor vehicle which (1) is possessed by a consumer, (b) is being used by him or a member of a family wholly or partly supported by him, (c) is or may be claimed to be exempt from execution on a money judgment under the laws of this State, and (d) is collateral for a supervised loan.
>
> (2) Unless the consumer, after written notice to him of his rights under this section, voluntarily surrenders to the lender possession of any item of goods to which this section applies, the lender, without an order or process of the [ —— ] court, may not take possession of the item or otherwise enforce the security interest according to its terms. The notice to the consumer shall conform to any rule adopted by the Administrator.
>
> (3) The court may order or authorize process respecting an item of goods to which this section applies only after a hearing upon notice to the consumer of the hearing and his rights at it. The notice shall be as directed by the court. The order or authorization may prescribe appropriate conditions as to payments upon the debt secured or otherwise. The court may not order or authorize process respecting the item if it finds upon the hearing both that the consumer lacks the means to pay all or part of the debt secured and that continued possession and use of the item is necessary to avoid undue hardship for the consumer or a member of a family wholly or partly supported by him.
>
> (4) The court, upon application of the lender or the consumer and notice to the other, and after a hearing and a finding of changed circumstances, may vacate or modify an order or authorization pursuant to this section.

A "supervised loan" is an installment loan of $25,000 or less at an interest rate of more than 18 per cent, made to an individual for personal, family, household, or agricultrual purposes. U.C.C.C. (1974) § 1.301.

179 U.C.C.C. (1974) § 5.116.

tection for debtors against the creation of security interests in exempt property in connection with consumer leases, sales and loans.[180] The 1968 U.C.C.C. provides similar protection against the creation of security interests,[181] but does not restrict the collateral available to secure consumer loans.[182] The U.C.C.C. provisions appear to be in harmony with the public policy underpinning exemption statutes.[183]

It can be argued, however, that the 1974 U.C.C.C. provisions are overly protective of debtors' exemption rights. The U.C.C.C. places procedural and substantive restrictions on enforcement of security interests in all property exempt under state law other than motor vehicles.[184] In contrast, the 1974 report of the National Commission on Consumer Finance recommended that the prohibition of nonpurchase-money security interests be limited to "household goods."[185] The 1974 U.C.C.C. requires that notice and a hearing be provided prior to the enforcement of a security interest. In contrast, under the U.C.C. the creditor may repossess his collateral unencumbered by costly procedural safeguards.[186] The stringent approach of the 1974 U.C.C.C. is justified if one assumes that only the basic "necessities of life"[187] are protected by state exemption statutes. In some states, however, exemption laws protect assets which may properly be the basis for extensions of credit without creating potential hardship for debtors.[188] In this situation, the safeguards of the 1974 U.C.C.C. impose unnecessary burdens on creditors.

Due in part to its pro-debtor orientation, the U.C.C.C. has not been warmly received in state legislatures. Eight states have enacted

180 U.C.C.C. (1974) § 3.301.

181 U.C.C.C. § 2.407.

182 *See generally* U.C.C.C. art. 3, part. 4.

183 *See* NATIONAL COMMISSION ON CONSUMER FINANCE, CONSUMER CREDIT IN THE UNITED STATES (1974). The Commission recommended that creditors not be permitted to take nonpurchase-money security interests in household goods. It further recommended that in consumer sales creditors not be permitted to take security interests in debtors' property, other than the property which is the subject of the sale. *Id.* at 27. These recommendations were based in part on the Commission's findings that there exists no significant need for the use of such collateral in the credit industry. *Id.*

184 U.C.C.C. (1974) § 5.116, *supra* note 178.

185 NATIONAL COMMISSION ON CONSUMER FINANCE, CONSUMER CREDIT IN THE UNITED STATES, *supra* note 183, at 27.

186 *See* Karp Bros., Inc. v. West Ward Sav. & Loan Ass'n, 440 Pa. 583, 271 A.2d 493 (1970).

187 Official Comment to U.C.C.C. (1974) § 5.116, 7 UNIFORM LAWS ANN. 776 (1978).

188 *Cf.* MINN. STAT. ANN. § 550.37 (West Cum. Supp. 1981) (treating different categories of exempt property differently regarding security interests and prospective exemption waivers).

the 1968 version of the U.C.C.C.[189] Only three states have passed the 1974 U.C.C.C.[190] The U.C.C.C. provisions that touch upon the problem of security interests in exempt personalty are part of a comprehensive scheme of consumer credit regulation that is worthy of examination. Absent renewed legislative enthusiasm for the Code as a whole, however, the pertinent provisions of the U.C.C.C. are unlikely to be enacted.

6. Conclusion

The state statutes that regulate consensual liens generally fail to resolve the conflict between the need to safeguard exemption rights in basic necessities and the need to facilitate the creation and enforcement of security interests in other chattels. In general, the protection afforded exempt property against creditors' security interests is either too broad, as under the Maine statute and the 1974 U.C.C.C., or incomplete, as under the New Hampshire Small Loan Act and Article 9 of the U.C.C. Only the Minnesota statute recognizes that within the general category of exempt personalty there exists a subcategory of property of substantial importance to the well-being of debtors but of comparatively little economic worth as collateral to secure indebtedness.

### D. *Nonpossessory, Nonpurchase-Money Security Interests in Exempt Personalty*

1. An Evaluation

In most jurisdictions the law concerning exemption waivers is both contradictory and inadequate to achieve the purposes of exemption legislation. Most courts agree that prospective exemption waivers violate either statutory restrictions or public policy.[191] The same courts that condemn exemption waivers however, permit creation of security interests in exempt chattels without restriction.[192] The law readily permits debtors to bargain away their exemption rights

189 COLO. REV. STAT. §§ 5-1-101 to 5-9-103 (1973 & Supp. 1980); IDAHO CODE §§ 28-31-101 to 28-39-103 (1979); IND. CODE ANN. tit. 24, §§ 24-4.5-1-101 to 24-4.5-6-203 (Burns 1974 & Supp. 1980); OKLA. STAT. ANN. tit. 14A, §§ 1-101 to 9-103 (West 1980); S.C. CODE §§ 37-1-101 to 37-6-416 (1976 & Supp. 1980); UTAH CODE ANN. §§ 70B-1-101 to 70B-11-105 (1980 & Supp. 1981); WIS. STAT. ANN. §§ 421.101-427.105 (West 1974 & Supp. 1981); WYO. STAT. §§ 40-14-101 to 40-14-702 (1977).

190 IOWA CODE ANN. §§ 537.1101-537.7103 (West Supp. 1980); KAN. STAT. ANN. §§ 16a-1-101 -16a-9-102 (1974); ME. REV. STAT. ANN. tit. 9A, §§ 1-101 to 6-415 (1980).

191 *See* Section III *supra*.

192 *See* Section IV B *supra*.

through chattel mortgages[193] or security agreements.[194] Moreover, enforcement of creditor rights against exempt property is generally authorized by state statute.[195]

It is argued that to inhibit debtors' ability to use exempt chattels as collateral would be to deny debtors the right to dispose of their property.[196] Although it is accurate to portray exemption policy as inconsistent with traditional principles of property and contract law, that is an insufficient reason to enforce security interests in all exempt chattels. Exemption statutes, as applied by the courts, have long entailed significant restrictions on debtors' rights to "dispose" of their property.[197] For example, judicial and statutory invalidation of prospective exemption waivers amounts to a restriction on the debtor's power to barter property and exemption rights for credit. Joint execution requirements represent an outright denial of the debtor's right unilaterally to alienate his exempt property.[198] Provisions of small loan acts,[199] the U.C.C.[200] and the U.C.C.C.,[201] similarly restrict a debtor's ability to enhance his creditworthiness by consensually transferring interests in his property.

States that have enacted statutes prohibiting the enforcement of security interests in exempt chattels have recognized that exemption policy is not compatible with traditional notions governing the alienation of property. For the most part, however, traditional contract and property rights have attained ascendancy over the aims of exemption policy. Nonpossessory, nonpurchase-money security interests in even the most basic exempt necessity have routinely been enforced.[202]

## 2. Legislative Solutions—A Modest Proposal

Personal property exemption statutes are intended to insulate debtors from abject poverty. The essence of exemption policy re-

193 *E.g.*, City Loan & Savings Co. v. Keenan, 136 Ohio St. 125, 24 N.E.2d 452 (1939); Congress Candy Co. v. Farmer, 73 N.D. 174, 12 N.W.2d 796 (1944).

194 *E.g.*, Hernandez v. S.I.C. Fin. Co., 79 N.M. 673, 448 P.2d 474 (1968); State v. AVCO Fin. Servs., 50 N.Y.2d 383, 406 N.E.2d 1075, 429 N.Y.S.2d 181 (1980); Montford v. Grohman, 36 N.C. App. 733, 245 S.E.2d 219 (1978).

195 *See* note 36 *supra*.

196 See text accompanying notes 101-03 *supra*.

197 *See* text accompanying notes 137-46 *supra*.

198 *See* text accompanying notes 115-17 *supra*.

199 *See* text accompanying notes 120-21 *supra*.

200 *See* text accompanying notes 127-29 *supra*.

201 *See* text accompanying notes 169-190 *supra*.

202 *See* Section IV *supra*.

quires that the state legislature identify and protect property necessary to the continued well-being of embarrassed debtors. This type of property will be termed "basic exempt necessities."[203] A statute should provide the standard exemptions from executions coupled with provisions denying debtors the ability to create nonpossessory, nonpurchase-money security interests in basic exempt necessities.[204]

The property classified as basic exempt necessities should include: (1) the wearing apparel of the debtor and his dependents;[205] (2) household goods, furnishings and appliances that are necessary to provide for the daily needs of the debtor and his family;[206] (3) tools of the debtor's trade, farm implements and necessary professional libraries;[207] (4) professionally prescribed medical aids necessary to the

203 Set forth below is the author's recommended minimum content for the category "basic exempt necessities." Because exemption provisions reflect the particular policies a state wishes to promote, *see* Section II at notes 16-22 *supra*, there is good reason to expect variation among the states. *Cf.* Kennedy, *Limitation of Exemptions in Bankruptcy*, 485 IOWA L. REV. 445, 485-86 (1959). Other commentators have suggested that certain exempt chattels be protected against the claims of creditors by restricting the creditor's ability to create security interests in such property. *See, e.g.*, Vukowich, *supra* note 10, at 873-75; UNIFORM EXEMPTIONS ACT §§ 10-11. *See also* NATIONAL COMMISSION ON CONSUMER FINANCE, CONSUMER CREDIT IN THE UNITED STATES 27 (1974).

204 Invalidation of nonpossessory, nonpurchase-money security interests in certain categories of exempt property would protect possession and use of such property thereby providing a *physical* barrier against abject poverty. Current law provides only a temporary *economic* barrier against destitution.

205 Protecting wearing apparel is consistent with the earliest concerns of exemption policy. *See* note 10 *supra*. Provisions extending basic exempt necessity protection to wearing apparel must be drafted to include only apparel that is actually in use by the debtor and his dependents and to exclude jewelry. Given proper definitional restrictions, a limitation on the dollar value of exempt apparel would not be required.

206 Protection should extend only to items actually necessary for personal, family or household purposes. "Household goods, furnishings, and appliances within the category of basic exempt necessities" should be defined to include one cooking stove, one refrigerator or refrigerator-freezer, one television, one radio, one washing machine, one clothes dryer, beds and bedding for the debtor and each dependent, a table, and a chair for the debtor and each dependent. If the statute requires that items claimed exempt within this category be necessary and actually used for personal, family or household purposes a value limitation upon this exemption category would be unnecessary.

A provision enumerating items within this proposed exemption should indicate that the list is not exclusive. A debtor, upon demonstrating actual need, should be able to bring additional items of household goods, furnishings and appliances within the protection of the basic exempt necessity category. *Cf.* ARIZ. REV. STAT. ANN. § 33-1123 (1980 Supp.) (comprehensive list of exempt household furniture, furnishings and appliances).

207 Tools of trade or similar items should be beyond the reach of nonpossessory, nonpurchase-money security interests. The debtor thus retains a means of generating income with which to rehabilitate himself. A value limitation of at least $2,000 is advisable on this exemption category. The debtor's interest in tools of trade, professional libraries and farm equipment may often be of sufficient value in excess of the non-waivable portion of the exemption to be used as collateral for an extension of credit. Moreover, creditor's seizure and sale of such

health of the debtor or his dependents;[208] and (5) family religious volumes, portraits, books and heirlooms of personal, sentimental, or historical value.[209]

To insure the proper protection of basic exempt necessities the exemption provisions currently covering such property[210] should include language similar to the following: "The exemption provided by this subsection may not be waived expressly or impliedly by creation of nonpossessory, nonpurchase-money security interests in the property subject to this exemption."

The statute may set a maximum value of property that may be claimed as exempt within a given category.[211] Basic exempt necessity protection may be extended up to a stated value by requiring the debtor, at the time a security interest is created, to provide a schedule of all property potentially claimable as exempt and to designate which items will remain unencumbered as basic exempt necessities.[212]

Protecting basic exempt necessities against nonpossessory, nonpurchase-money security interests should not be condemned as unjus-

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items is less likely to subject a debtor and his family to immediate deprivation of basic comforts than would a creditor's seizure and sale of items such as wearing apparel and household goods.

208 *Cf.* UNIFORM EXEMPTIONS ACT § 11(1) (1980).

209 This category has traditionally been limited to family Bibles. *See, e.g.*, GA. CODE ANN. § 51-1301(12) (1979); ILL. ANN. STAT. Ch. 52, ¶ 13 (Smith-Hurd Supp. 1980). This limitation is not justified in a religiously diverse society. This category should provide sufficient flexibility so that volumes of an important personal or family library, musical instruments, and family portraits and heirlooms may, upon a showing by the debtor, be protected as basic exempt necessities. Of course, such items may be protected by standard exemption treatment in the absence of a showing of substantial personal, family or historical value.

210 *E.g.*, ALASKA STAT. § 09.35.080 (Cum. Supp. 1980); ARIZ. STAT. ANN. §§ 35-1123, 35-1125 (Supp. 1980); CAL. CIV. PROC. CODE § 690.1 (West 1973); HAWAII REV. STAT. § 651-121 (1976 & Supp. 1980).

211 *E.g.*, MINN. STAT. ANN. § 550.37 (West Cum. Supp. 1981); NEV. REV. STAT. § 21.090 (1979).

212 The Minnesota provision is a useful model:

> Provided, however, if a debtor has property of the type which would qualify for the exemption provided by this subdivision, of a value in excess of $3,000, an itemized list of the exempt property, together with the value of each item listed, shall be attached to the security agreement at the time a security interest is taken, and a creditor may take a nonpurchase-money security interest in the excess over $3,000 by requiring the debtor to select his exemption in writing at the time the loan is made.

MINN. STAT. ANN. § 550.37(4) (West Cum. Supp. 1980). The Minnesota exemption statute and this provision in particular, are discussed in detail in notes 156-66 *supra* and accompanying text.

tifiably "paternalistic."[213] Exemption statutes have always been essentially paternalistic in that their purpose is to protect debtors against their own improvidence.[214] The issue is the degree and certainty of protection to be afforded.

Once basic exempt necessities have been identified, defined and protected, legislatures could enact or retain additional exemptions as they saw fit. Creditors and debtors should be free to bargain for security interests in chattels falling within the additional exemptions.

Some jurisdictions permit debtors to select any personal property as exempt, up to a given dollar value.[215] Although there is merit to this "flexible" approach,[216] the creation of specific categories of basic exempt necessities is more consistent with exemption policy. Using specific categories, items of basic exempt necessity can be identified by the debtor and withheld from any transaction creating a nonpossessory, nonpurchase-money security interest in personal property.[217]

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213 *Cf.* State v. AVCO Fin. Servs., 50 N.Y.2d 383, 406 N.E.2d 1075, 429 N.Y.S.2d 181 (1980); Montford v. Grohman, 36 N.C. App. 733, 245 S.E.2d 219 (1978).

214 *See, e.g.*, Kneettle v. Newcomb, 22 N.Y. 249 (1860). The paternalistic character of exemption policy was articulated by the Florida Supreme Court in Carter's Adm'rs v. Carter, 20 Fla. 558 (1884):

> The object of exemption laws is to protect people of limited means and their families in the enjoyment of so much property as may be necessary to prevent absolute pauperism and want, and against the consequence of ill advised promises which their lack of judgment and discretion may have led them to make, or which they may have been induced to enter into by persuasion of others.
>
> In this country especially where there happen to be many illiterate and unsophisticated people it would be mischievous to encourage such agreement in which by the mere scratch of a pen the whole policy of exemption laws would become nugatory. Such people, without reference to "race, color or previous condition," are and ought everywhere to be the wards of the state and to be protected accordingly.

*Id.* at 569-70.

215 *E.g.*, ARK. CONST. art. 9, § 1; GA. CODE ANN. § 51-101 (Supp. 1981); W. VA. CODE § 38-8-1 (Supp. 1980).

216 *See* Joslin, *Debtor's Exemption Laws: Time for Modernization*, 34 IND. L.J. 355, 356-59 (1959).

217 For example, West Virginia's "open designation" personal property exemption provision, W. VA. CODE § 38-8-1 (Supp. 1980), set forth below, could be so amended by adding the italicized language:

> Any husband, wife, parent or other head of a household residing in this State, or the infant children of deceased parents, may set apart and hold personal property not exceeding one thousand dollars in value to be exempt from execution or other process, except as hereinafter provided. Any mechanic, artisan or laborer residing in this State, whether he be a husband, wife, parent or other head of a household, or not, may hold the working tools of his trade or occupation to the value of fifty dollars exempt from forced sale or execution: Provided, that in no case shall the exemption allowed any one person exceed one thousand dollars. *The*

An other means of furthering exemption policy would be to enact a statute prohibiting the enforcement of security interests in exempt personalty created by dragnet collateral clauses. This could be achieved by requiring that security interests be enforced only as to items specifically identified in the security agreement.[218] Alternatively, a statute could provide that a loan or security agreement purporting to create a security interest in all personal property will not create a security interest in the debtor's exempt property.[219]

### 3. Judicial Solutions: Public Policy and Unconscionability

The courts, in the absence of legislative direction,[220] are unlikely to invalidate consensual liens in basic exempt necessities.[221] Creditors' use of dragnet collateral clauses,[222] however, can and should be

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*exemption provided for in this section may not be waived as to the debtor's interest in household furnishings, goods, and appliances; wearing apparel of the debtor and his dependents; tools of trade, farm implements, or professional libraries; professionally prescribed health aids necessary to the health or ability to work of the debtor or his dependents; or family religious volumes, portraits, books, and heirlooms of substantial personal, sentimental or historical value; by creation of nonpossessory, nonpurchase-money security interest therein. Provided, however, if the debtor owns property in the aforesaid categories of a value in excess of one thousand dollars, or in working tools of his trade or occupation in excess of fifty dollars, an itemized list of such property, together with a designation of the value of each item thereof, shall be attached to the security agreement at the time the security interest is taken, and a creditor may take a security interest in the excess over one thousand dollars, or in the case of working tools of the debtor's trade or occupation in excess of fifty dollars, by requiring the debtor to select his exemption in writing at the time credit is extended.*

Use of the value limitations in the West Virginia statute set forth above should not be construed as the author's endorsement of their propriety. *See* notes 205-207 *supra*.

218 Enactment of such a statute would present difficult problems in drafting a provision harmonious with existing law. Under article 9 of the U.C.C. a valid security agreement must include a description of the collateral. U.C.C. § 9-203. As a general rule, a detailed description of collateral is not required on an item by item basis. In re Amex-Protein Dev. Corp., 504 F.2d 1056 (9th Cir. 1974); United States v. First Nat'l Bank, 470 F.2d 944 (8th Cir. 1973).

219 A suggested form of enactment is:

> Any instrument which creates a consensual lien, security interest or chattel mortgage in favor of a creditor in all personal property owned or possessed by a debtor will not operate to create such an interest in any of the debtor's personal property which is, or may be claimed as, exempt under the laws of this state. Exemption rights in personal property may be waived by execution of such an instrument only in cases where the specific item of exempt property made subject to the creditor's interest is individually identified and creation of such an interest is not otherwise proscribed by law [referring to provisions creating and defining basic exempt necessities].

220 As discussed earlier, many jurisdictions have enacted statutes making security interests in exempt chattels enforceable. *See* note 36 *supra*. Wholesale change in such states must necessarily await legislative action.

221 *But see* Beneficial Consumer Discount Co. v. Hamlin, 263 Pa. Super. Ct. 393, 398 A.2d 193 (1979).

222 *See* note 39 *supra*.

curtailed by judicial action. Dragnet collateral clauses, generally found in boilerplate consumer loan agreements,[223] are both unconscionable and contrary to the policy behind state exemption statutes.

a. *Public Policy*

Early decisions found prospective exemption waivers to be inconsistent with public policy because they permitted debtors to forfeit the right to retain exempt chattels against creditors' claims.[224] The courts felt the debtor was unlikely to appreciate the significance of the waiver or to understand its consequences upon default. In contrast, the chattel mortgage was viewed as a present, implied waiver[225] of exemption rights and a transfer of interest in specific items of property.[226] The chattel mortgage was less threatening to the debtor because its consequences were more easily appreciated at the time of its execution.[227]

The dragnet collateral clause more closely resembles the prospective waiver than the grant of a security interest in a specific item of personal property. The debtor relinquishes his exemption rights by signing a document containing a vague clause purporting to create a security interest in all the debtor's personalty. Although in form a present release and transfer of rights has been affected, the substance of the transaction is identical to a prospective exemption waiver. The same rationale that prompted courts to refuse to enforce prospective waivers logically requires that dragnet collateral clauses not be enforced[228] in derogation of debtors' exemption rights.[229] The

223 *See, e.g.*, Hernandez v. S.I.C. Fin. Co., 79 N.M. 673, 448 P.2d 474 (1968); State v. AVCO Fin. Serv., 50 N.Y.2d 383, 406 N.E.2d 1075, 429 N.Y.S.2d 181 (1980); Montford v. Grohman, 36 N.C. App. 733, 245 S.E.2d 219 (1978).

224 *See* Section III *supra*.

225 *E.g.*, City Loan & Sav. Co. v. Keenan, 136 Ohio St. 125, 24 N.E.2d 452 (1939); Morgan Plan Co. v. Ates, 8 La. App. 806 (1928).

226 The early decisions considered chattel mortgages covering interests in specific assets, as opposed to across-the board grants of security interests in all of the debtors' property. *See, e.g.*, Ohio Loan Co. v. Kletecka, 47 Ohio App. 514, 192 N.E. 182 (1934) (specifically listed articles subject to chattel mortgage).

227 *See* Carter's Adm'rs v. Carter, 20 Fla. 558, 570 (1881).

228 Such arguments have been rejected in several recent decisions. *See* Hernandez v. S.I.C. Fin. Co., 79 N.M. 673, 448 P.2d 474 (1968); State v. AVCO Fin. Servs., 50 N.Y.2d 383, 406 N.E.2d 1075, 429 N.Y.S.2d 181 (1980); Montford v. Grohman, 36 N.C. App. 733, 735, 245 S.E.2d 219, 222 (1978). The *Hernandez*, *AVCO*, and *Montford* courts emphasized the debtors' right to sell or otherwise dispose of their property and freedom of contract principles. These courts also relied on earlier decisions permitting foreclosure of mortgages on specific exempt chattels. As discussed above, such reasoning is simply unsound when reconciling public policy with other legal principles.

229 Provided the dragnet clause is a mutually agreed upon contract term, the courts

result will not be to nullify the clause *in toto*, but merely to deny enforcement as to security interests in exempt chattels.

b. *Unconscionability*

Dragnet collateral clauses are vulnerable to charges of unconscionability. A contract or clause may be unconscionable[230] either if the bargain was reached in the absence of meaningful free assent[231] or if the substantive terms are so heavily one-sided as to make its enforcement manifestly unfair.[232]

Under section 2-302 of the Uniform Commercial Code, unconscionability is expressly applied to the law of sales.[233] The concept, however, is not limited to "transactions in goods."[234] Its common law roots are evident in several pre-U.C.C. decisions.[235] Specific stat-

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should deny enforcement of the security agreement on public policy grounds only to the extent necessary to protect exemption rights.

230 *See* Ellinghaus, *In Defense of Unconscionability*, 78 YALE L.J. 757 (1967) [hereinafter cited as Ellinghaus]. Professor Ellinghaus characterized unconscionability as a legal "standard" under the definition formulated in Pound, *The Theory of Judicial Decision*, 36 HARV. L. REV. 641, 645-46 (1923). The unconscionability standard functions in a manner akin to other "residual categories" in law, such as "good faith," "reasonableness," and "due care," as a principled, if ephemeral, guide to decisionmaking in the development of the common law. Ellinghaus, *supra* note 230, at 759-60. *Cf.* Leff, *Unconscionability and the Code*, 115 U. PA. L. REV. 485 (1967) (criticizing the ill defined, vague nature of unconscionability).

231 This type of unconscionability has been termed "procedural unconscionability." It can include deceptive bargaining conduct, use of adhesion contracts, taking advantage of unequal bargaining power, and exploitation of the underprivileged. Ellinghaus, *supra* note 230, at 762-73.

232 Unconscionability can also be substantive. Substantive unconscionability requires nonenforcement of one-sided contract terms in some cases notwithstanding equality of bargaining position and the presence of meaningful free assent. Ellinghaus, *supra* note 230, at 773-808.

233 Article 2 of the U.C.C. governs the law of sales, which it defines in the following terms:

> Unless the context otherwise requires, this Article applies to transactions in goods; it does not apply to any transaction which although in the form of an unconditional contract to sell or present sale is intended to operate only as a security transaction nor does this Article impair or repeal any statute regulating sales to consumers, farmers or other specified classes of buyers.

U.C.C. § 2-102. U.C.C. § 2-302 provides:

> (1) If the court as a matter of law finds the contract or any clause of the contract to have been unconscionable at the time it was made the court may refuse to enforce the contract, or it may enforce the remainder of the contract without the unconscionable clause, or it may so limit the application of any unconscionable clause as to avoid any unconscionable result.
>
> (2) When it is claimed or appears to the court that the contract or any clause thereof may be unconscionable the parties shall be afforded a reasonable opportunity to present evidence as to its commercial setting, purpose and effect to aid the court in making the determination.

234 Such is the limited scope of Article Two of the Code. U.C.C. § 2-102.

235 *See, e.g.*, authorities cited in Official Comment to U.C.C. § 2-302. *See* Ellinghaus, *supra*

utory treatment of unconscionability in the U.C.C. Article on sales should not limit its application in other contexts, including secured transactions.[236] Several states have recognized that unconscionability is an appropriate standard in consumer credit transactions. A number of statutes have been enacted permitting courts to refuse to enforce credit terms found to be unconscionable.[237]

In several cases, debtors have challenged as unconscionable security interests in exempt property created by dragnet collateral provisions. In *Hernandez v. S.I.C. Finance Co.*,[238] the New Mexico Supreme Court upheld the enforcement of a clause subjecting all of the plaintiff's personalty, including otherwise exempt household furnishings, to a creditor's security interest.[239] The debtors were immigrants of Hispanic descent, without formal education. Although the creditor had not explained the terms of the agreement to the debtors, the court refused to employ unconscionability standards in its analysis of the contract.[240] In contrast, the Court of Appeals of New York recently[241] recognized the propriety of applying unconscionability standards to dragnet collateral provisions but refused to enjoin their use on grounds of unconscionability.[242] The New York court noted that the doctrine of unconscionability was not aimed at "disturbance of allocation of risks because of superior bargaining power, but instead at 'the prevention of oppression and unfair surprise'."[243] The

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note 230, at 808-12. Unconscionability is a "flexible doctrine with roots in equity." State v. AVCO Fin. Servs., 50 N.Y.2d 383, 389, 406 N.E.2d 1075, 1078, 429 N.Y.S.2d 181, 185 (1980) (citing cases).

236 The application of unconscionability to security interests created by dragnet collateral clauses is, in one sense, divorced from the central theme of this paper—the interplay between state exemption policy and the rights of secured creditors. The use of dragnet collateral clauses, however, relates to the concept of procedural unconscionability. The thoroughly one-sided nature of such contract provisions is a matter of substantive unconscionability.

237 ALA. CODE § 5-19-16 (1975); D.C. CODE § 28-3812 (1971); IDAHO CODE § 28-35-108 (1980); IND. CODE ANN. § 24-4.5-5-108 (Burns 1974); IOWA CODE ANN. § 537.5-108 (West Supp. 1980); KAN. STAT. ANN. § 16a-5-108 (1974); LA. CIV. CODE § 9:3516(29) (West Supp. 1980); ME. REV. STAT. ANN. tit. 9A, § 5-108 (West 1980); N.C. GEN. STAT. § 25A-43 (Cum. Supp. 1979); OHIO REV. CODE § 1345.03 (Page 1979); OKLA. STAT. ANN. tit. 14A § 5-108 (West 1972); S.C. CODE § 37-5-108 (Cum. Supp. 1980); UTAH CODE ANN. § 70B-5-108 (1953); W. VA. CODE § 46A-2-121 (1980); WIS. STAT. ANN. § 425.107 (West 1974 & Supp. 1980).

238 79 N.M. 673, 448 P.2d 474 (1968).

239 *Id.* at 675, 448 P.2d at 476.

240 *Id.*

241 State v. AVCO Fin. Servs., 50 N.Y.2d 383, 406 N.E.2d 1075, 429 N.Y.S.2d 181 (1980).

242 *Id.* at 386, 406 N.E.2d at 1076, 429 N.Y.S.2d at 183. *AVCO* was a case brought by the New York Attorney General on a consumer complaint. The state sought an order enjoining AVCO's use of a dragnet collateral clause. *See* note 44 *supra*.

243 50 N.Y.2d at 389, 406 N.E.2d at 1076, 429 N.Y.S.2d at 185 (citations omitted).

court appeared to consider unconscionability an inappropriate standard by which to invalidate dragnet collateral provisions, but its holding is more readily explained by the lack of an adequate record upon which to consider the unconscionability issue.[244]

Dragnet collateral provisions should be subject to judicial invalidation on grounds of unconscionability. These clauses give creditors the power to compel payment or refinancing[245] by defaulting debtors without clear identification of the specific items of personalty that will be subject to seizure and sale. The fundamental unfairness of dragnet collateral clauses is evident when one considers that they operate, *sub silentio*, to abrogate debtors' exemption rights.

In light of decisions invalidating prospective exemption waivers,[246] creditors turned to dragnet collateral clauses to accomplish impliedly what the prospective waiver could no longer do expressly. As the product of this effort, the dragnet collateral clause is substantively unconscionable. Moreover, the indicia of procedural unconscionability are likely to be present when dragnet collateral provisions are included in security agreements.[247]

## IV. Conclusion

Exemption statutes are intended to insulate debtors and their families from destitution. In most jurisdictions the protection afforded by exemption statutes is seriously impaired by the ability of creditors to enforce security interests in exempt property.

State legislatures should identify basic necessities that should be protected from the reach of creditors and enact legislation prohibit-

244 *Id.* at 389, 406 N.E.2d at 1076, 429 N.Y.S.2d at 185. Unconscionability was not argued by the plaintiff at the trial court level. The trial court enjoined use of the clause on public policy grounds. Unconscionability was raised for the first time on appeal. The Appellate Division adopted it as the grounds for its order enjoining use of the clause.

245 Such clauses provide creditors with a weapon that is powerful to the point of unfairness. One can appreciate the *in terrorem* effect of a creditor's threat to seize any or all of a debtor's personal property and to sell it to satisfy the debt. Many of the items of utmost importance to the security and comfort of the debtor and his family, such as household furnishings and bedding, the loss of which would subject them to substantial hardship, are of little economic value to the creditor. How much could a creditor expect to realize from the forced sale of a used mattress or used clothing?

Congress, in enacting debtors' bankruptcy lien avoidance powers, 11 U.S.C. § 522(f) (Supp. 1978), concluded that nonpossessory, nonpurchase-money security interests in exempt chattels are instruments of "creditor abuse" rather than "legitimate credit-facilitating devices." *See* Note, *Constitutionality of Retroactive Lien Avoidance under Bankruptcy Code Section 522(f)*, 94 HARV. L. REV. 1616, 1618-19 (1981).

246 *See* Section III *supra*.

247 *See* note 231 *supra*.

ing security interests in such property. Further, the courts should invalidate as unconscionable security interests in exempt property created by dragnet collateral clauses. Admittedly, these remedial measures will restrict creditors' and debtors' rights. If the goals of exemption policy are to be achieved, however, strict adherence to traditional notions of freedom of contract and property rights must be abandoned.