The Bankruptcy Commission's Proposal Regarding Bankrupts' Exemption Rights

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Professor Vukowich carefully addresses the problems implicit in reliance on state exemption laws in bankruptcy and argues in favor of adopting a uniform scheme of bankruptcy exemptions. Within the context of the Bankruptcy Commission's Proposed Act, Professor Vukowich critically examines the problems that a uniform exemption scheme would raise and offers suggestions for strengthening the Commission's proposals. He then analyzes the Proposed Act's principal exemptions, including the life insurance exemption—a favorite topic of Professor Riesenfeld's. Finally, Professor Vukowich illustrates how the Proposed Act addresses some of the other longstanding problems surrounding exemptions in bankruptcy.

When the editors of the California Law Review asked me to contribute an Article for an issue honoring Professor Riesenfeld on his retirement from Boalt, I was stunned and honored. I was stunned because it was hard to believe that this vital and energetic teacher, under whom I had studied just 7 years ago, was retiring; and I was honored because I was asked to contribute an Article dealing with bankruptcy exemptions, a topic in which Professor Riesenfeld had interested me while I was at Boalt Hall.

I doubt that any of Professor Riesenfeld's students will forget him. He is an excellent teacher and his brilliance and dedication have inspired all of us. He is also somewhat of a tease. One instance in particular epitomizes his antics. With but a few minutes left in the last class of the semester in creditors' rights, we were instructed by Professor Riesenfeld, "Take down the following sections of the U.C.C. and Bankruptcy Act." He then rattled off a long and apparently random list of sections from both laws. As he approached the end of the list, he was chuckling. When

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he had finished, he exclaimed, "I have just given you the answer to the most difficult question on the exam. Even so, none of you will get it right!" (As it turned out, I wasn't even sure what question the sections applied to!) Although Professor Riesenfeld is leaving the classroom officially, his enthusiasm, academic rigor, and almost consuming interest in the law will continue to influence other students and colleagues. Indeed, I have no doubt that he will follow and contribute to the developments accompanying the success or failure of the proposed law which is the subject of this Article.

The Commission on the Bankruptcy Laws of the United States [hereinafter the Commission] has developed a proposal for providing bankrupts with assets which are designed both to assist their financial rehabilitation and to provide for the support of bankrupts and their families. Presently, bankrupts are awarded the exemptions given to them under state laws. One of the Commission's major proposals would replace this practice by a uniform bankruptcy exemption, applicable to all bankrupts throughout the United States. The Commission's proposed statute follows the traditional scheme of state exemption laws by listing the types and maximum quantities of property that may be retained by bankrupts. The Commission favored this traditional scheme over one whereby bankrupts may select, within a dollar value limitation, those assets they wish to retain without being limited to specific kinds of property. Moreover, the Proposed Act does not provide rehabilitative and support assistance for very poor bankrupts beyond the assets they already own. The exemption rights of bankrupts exist only to the extent that they own assets. Poor bankrupts must therefore rely on state welfare laws for support; these laws, however, offer little hope for rehabilitation.

This Article first discusses the desirability of changing to a uniform bankruptcy exemption. Then consideration is given to the problems that such a change would create, and suggestions are made for overcoming these problems. Next, the assets the Commission would allow bankrupts to retain are briefly discussed. Finally, the Article comments upon a variety of other provisions designed to overcome problems that either have arisen under existing state laws or have confounded the policy of the exemptions laws. Throughout the Article, reference will also be made to a slightly different exemption provision proposed by the National Conference of Bankruptcy Judges. Both the Judges' Bill and the Commission's Bill are being considered by Congress.

I

THE IMPACT OF A FEDERAL BANKRUPTCY LAW

The Commission's proposal for a uniform exemption law represents one of the major reforms in the Proposed Act. With few exceptions, commentators have criticized the current policy of deferring to state exemptions in bankruptcy proceedings. In the last major bankruptcy reform, the adoption of the Chandler Act in 1938, Congress amended Section 6 of the Bankruptcy Act in three minor ways, but did not change the basic policy of deferring to state exemptions laws. Just a little over 1 year after the Chandler Act was adopted, the Chairman of the National Bankruptcy Conference noted that "there is no one thing which makes our uniform Bankruptcy Act more un-uniform than Section 6." Although a uniform bankruptcy exemption law would remove many of the inequities and policy conflicts existing under the present Bankruptcy Act, however, it raises some problems of its own.

A. The Desirability of a Uniform Law

There are four major arguments for abandoning the current policy of deferring to state law for a determination of the property bankrupts will be allowed to retain in order to achieve a successful "fresh start." These arguments support the development of a new bankruptcy exemption policy which treats all bankrupts equally, which reflects congressional judgment about the quantity and type of assets to allow for rehabilitation and family protection, and which is consistent with policies regarding discharge and priorities.

First, given the great variety among state exemption laws, Section 6 of the present bankruptcy law results in unequal treatment of debtors. Debtors in states with penurious exemptions are allowed to keep little or

5. The short-lived bankruptcy acts of 1800 (repealed in 1803) and 1841 (repealed in 1843) also provided their own set of exemptions. See Countryman, For a New Exemption Policy in Bankruptcy, 14 Rutgers L. Rev. 678, 680 (1960).


8. See 1A COLLIER ON BANKRUPTCY ¶ 6.02 (14th ed. 1975) [hereinafter cited as COLLIER ON BANKRUPTCY]. ¶ 6 states the basic policy that bankrupts are entitled to the exemptions of their state of domicile.

9. King, supra note 7, at 40.
nothing with which to begin afresh, whereas debtors in states with generous exemption laws are entitled to retain assets capable of insuring a comfortable life.\textsuperscript{10} In addition to the disparities in the size of exemptions, the types of property exempted also vary among the states. Thus bankrupts in seven jurisdictions may not exempt an interest in their home,\textsuperscript{11} whereas debtors in the rest of the United States may. The right to claim exemptions in such items as jewelry, burial plots, and an automobile exists in some states, but not in others.\textsuperscript{12} Finally, the different rules regarding the right to waive exemption rights, exceptions to the right to claim exemptions, and requirements—such as being “head of a family”—to qualify for exemptions frequently cause unequal treatment in bankruptcy between residents of different states.

These differences in state laws, resulting in different treatment of debtors under the federal bankruptcy law, is a situation which relates to the second criticism of Section 6: Congress should not delegate to state legislatures the important task of determining what property bankrupts may retain for their economic rehabilitation and for support of their families. First, Congress’s carte blanche incorporation of state exemptions into federal bankruptcy law overlooks the different contexts in which exemptions are used and consequently ignores the policy question of whether exemptions ought to differ in bankruptcy from exemptions allowed under ongoing state collection procedures. State legislatures, in enacting exemption laws, are generally concerned with collection of judgments under state laws—execution, garnishment, and attachment. Unlike collection under state laws, where the chief concern is debtor protection in the ongoing collection by creditors, bankruptcy provides an opportunity for the orderly liquidation of all the debtors’ assets\textsuperscript{13} and grants debtors discharges from their debts. These differences between state collection and federal bankruptcy indicate that the exemptions granted to debtors ought to differ accordingly. For example, rather than listing property in a piecemeal fashion, as is done in state laws, the bankruptcy law could grant bankrupts a fixed dollar allowance and allow them to select the property they want to be exempt.\textsuperscript{14} Furthermore, because debtors in bankruptcy are relieved of their debts, which is not true where state collections are involved, it might be desirable to grant a smaller exemption in bankruptcy than is available under state laws. Such disparity would be justifiable on two grounds: (1) it would dissuade debtors from seeking discharges, thereby encouraging payment

\textsuperscript{10} See generally Comment, supra note 3, at 1515-16.
\textsuperscript{11} See Comment, supra note 3, at 1469 n.76; S. Riesenfeld, Creditors’ Remedies and Debtors Protection 303 (2d ed. 1975).
\textsuperscript{13} Countryman, supra note 5, at 681.
\textsuperscript{14} See text accompanying notes 116-21 infra.
of debts; and (2) debtors who are attempting to pay their debts have a greater need for more assets than do ex-bankrupts who have no debts.

A third argument against the incorporation of state exemption policies into bankruptcy law is that it permits the establishment of a state-created priority. The incorporation of state exemption policy creates a priority in cases where state law creates exceptions in favor of certain types of creditors. The exceptions vary from state to state, but common exceptions are claims for support, taxes, necessaries, and torts. Many of these claims are not treated as priorities or nondischargeable debts under Sections 64 and 17. A creditor who holds a claim which is an exception to the bankrupt's exemption rights may enforce his claim outside of bankruptcy against otherwise exempt assets. Thus, such creditors may realize more on their claims than they would realize if they were to receive distribution pursuant to the policy of the bankruptcy law. The result is that state exceptions to exemptions upset congressional priorities for certain creditors and hinder the equal treatment of other creditors.

A final argument for abandoning the scheme embodied in Section 6 of the present bankruptcy law is that “by eliminating the reference to nonbankruptcy law, much litigation . . . [may be] avoided. Questions as to the applicable law, its scope, and whether a law provides an exemption . . . are mooted.” Under Section 6, federal courts have to resolve state constitutional issues, determine what state laws create “exemptions”—on occasion arriving at different results even when analyzing the same statute—and determine what law is applicable in cases of bankrupts who have established new residences within 6 months.

18. See Countryman, supra note 5, at 708-32.
21. Proposed Act § 4-503, n.3.
24. Compare Jones v. WaKeeney State Bank, 100 F.2d 879 (10th Cir. 1939) (Kansas statute regarding redemption rights creates exemption under § 6), with Garber v. Bankers' Mortgage Co., 27 F.2d 609 (D. Kan. 1928) (same statute not an "exemption" for § 6 purposes).
prior to bankruptcy. A uniform bankruptcy exemption law would obviate the resolution of such issues.

Despite the arguments supporting a uniform bankruptcy law, a variety of arguments have been pressed in favor of maintaining the current policy embodied in Section 6. The rationale behind Section 6 is that, because creditors grant credit with reference to the exemption laws of the state whose laws govern the rights of the creditors and debtors, it is logical and desirable to retain those same laws in the event of bankruptcy. The state exemption law imposes a restriction on creditors' enforcement rights, and incorporation of this same restriction in bankruptcy is fair and expedient. This rationale has been used to defend Section 6 against constitutional attack on the ground that it violated the constitutional grant of power to Congress "to establish . . . uniform laws on the subject of bankruptcies throughout the United States . . . ."

The addition of a separate and uniform exemption for bankruptcy, as the Commission proposes, would require creditors to consider both the federal and state exemption laws in granting credit. Although this might appear to complicate credit granting policies, however, the impact seems to be minimal. Indeed, creditor interests generally support the concept of a uniform exemption in bankruptcy, and this support is understandable. Today American society is mobile, which means that the state exemption laws applicable to a creditor-debtor relationship at the time a debt is created might be different when the debt is being enforced. Moreover, a uniform bankruptcy law would discourage "forum shopping" since prospective bankrupts would find no advantage in moving to states with more favorable exemption laws. Thus, a uniform law in bankruptcy may facilitate, rather than frustrate, credit granting policies.

25. Section 6 grants bankrupts exemptions pursuant to the laws of the state "wherein they have had their domicile for the six months immediately preceding the filing of the petition, or for a longer portion of such six months than in any other State. . . ." See, e.g., In re Armitage, 54 F. Supp. 768 (W.D. Pa. 1943).


27. U.S. CONST. art. I, § 8, cl. 4 (emphasis added); Hanover Nat'l Bank v. Moyses, 186 U.S. 181, 190 (1902); see Note, supra note 26, at 666-67 & n.20.


29. Id. at 146, 172. Judge Lee, of the National Conference of Bankruptcy Judges, has stated that he doubts that this practice is prevalent because most bankrupts cannot afford to move. Id. at 120.
Professor Kennedy has offered other reasons for preferring the policy of Section 6 to a uniform bankruptcy exemption. He has argued that exemption policy be left to the states:

The state's interest in preserving the family unit and in averting poverty and dependence on public support is entitled to careful consideration when weighed against the national interest in the improved effectiveness and uniformity in debt collection attainable by superimposing federal designation or limitation on exemptions allowable to its domiciliaries. 30

This argument notwithstanding, the idea that it is exclusively within the states' province to look after the welfare of citizens appears unfounded. The national interest in the welfare of citizens, especially in recent years, has been substantial. Moreover, when the citizens are involved in federal bankruptcy proceedings, the national interest seems paramount; a major goal of bankruptcy is debtor rehabilitation, 31 and the exemption policy of the bankruptcy law strongly affects the realization of that goal. 32

Professor Kennedy has also argued:

If a state legislature is exceedingly liberal in its grant of exemptions to debtors, creditors are entitled, and may be expected, to take the exaggerated risk into account in their dealings with debtors. If the legislative choice is unwise, it is likely that the impact will be felt within the state in the form of decreasing availability of credit and financial hardship accruing to lenders and sellers of goods and services on credit. . . . If the state legislature remains unresponsive to demands of creditor groups for relief against extravagant exemptions, there is at best only a tenuous national interest in a reappraisal of the interests of creditors and debtors which disregards the state's policy. 33

Again, however, the argument seems to overlook the goal of rehabilitation and the fact that many state exemptions do not afford a reasonable opportunity for rehabilitation. 34 The exemption provision of the Judge's Bill 35 appears to reflect the view that there is an insubstantial national

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32. Id. at 79-80.
33. Kennedy, supra note 6, at 450.
35. Judges' Bill. supra note 4, at § 4-503.
interest in supplanting liberal state exemptions while recognizing that
many state exemptions are too small to provide debtor rehabilitation.
The judges propose to grant bankrupts their choice of either the bank-
ruptcy exemption or their state exemptions (up to a $25,000 maxi-
num). The Proposed Act, on the other hand, would supplant the
liberal exemption laws provided by some states, thus making available to
creditors more assets in bankruptcy than would be available in state
collection proceedings. This result seems preferable notwithstanding the
possible "windfall" to creditors, since fair treatment of creditors is also a
good of bankruptcy. The exempt assets provided in the Proposed Act
for rehabilitation of debtors and protection of their families are ample.
Those goals having been achieved, there is no reason to allow bankrupts
from some states greater assets; on the contrary, the goal of fair treat-
ment of creditors calls for applying the remaining assets to the satisfac-
tion of their claims.

In summary, the reasons in favor of deferring to state law for a
determination of bankrupts' exemptions are not persuasive. A uniform
law is better able to achieve the goals of bankruptcy. The fact that
creditors will have to consider both state and bankruptcy exemption
laws will not unduly complicate credit transactions and the uniform
bankruptcy exemption scheme will most likely add a certainty to such
transactions which does not now exist.

B. The Impact of a Uniform Federal Law on the Incidence of
Bankruptcies and on State Exemption Laws

The proposed uniform exemption law may affect the incidence of
bankruptcies. The exemption law proposed by both the Commission and
the judges falls about midway between the laws of the states granting the
most and the least liberal exemptions. In states with exemptions that
are less generous than the uniform bankruptcy exemption, there will be
an added incentive for debtors to file petitions in bankruptcy. In states
with exemptions that are more generous than the federal law allows, the
incentive for debtors will be just the opposite. Where generous exemp-
tions are the rule, however, creditors may be motivated to file involun-
tary petitions against debtors who are not paying their obligations. The
Proposed Act's new criteria for involuntary adjudications greatly facili-
tate their administration, which means that creditors in states with
substantial exemptions may find the use of involuntary petitions to be

36. Id. § 4-503(a).
37. See COMMISSION REPORT, supra note 31, at 75-79.
38. See Part II of this Article.
39. Proposed Act § 4-205.
40. See COMMISSION REPORT, supra note 31, at 186-89; Comment, Involuntary
advantageous. Moreover, the involuntary adjudication may serve as a
deterrent against what creditors consider to be abuses of liberal state
exemption laws. Thus, while the degree to which a uniform bankruptcy
exemption will affect the incidence of bankruptcies is uncertain, it will
be an important factor to consider in deciding whether to file a peti-
tion.42

Because the differences between the federal bankruptcy exemption
and exemptions allowed under state law may influence the incidence of
bankruptcy, state legislatures might amend their laws to conform more
closely to the federal bankruptcy law. This would probably not develop,
however, until actual experience under the uniform law showed that it
had a significant impact on the decision to file petitions.43 Alternatively,
Congress might choose to preempt all state laws and make the federal
exemption law applicable in state collection proceedings as well as in
bankruptcy.44 However, such congressional action seems unlikely at this
time because of uncertainty regarding the impact of a uniform bank-
ruptcy exemption law on the incidence of bankruptcies, political opposi-
tion to preemption of state collections policies, and substantial procedur-
al problems that would be encountered in attempting to adapt a national
scheme of exemptions to the collection procedures of the 50 states.45

C. Problems Created by a Uniform Bankruptcy Law

The Commission's recommended uniform exemption law follows
75 years of primary reliance upon state exemption laws. In addition to
the affect upon the state exemption laws, federal legislation also creates

41. Professor Kennedy has stated that the Commission concluded "that there
would be no significant impact on filings." Hearings on Commission and Judges' Bill,
supra note 28, at 25.

42. The author's experiences indicate that it would be an important factor. Most
of the potential bankrupts the author encounters are from Maryland, the District of
Columbia and Virginia. The exemptions in these jurisdictions are significantly less than
those proposed by the Commission. If the state laws remain the same and the Commissi-
on's proposal is enacted, it is likely that lawyers in this area of the country will much
more readily recommend bankruptcy.

43. The National Conference of Commissioners on Uniform State Laws is cur-
rently considering a "Uniform Exemptions Act" which reflects many of the substantive
provisions of the proposed bankruptcy exemption law. Uniform Exemptions Act (1st

44. See Hearings on Commission and Judges' Bills, supra note 28, at 25, 30. Con-
gress has already done this regarding earnings, Consumer Credit Protection Act § 303,
§ 407 (1970); and other assets, see text accompanying notes 50-57 infra.

45. Congress would have to prescribe a number of procedural steps which are not
necessary or are otherwise provided for in bankruptcy. For example: When and how
must exemptions be claimed? Who may claim them? Who is to determine the value
of assets and how is this to be done?
and otherwise affects exemption rights. Federal exemptions are controlling in state collection proceedings and are incorporated in Section 6 of the Bankruptcy Act. On the other hand, Congress has denied state and most federal exemptions in cases involving the enforcement of federal tax claims and has substituted a separate and parsimonious list of exemptions for such cases. Superimposing a federal bankruptcy law onto state and federal nonbankruptcy plans raises problems of policy, federalism, and procedure.

1. Proposed Uniform Law Highlights the Lack of a Uniform Federal Exemption Policy

Federal laws presently exempt civil servants' retirement income, social security benefits, foreign service retirement and disability benefits, servicemen's retirement benefits, compensation and benefits under the Longshoremen's and Harbor Workers' Compensation Act, veterans' benefits, railroaders' unemployment insurance and retirement payments. The sweeping protection granted to federal employees and employees in certain government-regulated occupations is difficult to justify. Some of these statutes might be codifications of the doctrine of sovereign immunity, which prohibits garnishment of the federal government, and therefore might not be intended to protect debtors.

49. Intr. Rev. Code of 1954 §§ 6334(a), (c). These meager exemptions are for school books and clothing, fuel, furniture, provisions and personal effects necessary to the taxpayer and his family and valued at not more than $500, trade and professional implements worth $250 or less, unemployment and workmen's compensation benefits, income needed to make child support payments, and certain retirement and unemployment benefits—i.e. railroad retirement, railroad unemployment, medal of honor recipient's special pensions, and servicemen's retirement, id. §§ 6334(a)(6).
57. Railroad Retirement Act, 45 U.S.C. § 228(1) (1971). In discussing federal exemptions it is also important to note that the federal homestead exemption is sui generis in that it applies only to debts contracted prior to the acquisition of the homestead. 43 U.S.C. § 175 (1970).
58. Countryman, supra note 5, at 740.
However, many of the statutes extend the prohibition even after payments have been made, indicating that an exemption is intended. In addition to these statutes, Congress has recently enacted legislation which restricts the garnishment of compensation "paid or payable for personal services," including "periodic payments pursuant to a pension or retirement program."61

Although none of these federal exemptions are explicitly mentioned in the Proposed Act, the Commission's law would effectively incorporate most of them. The Proposed Act exempts retirement benefit plans which either qualify under Section 401(a) of the Internal Revenue Code or are established by federal statute to the extent they are reasonably necessary for the support of the debtor and his dependents.63 This would encompass the retirement benefits of federal employees. In addition, the retirement plans for railroad employees, longshoremen, and other such workers would generally qualify under Section 401(a) of the Internal Revenue Code. Although the federal exemptions are unlimited, they would be limited in bankruptcy to those which are reasonably necessary for the support of the debtor and his dependents. Unemployment compensation, workmen's compensation, and disability benefits are also exempted by the Proposed Act, and bankrupts are allowed to keep a certain amount of paid and payable earnings. Therefore, although some differences do exist, the Commission's Proposed Act is generally in harmony with other federal exemptions.

However, as previously noted, when the federal government is collecting taxes as a creditor, all state exemptions are denied, and many of the assets exempted by other federal laws are subject to collection for federal tax debts. The difference between the exemptions allowed for tax collection

62. I.R.C. § 401(a) (1970) sets out the requirements for employer established pension plans to qualify for tax exempt status.
63. Proposed Act § 4-503(c)(6).
64. Id. §§ 4-503(c)(7)-(8).
65. Id. § 4-503(c)(3). The Proposed Act does not incorporate the provisions of the Federal Consumer Credit Protection Act. Note 2 to § 4-503 expressly states that § 4-503 supersedes those provisions. Nonetheless, the Proposed Act allows bankrupts to retain "cash, securities, and receivables, including unpaid personal earnings, accrued vacation pay, and income tax refund, to the aggregate value of not more than $500 . . . " § 4-503(c)(3) (emphasis added).
66. Social security benefits that have been paid could be exempt as "cash." Unpaid benefits and rights to future benefits are presumably also exempted, but it would be preferable to state this explicitly. Veterans' benefits do not appear to be exempt under the Proposed Act except to the extent they would fall within the $500 cash and receivables exemption.
67. See text accompanying notes 46-57 supra.
purposes and those provided by the Proposed Act is striking and may result in a significant policy difference between the Internal Revenue Code and the federal bankruptcy law. The proposed bankruptcy exemption law is designed to supersede the provisions of the Internal Revenue Code, but the Code’s provisions expressly apply “Notwithstanding any other law of the United States.” It would be advisable to amend the text of the Commission’s statute to make it clear that the Proposed Act supersedes the Internal Revenue Code and to amend the Internal Revenue Code to recognize an exception for bankrupts. Better yet, the Internal Revenue Code should be amended to conform its exemption scheme to that of the bankruptcy law.

Another point of discontinuity between the federal laws is the allowance of claims against debtor assets which are exceptions to exemptions. The only unsecured claims which are exceptions in the Proposed Act are liabilities for maintenance and support, alimony, and property settlements; property which is otherwise exempt may be used to satisfy these liabilities. This exception is also found in the federal restriction on garnishment of earnings, and the recent Congressional waiver of sovereign immunity allows for the garnishment of the federal government and its agencies to enforce child support and alimony liabilities. However, no exceptions are contained in any of the other previously discussed federal exemptions, and it is unlikely that the recently enacted waiver of sovereign immunity was intended to deny these exemptions where benefits payable by the United States are involved.

A similar discrepancy appears regarding liability for state taxes. The federal restriction on the garnishment of earnings does not apply in

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68. Proposed Act § 4-503, and Note 2 to the Section.
69. INT. REV. CODE OF 1954 § 6334(c); see Plumb, supra note 6, at 13-14 & n.58.
70. The Proposed Act permits the enforcement of security interests in exempt property in certain cases. See text accompanying notes 182-87 infra.
73. But see LaFarr v. LaFarr, 132 Vt. 191, 315 A.2d 235 (1974); Vukovich, supra note 12, at 853-54.
74. The law states: “Notwithstanding any other provision of law, . . . moneys (the entitlement to which is based upon remuneration for employment) due from, or payable by, the United States . . . to any individual . . . shall be subject, in like manner and to the same extent as if the United States were a private person, to legal process . . . .” (emphasis added). Although this statement may imply a denial of existing exemptions, it is more likely meant to be a waiver of sovereign immunity. The law is titled, in part, “Consent by the United States to Garnishment . . . .” (emphasis added), which appears to be directed at sovereign immunity, not exemptions. Therefore, benefits and compensation that are expressly exempted by federal statute will likely continue to be exempt against family support claims. But see note 73 supra.
actions to enforce liabilities for taxes. However, neither the Proposed Act nor other federal exemptions recognize such exceptions.

In considering the proposed bankruptcy exemption, Congress should review all federal exemptions and the exceptions thereto, formulate a uniform federal exemption policy, and enact, repeal or amend laws to conform to that policy.

2. Nondischarged Debts and Section 4-503 Assets

Section 4-503 of the Proposed Act presents a difficult problem where nondischarged claims and exempt assets are involved. The Proposed Bill lists 10 categories of debts which are nondischargeable. Under the provisions of the Proposed Act nondischarged federal tax claims and other nondischargeable claims against bankrupts who reside in states whose exemption laws are either less generous than Section 4-503, do not cover all of the assets included in Section 4-503, or create exceptions for nondischarged claims, would all appear to be enforceable against assets exempted by Section 4-503. For example, the Internal Revenue Service could immediately enforce its claim against assets which are exempted by Section 4-503 and not exempted by the Internal Revenue Code. As has been noted, this represents a substantial amount of assets. Similarly, a creditor holding a nondischarged claim could enforce the claim through state process against assets exempted by Section 4-503 if either the assets were not exempt under state law or the nondischarged claim were an exception to the state exemptions. These results follow unless Section 4-503 is to have effect in post-bankruptcy state proceedings, a result that is unlikely.

If creditors with nondischarged debts may pursue assets not exempt under the governing nonbankruptcy laws, it would be simpler and more efficient to allow the bankruptcy court to administer collections belonging to these creditors. Under the doctrine of Lockwood v. Exchange Bank, such a practice has not been followed under the existing

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75. However, the Proposed Act does make certain state taxes nondischargeable. As discussed in the next section, this may effectively create an exception to the exemptions for such claims. Moreover, the Proposed Act recognizes certain statutory liens for taxes against exempt property. See text accompanying notes 77, 189-91, 212-20 infra.

76. Proposed Act § 4-506(a).

77. These generally include local, state and federal tax claims "accruing within one year of the petition" (Id. § 4-405 and Note 5 to the Section); "taxes with respect to which . . . a return, if required to be filed, was not filed more than one year prior to the date of the petition," (Id. § 4-506(a)(1)(B)); and taxes with respect to which the bankrupt made a false or fraudulent return or willfully attempted to evade or defeat (Id. § 4-506(a)(1)(C)).

78. See text accompanying note 67 supra.

79. See text accompanying notes 89-91 infra.

80. 190 U.S. 294 (1903).
bankruptcy act. However, the Proposed Act is designed to overrule Lockwood and expressly extends the jurisdiction of the bankruptcy courts “to the determination of all controversies . . . including . . . controversies involving property set apart to the debtor as exempt, including the enforceability of claims . . . against such property.” Moreover, under the Proposed Act the bankruptcy court must determine whether a claim, alleged to be one of three types of non-dischargeable claims, is in fact dischargeable and may, at the request of either a creditor or the debtor, determine the dischargeability of any debt. Therefore, the bankruptcy courts operating under the Proposed Act would be ordering the satisfaction of nondischargeable claims from Section 4-503 assets in certain cases. It is fairly certain that the Commission did not consider this problem since no specific reference is made to it. Moreover, the Commission’s position that Section 4-503 supersedes the Internal Revenue Code’s exemption provision further indicates that the problem was not considered, since—as the above analysis demonstrates—nondischarged tax claims would be enforceable against many assets which are exempted by Section 4-503.

The effect of this situation is that nondischargeable claims are exceptions to Section 4-503, like claims for alimony and child support, but only to the extent that the applicable state or federal nonbankruptcy law does not exempt assets listed in Section 4-503 or creates exceptions for claims against such assets. This result is due to an attempt to accommodate conflicting policy interests. First, there are policy reasons supporting the nondischargeability of certain debts. Second, the coexistence of separate exemption schemes—a bankruptcy plan on the one hand and state and nonbankruptcy federal schemes exempting less or different assets on the other—entails this result.

Faced with this inevitability, the Proposed Act should be amended to state how creditors with nondischarged claims might proceed against assets that are not exempted by nonbankruptcy law. Although enforcement of certain claims by the bankruptcy court may not be feasible it would be expedient where most claims are concerned. Of course, if

81. The doctrine of the Lockwood case has been severely criticized. See, e.g., Countryman, supra note 5, at 709-10; Kennedy, supra note 6, at 462-69.
82. Proposed Act § 4-503 and Note 1 to the Section.
83. Id. § 2-201(a); see Commission Report, supra note 31, at 173.
84. Proposed Act § 4-506(b).
85. See text accompanying note 68 supra.
86. See Commission Report, supra note 31, at 61-80. The policy reasons include imposing the debt on the bankrupt if he is better able to bear it and/or if the claimant has no effective ability to pass on the loss, id. at 78-79; and the belief that the bankrupt should not be able to avoid responsibility for claims arising out of the bankrupt’s violation of community standards, e.g., fraud or embezzlement, id. at 80.
87. For example, claims of creditors who did not receive notice could not be enforced; Proposed Act § 4-506(a)(4).
88. Presently, the Bankruptcy Act provides that the bankruptcy court shall “render
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state laws are amended to conform to the Proposed Act’s exemptions and the Internal Revenue Code is amended to conform more closely to the policy of the bankruptcy exemption law, the need for such a procedure will be obviated.

If the results outlined above were not intended by the Commission, then further provisions must be added to the Proposed Act. However, the described results appear to be inevitable if the Commission desires to maintain a law which has nondischargeable claims, leaves state and federal nonbankruptcy exemption policies as they are, and has a uniform bankruptcy exemption provision.

D. Creation of Exemptions Which Are Applicable in Nonbankruptcy Proceedings

1. The Reach of Section 4-503 Generally

The problem discussed in the preceding section does not arise if the exemptions in Section 4-503 are construed to apply to situations in which nondischarged claims exist outside of bankruptcy. This construction is supportable on the grounds that not all nondischarged debts are made exceptions to Section 4-503 and that the Commission has indicated that Section 4-503 should supersede the Internal Revenue Code’s exemption provision and other federal exemptions.90

However, the Commission probably did not intend to extend the reach of Section 4-503 to creditors enforcing nondischargeable claims. First, no express language so provides. Second, to extend the reach of Section 4-503 to creditors enforcing nondischargeable claims would thwart the policy underlying nondischargeable debts, for the creditors would be confronted by both Section 4-503 and a nonbankruptcy exemption law. This would make it more difficult for creditors enforcing nondischargeable claims—who are presumably favored—to collect their debts. It is unlikely that only Section 4-503 would be applied—that is, that the nonbankruptcy state or federal exemption law would be preempted—because this would add confusion to state and federal nonbankruptcy collections. Moreover, application of Section 4-503 would involve nonbankruptcy courts in administration of a bankruptcy judgment, and make all orders necessary for the enforcement thereof, regarding claims for which a determination of nondischargeability has been made. Bankruptcy Act § 17 (c)(3), 11 U.S.C. § 35(c)(3) (1970). Although this same language is not used in the Proposed Act earlier discussion suggests that the proposed act is designed to allow for a similar result; see text accompanying notes 82-84 supra.

89. The only express exceptions are liabilities to a spouse or child for maintenance or support, for alimony, or under property settlements in connection with a divorce or separation agreement. Proposed Act §§ 4-503(a), 4-506(a)(6).

90. Proposed Act § 4-503 and Note 2 to the Section.
exemption policy, a practice the Commission seeks to abandon. Consequently, Section 4-503 should not be construed to apply to the enforcement of nondischarged claims.

A possible solution would be to extend the effect of Section 4-503 for a short period—for example, 6 months—during which time creditors with nondischarged claims could not levy on Section 4-503 assets and the former bankrupts could either pay or arrange for deferred payment of nondischarged claims. This arrangement would not be unduly harsh to the creditors and would allow the former bankrupts their “fresh starts” with the assets that the Commission had deemed necessary for that purpose.

2. Family Allowance Exemption

Although Section 4-503 generally does not apply to nonbankruptcy proceedings, it does exempt a family allowance for dependents of a bankrupt who dies after a petition has been filed. The exemption does not apply in favor of bankrupts, but rather in favor of persons who are dependents—spouses and minor and dependent children—of bankrupts. The allowance consists of an amount necessary for support of the dependents. But it cannot exceed $1,000 per person, and it is reduced to the extent life insurance payable to the dependents exceeds $10,000. Furthermore, the allowance is exempt “from the claims of creditors of the surviving spouse and dependent children,” and the Proposed Act gives the dependent's allowance priority over all claims on nonexempt assets. The other exempt assets of Section 4-503 pass to the deceased's estate and are administered under state law. These assets are subject to the claims of post-petition creditors and presumably creditors with nondischargeable claims in accordance with state probate law. However, these creditors might receive little or nothing because of state probate homestead allowances and exempt property provisions.

The grant of an exempt family allowance by the bankruptcy laws is awkward. The dependents are not before the bankruptcy court and a determination of what amount is “necessary for their support” may be difficult to ascertain. Moreover, the family allowance grants are but one of many provisions in state schemes for the protection of dependents of

91. COMMISSION REPORT, supra note 31, at 91.
92. Proposed Act § 4-503(e)(1)-(2).
93. Id. § 4-503(e)(3).
94. Id. § 4-503(e)(1).
95. Id. § 4-503(e)(3).
96. Id. and Notes 10-12 to the Section.
97. Proposed Act § 4-503 and Note 10 to the Section.
98. See, e.g., UNIFORM PROBATE CODE § 2-401.
99. See, e.g., id. § 2-402.
deceased persons and may differ from the amount granted by the bankruptcy law and add confusion to state probate administrations. Yet, the provision appears to be a necessary measure to protect the dependents of insolvents. If the deceased had not filed a petition in bankruptcy, under most state laws his dependents would be entitled to both property exemptions and an allowance for their support while the estate was being administered;\textsuperscript{100} correlative, creditors’ rights would not only be limited by the probate exemptions, but would also be diminished by the family allowance. If the bankruptcy laws did not grant the family allowance, the dependents would be limited to the Section 4-503 assets that passed to the deceased’s estate. Thus, the family allowance grant in the Proposed Act is needed to protect the dependents of a bankrupt who dies before distribution of the estate.

The Commission’s exemption of the family allowance from the claims of the dependent’s creditors needs clarification.\textsuperscript{101} If it is intended to exempt the assets from the claims of creditors who come into existence after the allowance has been paid, the provision is unsound. The fund is for the support of dependents. If the dependents incur liabilities, creditors should be entitled to hold this fund for their debts. On the other hand, the fund should be exempt from the claims of those dependents’ creditors who exist at the time the allowance is made, and it is possible that this is what the Commission intended. Otherwise, the purpose for the allowance, to insure support of dependents while the estate is being administered, would be defeated.\textsuperscript{102}

Thus, the Commission’s proposed family allowance may be justified on the ground that the allowance, which would be granted by the state but for bankruptcy, even though the deceased’s estate is insolvent, would be lost if the bankruptcy court distributed all nonexempt assets to creditors. Another, arguably sounder, procedure in cases of a bankrupt’s death prior to distribution would be for the bankruptcy proceeding to be terminated and the assets surrendered to state courts for administration. This course might be impracticable if some assets have been distributed prior to death, but no practical problems are confronted if no distribu-

\begin{footnotesize}
\begin{enumerate}
\item See, e.g., id. §§ 2-401 to 403; T. Atkinson, Handbook of the Law of Wills § 34 (2d ed. 1953).
\item The Proposed Act and notes do not clarify whether the allowance is exempt from all creditors or only existing creditors. The Commission’s report sheds no light on the problem:

[The family allowance] is the only situation where an exemption operates against persons not having allowable claims against the debtor’s estate: The family allowances are exempt from the claims of creditors of the surviving spouse and the dependent children . . . .

\textit{Supra} note 31, at 173. \textit{See also} Plumb, \textit{supra} note 6, at 76.
\item Section 2-403 of the Uniform Probate Code provides no exemption vis-a-vis any creditors of the spouse and children.
\end{enumerate}
\end{footnotesize}
tions have been made. This alternative seems preferable for a variety of reasons. First, the goals of bankruptcy would not be frustrated by such a procedure, except in the relatively rare cases of involuntary proceedings,\textsuperscript{103} since the goal of a "fresh start" for the bankrupt is obviously inapposite. The state forum would provide an orderly settlement of creditors' claims and would have been the forum for this settlement had the deceased not filed a petition in bankruptcy. Second, complete deference to the state allows the state to satisfy the policy of providing for the deceased's dependents. States have a unified and complete method of providing for dependents through exemption, allowance, dower, welfare and similar laws. Bankruptcy administration of some assets and provision for some protection of dependents upsets the policy and administration of the state laws. Third, the recommended alternative would be more efficient and economical.\textsuperscript{104} There would be only one administration of the estate under the state laws. The Proposed Act contemplates administration of nonexempt assets (less the family allowance) under the bankruptcy laws and of exempt and post-petition assets under the state laws. Since the exempt assets of Section 4-503 are not necessarily identical to the exempt assets under state probate laws,\textsuperscript{105} and since there may be post-petition assets, state administration will frequently be necessary to deal with nondischargeable and post-petition claims.

A drawback to a policy favoring the termination of bankruptcy proceedings in the event the bankrupt dies prior to distribution of assets is that creditors' rights may be treated differently under state laws. Priorities, voidability of transfers, recovery of assets, and treatment of secured creditors may be different in bankruptcy than under state probate laws. This should not, however, dictate that bankruptcy proceedings must be completed in all cases. For example, in cases of voluntary bankruptcy, if the deceased had not filed a bankruptcy petition, creditors' rights would have been determined under state law.\textsuperscript{106}

\subsection*{E. Summary}

The idea of a uniform bankruptcy exemption represents a significant and desirable change. It treats bankrupts equally. Moreover, it

\textsuperscript{103} 1974 \textsc{Dir. Admin. Office U.S. Courts Ann. Rep.} 161, Table 18. In involuntary personal bankruptcies, creditors use the bankruptcy laws for their own benefit and their interests are consequently greater—the fact that the deceased's estate is in bankruptcy rather than being administered under state law is not fortuitous from the creditor's perspective as it is in cases of voluntary petitions. In these rare cases, therefore, the estate should be administered in bankruptcy.

\textsuperscript{104} \textit{Cf. Commission Report, supra} note 31, at 81-82.

\textsuperscript{105} \textit{Compare} Proposed Act § 4-503, \textit{with Uniform Probate Code} §§ 2-401, 2-402.

\textsuperscript{106} In some cases, however, creditors might have filed petitions if the debtors had not filed them. But the number of such cases is probably few and the uncertain interest of creditors should not necessitate the continuation of voluntary bankruptcy proceedings.
establishes a federal policy of what assets bankrupts should have for their rehabilitation and their families’ protection. In adopting this policy, Congress should address other federal laws which deal with exemptions. Special attention should be given to the exemption policy regarding federal tax liabilities. Currently, that policy conflicts with other federal exemptions, state exemptions, and contemporary attitudes towards humane treatment of debtors. Moreover, it will conflict with a basic principle of the proposed bankruptcy law, that of imposing losses on the party better able to bear them.107

The superimposition of a bankruptcy exemption scheme on states’ and federal nonbankruptcy exemptions raises problems regarding nondischargeable claims. These problems might be obviated by changes in both federal nonbankruptcy exemptions and states’ exemptions. In the meantime, the Proposed Act should clarify what exemption law is to be applied to collections of nondischarged debts. Extending Section 4-503 for a short period—for example, 6 months—during which the former bankrupt might be able to pay such debts, may be a solution.

Though a few problems are raised by a uniform bankruptcy exemption law, they are minor and can generally be overcome by their recognition and the establishment of procedures to deal with them. Certainly the problems do not justify retaining the present system of disparate treatment of bankrupts.

II

THE EXEMPT PROPERTY UNDER THE PROPOSED ACT

At first glance, the Commission’s uniform exemption provision appears similar to most state statutes. The Proposed Act parallels state laws with regard to the types of property exempted, and the exemptions in the Proposed Act are generally about midway between those granted by the most and least generous state laws. Notwithstanding the similarities, however, the Proposed Act will effect numerous changes. These changes, like most others in the Proposed Act,108 will generally operate to benefit bankrupts.

Through a variety of provisions, the Proposed Act insures that the exemption policies or rehabilitation and family protection will be realized. Devices to defeat exemptions are carefully proscribed. The law also abandons some traditional state law requirements for and exceptions to exemptions. Thus, the Act’s exemptions are available to more bankrupts

108. See Proposed Act § 3-302(a) and Note 2 to the Section; § 4-505 and Note 4 to the Section; § 4-506 and Notes 6, 19 to the Section; § 4-507(a) and Notes 1-3 to the Section; § 4-508 and Notes 1-3 to the Section; Commission Report, supra note 31, at 175-77.
and are valid against more creditors. The Proposed Act is also intended to address two thorny problems that have heretofore been a matter of case law: the creation of exempt assets on the eve of bankruptcy and the trustee's rights to exempt assets the bankrupt preferentially or fraudulently transferred. Finally, the Proposed Act contains provisions for bankrupts to redeem exempt property from liens. Before considering the Proposed Act, alternative exemption plans will be considered.

A. Alternative Exemption Schemes: The Roads Not Taken

The Commission's approach to exemptions is but one of many which might be adopted in bankruptcy. Two alternatives are discussed here: the bankruptcy judges' alternative and a cash allowance, "buy-back" scheme.

The bankruptcy judges would grant bankrupts an exemption, in no event exceeding $25,000 in value, which is the greater of the exemptions granted under the Judges' Bill or those allowed under state law.109 The Judges' Bill overcomes the rehabilitative and family protection shortcomings of many state exemption laws which are too niggardly—either because of legislative inadvertence and failure to make dollar amounts contemporary or because of conscious legislative policy—while deferring to state policy when that policy favors debtors more than the Commission's exemptions would favor them.

The major deficiency in the Judges' Bill lies in its treatment of the manifold problems of the present Section 6.110 The Judges' Bill would mitigate those problems, but would still allow unequal treatment of bankrupts, some abdication of federal policy, and would create problems where federal bankruptcy courts administer state exemption laws. Moreover, the Judges' Bill evidently does not incorporate state excep-

109. Generally the same type as those given by the Proposed Act in section 4-503. Differences between the Judges' Bill and the Proposed Act regarding items of exempt property are slight; they are noted in the text.

110. Judges' Bill § 4-503(a). The Judges' Bill is unclear. It provides an exemption of "the greater of (1) the total value of property exemptions provided by applicable State law, without limitation, or (2)" the exemptions given in § 4-503, "but subject to the limitation that the total value of property exemptions allowable to the debtor under this section shall not exceed $25,000." (emphasis added). The "without limitation" phrase raises two questions. First, does it mean that state law limitations (for example, of $2,000 on the value of the homestead) are inapplicable (thus allowing one to exempt a $17,000 home)? Second, the "without limitation" conflicts with the $25,000 limitation. As the latter is a limitation to "this section," it presumably would take precedence. The only two documents issued by the judges shed no light on the problems. Synopsis of Bankruptcy Bill Sponsored by the Nat'l Conf. of Bankruptcy Judges, H.R. 16643 (Sept. 16, 1974); Comparison of Bankruptcy Commission Bill With Bill of Nat'l Conf. of Bankruptcy Judges (Sept. 16, 1974).

111. See text accompanying notes 10-25, 33-37 supra.
tions to exemptions. Although this removes the problem of state-created priorities through exceptions in bankruptcy, it seems unwise to incorporate only a part of a unified legislative scheme. State legislatures might not grant the liberal exemptions they grant today if their exceptions were not recognized. This assumption is not at all unreasonable if one considers the common state exceptions from exemptions for unsecured purchase money claims and state taxes which the Judges' Bill does not incorporate. Because the Judges' Bill would perpetuate the problems of the present bankruptcy exemption scheme, although admittedly to a lesser degree, the Commission bill is preferable.

Most critics of the policy of Section 6 have suggested an exemption plan different from the common extant schemes listing categories of exempt property and limiting the amount of property allowed in each category. Generally, the alternative proposes granting a bankrupt "a prescribed cash allowance from the proceeds of the liquidation of his estate." This cash allowance would be the only exemption, but the bankrupt could "apply part of his exemption to 'buy back' essential items of his own household equipment, apparel, and other goods." The merit of such a proposal is that it frees bankrupts to select the assets they believe will be most useful to themselves and their families rather than forcing them to adhere to types and amounts of property prescribed by inflexible and quickly outmoded statutes. Furthermore, because the bankrupt is an interested potential bidder, it is likely that the sale of assets would realize more under this plan than is realized under current practice. On the other hand, such a proposal may be criticized for not assuring that items necessary for family support will be selected by bankrupts. Two responses may be made to this criticism. First, the necessitous situation of bankrupts naturally protects against the purchasing back of frivolous assets. Second, the allowance and "buy-back"

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112. The Judges' Bill refers to state law only regarding "the total value of property exemptions" and further states that the "property allowed as exempt under this section is exempt from creditors holding claims . . . other than claims" relating to support, alimony and maintenance. Judges' Bill § 4-503(a). This indicates that the exceptions granted under the state law are not to be controlling in bankruptcy.

113. See text accompanying note 15 supra.


116. Countryman, supra note 5, at 746-48; Comment, supra note 3, at 1507-13; see Note, supra note 26, at 671-681.

117. Countryman, supra note 5, at 746.

118. Note, supra note 26, at 679.

119. See Comment, supra note 3, at 1465-69.
scheme is little or no more vulnerable to this criticism than is the Proposed Act, which allows great freedom in the selection of assets.

One drawback of a pure cash allowance and "buy-back" scheme is the procedural difficulty inherent in coping with certain types of potentially exempted assets. For example, what is the present value of a bankrupt's rights in a pension plan, to disability benefits, in a decree for alimony and child support? Furthermore if the value of the rights is greater than the cash allowance, would it be desirable to force, the present surrender of such rights? Even the cash allowance statute therefore, would probably have to cope with these and similar assets through separate provisions. The broad categorization of assets in the Proposed Act accomplishes approximately the same ends as the cash allowance, "buy-back" approach while avoiding the difficulties.

B. The Proposed Act's Exempt Property

Property exempted by the Proposed Act can be grouped into two categories: (1) items immediately necessary for family support, and (2) investment items that are not essential to family support or rehabilitation. As previously mentioned, the type of property exempted in the Proposed Act parallels that exempted by state statutes, and the size of the exemptions granted by the Commission generally falls about midway between the most extreme state laws. In a few instances, the Proposed Act presents a unique approach to exemptions.

1. Family Support and Rehabilitation Items

Clothing, furniture, tools of the trade or profession, livestock and motor vehicles are exempted up to a total value of $1,000. A burial plot up to the value of $2,500 is also exempt. These items may be exempt in excess of their respective monetary limits to the extent that the bankrupt does not use the $5,000 (plus $500 for each dependent) allocated for a homestead exemption. The Proposed Act further exempts alimony and support and rights under separate maintenance agreements; disability benefits; unemployment benefits; rights arising from personal injury; health aids; and $500 worth of cash, securities, receivables, unpaid earnings, vacation pay, and tax refunds. The Proposed Act also exempts interests in retirement plans, including profit

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121. See text accompanying notes 123-26, 143-48 infra.
122. See text accompanying note 108 supra.
123. Proposed Act § 4-503(c)(1).
124. Id. § 4-503(c)(2).
125. See text accompanying notes 143-48 infra.
126. Proposed Act §§ 4-503(c)(3), (4), (7), (8), (9).
sharing and stock bonus plans, established by state or federal statute or which qualify under Section 401(a) of the Internal Revenue Code.\textsuperscript{127} This exemption is limited to an amount “reasonably necessary for the support of the debtor and his dependents,”\textsuperscript{128} and provides needed support for retired bankrupts and preserves all of the bankrupt’s rights in reasonable retirement programs.\textsuperscript{129}

The Proposed Act provides an exemption for the proceeds or benefits of any life insurance policy, if the debtor is the spouse or a dependent of the insured, to the extent that proceeds or benefits are reasonably necessary for the support of the bankrupt and his dependents.\textsuperscript{130} Presumably, this exemption would not benefit a man or woman who was able to work since the benefits would not be necessary for such a person’s support. The exemption would benefit bankrupts who are too old to work or unable to work to the extent that social security, alimony, and retirement plans would not provide for support. Viewed in this way, the provision is most likely unnecessary since alternative sources of income would be available to those the provision is designed to benefit. The Judges’ Bill recommends that this exemption be allowable only to the extent that, together with the homestead, burial plots and cash surrender value exemptions, it is within a $6,000 (plus $600 for each dependent) limit.\textsuperscript{131} The approach of the Judges’ Bill is to treat these benefits as part of a package which supplements specific support items; thus it is a better characterization of the fund.

Besides the exemptions for bankrupts, the Proposed Act provides for family protection in the case of a bankrupt’s death after a petition is filed and before distribution to creditors.\textsuperscript{132} As has been discussed,\textsuperscript{133} recognition of this cash allowance in bankruptcy is necessary in order to implement the state policies of providing dependents of deceased persons with a cash allowance pending administration of the estate.

The above provisions amply provide for support and rehabilitation of bankrupts. One important point which is not clarified in the Proposed Act, however, is the meaning of “reasonably necessary for the support” of the bankrupt and his dependents.\textsuperscript{134} This phrase is used to define the
size of exemptions in at least three instances throughout the Proposed Act, and in another instance the adverb "reasonably" is omitted. The lack of federal precedent interpreting the concept in this context combined with state law precedent interpreting the concept contrary to the policies of the bankruptcy law accentuates the need for clarification. California courts have held that the "necessary" limitation is to be defined in terms of the debtor's social class and customary standard of living. This view has been supported by commentators. This interpretation promotes social injustice, however, because it allows a wealthy individual to retain more in the way of life insurance or retirement plan proceeds than a middle class laborer may retain. The law should reject such a standard and define "necessary" to mean "reasonably essential to or needed by an average and reasonable person."

2. Investment Assets

Beside exempting items which are directly related to immediate family support, the Proposed Act grants separate exemptions for life insurance policies and homesteads. Life insurance policies with a cash surrender value up to $1,500 are exempt, and policies with cash values in excess of $1,500 may also be exempted by payment of the excess to the trustee. The latter provision enables the bankrupt to maintain the same insurance; whereas, if the policy had to be forfeited, the bankrupt might no longer be insurable or might have to pay higher premiums due to advanced age or poor health. Homesteads, or property in lieu of homesteads, receive an exemption limited to $5,000 plus $500 per dependent. The Judges' Bill groups these investment assets, together with paid proceeds and benefits from life insurance, and provides one $6,000 limit (plus $600 per dependent) for the whole group. The approach of the Judges' Bill focuses on the fact that these types of property provide an investment value to the family. This approach is
BANKRUPT'S EXEMPTION RIGHTS

conceptually sounder than that of the Commission, but the practical differences are not significant.\(^\text{142}\)

a. The Homestead Exemption

The Proposed Act allows for the exemption of a bankrupt's home\(^\text{148}\) to the extent of an equity\(^\text{144}\) of $5,000 plus $500 per dependent.\(^\text{145}\) If the bankrupt does not own a home or has an equity which is under the maximum allowable, he may select certain other property to reach the maximum allowance.\(^\text{146}\) What the Commission intended that "other property" to be, however, is unclear. The Proposed Act provides that the selection of "other property" should be made from clothing, livestock, jewelry, furniture, automobiles, tools and burial plots;\(^\text{147}\) however, the Commission Report provides that it may be selected from "cash, securities, receivables, accrued vacation pay, and income tax refunds."\(^\text{148}\)

The author has previously criticized this proposed exemption plan because "it removes substantial assets from creditors without commensurate benefits to society from home ownership by debtors,"\(^\text{149}\) and the alternative exemption for debtors who do not own homes is unnecessary and exorbitant.\(^\text{150}\) The Commission's proposal is modest compared with many state laws\(^\text{151}\) and some recommendations for reform.\(^\text{152}\)

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\(^{142}\) Bankruptcy Judge Conrad K. Cyr has stated: "The inclusion in [the Judges' bill] of the homestead and insurance exemptions as part of the same package is in recognition of the fact that a bankrupt with a homestead will need less insurance protection for his family than a bankrupt who rents shelter." Statement of Bankruptcy Judge Conrad K. Cyr, on Behalf of National Conference of Bankruptcy Judges, Hearings on Commission and Judges' Bills, supra note 28, at 96-97 citing Riesenfeld (unpublished memorandum on exemption provisions circulated among membership of National Bankruptcy Conference). The Judges' Bill would be more advantageous to bankrupts who have an equity in a home which exceeds $5,000. Bankrupts who own a home and life insurance might prefer the Judges' Bill since they could elect to take all $6,000 of the exemption in the home and still preserve their life insurance policies by paying the trustee its surrender value. See text accompanying note 140 supra.

\(^{143}\) The property must be owned and used as a home at the date of the petition in bankruptcy. Proposed Act § 4-503(b)(1).

\(^{144}\) See id. § 4-503(g).

\(^{145}\) Id. § 4-503(b)(1).

\(^{146}\) Id. § 4-503(b)(2).

\(^{147}\) Id.; id. § 4-503(c)(1)-(2).

\(^{148}\) COMMISSION REPORT, supra note 31, at 171.

\(^{149}\) Vukovich, supra note 12, at 805; accord, Note, supra note 26, at 678.

\(^{150}\) Vukovich, supra note 12, at 831-32.

\(^{151}\) E.g., CAL. CIV. CODE § 1260 (West Supp. 1975) ($20,000); FLA. CONST. art. 10, § 4(a)(1) (no dollar limit; rural and urban homes limited in size to 160 acres and one-half acre respectively); N.D. CENT. CODE § 47-18-01 (Supp. 1973) (within a town plat, limited to two acres and $40,000 equity value; not within a town plat, limited to 160 acres with no dollar limit).

\(^{152}\) D. STANLEY & M. GIRTH, supra note 7, at 206 ("perhaps $20,000").
less, the homestead or alternative exemption is necessary for neither support nor rehabilitation.\textsuperscript{153} Interestingly, the Commission Report indicates that "only a small percentage [of bankrupts] were purchasing their own home\textsuperscript{154} and that bankrupts had frequently changed residences.\textsuperscript{155} These facts undermine the arguments for the necessity of a homestead exemption and demonstrate that renting living quarters today presents a realistic and sensible alternative to home ownership.

\textbf{b. The Life Insurance Exemption}

Professor Riesenfeld's history and analysis of state life insurance exemptions demonstrates that life insurance has achieved the status of "the most privileged capital asset in the United States."\textsuperscript{156} The existence of unlimited exemptions of this asset in many states and the large exemptions in other states has been a point of critical commentary\textsuperscript{157} and political concern.\textsuperscript{158} The Commission's proposed life insurance exemption reverses the historical trend and establishes a reasonable policy.

The Commission's approach to the exemption of a bankrupt's interest in a life insurance policy differs from that of the states in significant ways. The Proposed Act exempts "a policy or policies of life insurance having an aggregate cash surrender value of not more than $1,500 payable to the debtor, together with such value."\textsuperscript{159} If the cash surrender value exceeds $1,500, the policy or policies may be exempt if the debtor pays "the amount of such excess value to the trustee within 30 days after it has been ascertained and stated to the trustee by the insurer."\textsuperscript{160}

\textit{i. Unique Method of Measuring the Exemption.} The first divergence from state insurance exemptions is the method of limiting the

\textsuperscript{153} There appears to be some concern that home ownership and the size of exemptions generally might be significant in assuring bankrupts job security. If job security is the goal, then a special provision prohibiting discrimination by employers could easily be added to the act. \textit{Cf.} Proposed Act § 4-508.

\textsuperscript{154} Commission Report, \textit{supra} note 31, at 43.

\textsuperscript{155} Id. 43-44.

\textsuperscript{156} Riesenfeld, \textit{Life Insurance & Creditors' Remedies in the United States}, 4 U.C.L.A. L. REV. 583, 617 (1957); see id. 593.


\textsuperscript{158} In the course of hearings on the Commission and Judges' bills, Senator Burdick seemed quite concerned about "one State that has unlimited exemption on the cash value of life insurance policies." \textit{Hearings on Commission and Judges' Bills, supra} note 28, at 136. Indeed, about half of the states grant such a sweeping exemption.

\textsuperscript{159} Proposed Act § 4-503(d).

\textsuperscript{160} Id.
exemption. There are three types of state laws governing insurance exemptions. Many states exempt all life insurance, regardless of amount.\textsuperscript{161} Some western states limit the exemption by placing a ceiling on the size of the annual premiums; to the extent the annual premium exceeds the limit, creditors may proportionately collect the debtors' interests in the policies.\textsuperscript{162} The third group of states places a dollar limit on the face amount of the policies.\textsuperscript{163} The Commission's abandonment of these schemes and its focus upon the cash surrender value available to the bankrupt is more realistic in that the limit is placed upon the policy's actual value to the bankrupt rather than on less relevant factors such as what the policy might pay in the future or how much the policy has cost. In 1973, about 58 percent of all payments on life insurance policies were made to policyholders—in surrender value, annuities, dividends, and the like—and only 42 percent of the payments were made to beneficiaries as death benefits.\textsuperscript{164} Persons coming out of bankruptcy have need for assets and are likely to obtain the cash surrender values to meet this need. These considerations support the method of limiting the exemption by referring to the bankrupt's actual interests in the life insurance policy.

\textit{ii. The Exemption Is Small Relative to State Exemptions.} Reference to the size of the cash surrender value means that the size of the premium payments and the length of time the policy has been in effect will influence the amount of the exemption. The following chart may be helpful to illustrate the various sizes of cash surrender values.\textsuperscript{165}

\begin{center}
\begin{tabular}{|c|c|c|c|}
\hline
\textbf{} & \textbf{Whole Life} & \textbf{20 pay life} & \textbf{Endowment at 65} \\
\hline
Annual Premium & $372 & $628 & $478 \\
Cash value: 3 years & 439 & 1,104 & 735 \\
Cash value: 4 years & 814 & 1,740 & 1,234 \\
Cash value: 5 years & 1,202 & 2,418 & 1,747 \\
Cash value: 6 years & 1,627 & 3,136 & 2,300 \\
\hline
\end{tabular}
\end{center}

\textsuperscript{161} E.g., ALA. CODE tit. 7, § 624 (1960); FLA. STAT. ANN. § 222.14 (1961); MICH. COMP. LAWS ANN. § 500.2207 (1967); ORE. REV. STAT. § 743.102(1) (1973); TEX. REV. CIV. STAT. ANN. art. 3836(a)(6) (Supp. 1974).

\textsuperscript{162} E.g., CAL. CODE CIV. PRO. § 690.9 (West Supp. 1975); UTAH CODE ANN. § 78-23-1(8) (1953).

\textsuperscript{163} ARIZ. REV. STAT. ANN. § 33-1126 (Supp. 1970) ($10,000); COLO. REV. STAT. ANN. § 13-54-102(1)(e) (1973) ($5,000); MISS. CODE ANN. § 85-3-11 (1973) ($50,000).

\textsuperscript{164} STATISTICAL DIVISION OF INSTITUTE OF LIFE INSURANCE 1974 LIFE INSURANCE FACT BOOK 46-47, 51. Of the $20.3 billion paid on policies, $11.7 billion went to the insured-policyholders and $8.6 billion went to beneficiaries. Of the $11.7 billion paid to insureds, $3.4 billion was paid in surrender values. \textit{Id.}

\textsuperscript{165} The chart is adapted from figures supplied by the New York Life Insurance Company. Because New York Life is a participating company, dividends are due each year beginning the third year; the cash values shown represent the sum of the guaranteed cash value and the termination dividend.
Comparing the cash values on this chart for $25,000 policies with the state exemptions demonstrates a radical departure from the current treatment of life insurance policies. For example, the California exemption of a life insurance policy in which the insured's spouse or minor children are the beneficiaries is limited by an annual premium of $1,000. Reference to the table shows that this policy, if whole life, would be about a $70,000 policy; the full exemption under the Proposed Act would be reached about the fourth year (when cash value would be about $2,000). Similarly, a $50,000 whole life policy which is fully exempt under Mississippi law, would lose its full exemption after the fifth year under the Proposed Act. The proposed law obviously curtails exemptions in the many states with unlimited exemptions.

The desirability of any life insurance exemption is debatable when consideration is given to the other exemptions allowed by the Commission in addition to the bankrupt's right to preserve the policy by paying the cash value to the trustee. If there is to be a life insurance exemption, however, the Commission's proposed exemption is a reasonable one and represents a definite improvement over the current treatment of life insurance in bankruptcy.

iii. Exemption Not Restricted to Policies With Dependent-Beneficiaries. Many states condition the availability of the life insurance exemption or size of exemption on whether the beneficiaries of the policies are relatives or dependents of the insured. The Proposed Act contains no such requirement, another indication that the Proposed Act treats life insurance separately from support items. The Proposed Act's treatment of life insurance is also consistent with the Commission's measurement of the exemption size by the cash value rather than the size of the death benefits, since the law is concerned with the assets available to the bankrupt rather than the fund payable to support dependents after the bankrupt dies. The absence of a requirement that the policies be payable to a dependent is one more factor arguing against any insurance exemption.

166. CAL. CODE CIV. PRO. § 690.9 (West Supp. 1975).
168. See text accompanying note 140 supra.
169. Interestingly, life insurance companies will most likely not oppose the Proposed Act. With their $200 billion in reserves variously invested in businesses, insurers have come to recognize that their interests may be best served by protecting creditors' rights. Cf. Davis, supra note 157, at 369.
171. E.g., CAL. CODE CIV. PRO. § 690.9(b) (West Supp. 1975); N.Y. INS. LAW § 166(1) (McKinney 1966).
172. See text accompanying notes 159-63 supra.
iv. Conclusion. The Commission's proposed life insurance exemption represents a significant departure from current bankruptcy policy which incorporates the states' unlimited or generally large insurance exemptions. The departure is both one of form and one of substance. Reference to the cash surrender value rather than the sizes of premiums or death benefits properly focuses on the amount of assets available to bankrupts. The $1,500 limit on the cash surrender value would effectively reduce the sizes of the exemptions given by most states. The Proposed Act would thus properly reduce the status of what is "today the most privileged capital asset in the United States." It will still remain a privileged asset and whether it should enjoy even this status is debatable in light of other exemptions, the right of bankrupts to preserve their insurability and premium rates, and the absence of a requirement that the policy be for the purpose of protecting bankrupts' dependents. However, the Commission's proposal is modest and may be politically necessary.

C. Other Noteworthy Components of the Commission's Exemption Proposals

Although the Proposed Act's list of exempt property is similar to the current lists of exemptions in state laws, other aspects of the Act represent change and innovation. Many of these innovative provisions reflect dissatisfaction with results under existing laws and some of the provisions resolve issues that are unsettled under existing law. Generally, the changes favor bankrupts. But a few significant provisions will make more property available for distribution to creditors.

1. Periodic Adjustment of Sizes of Exemptions

The Proposed Act fills a much-criticized\textsuperscript{173} void in state laws. Section 1-105 of the Act provides that the dollar amounts of exemptions (and other provisions) shall be adjusted to reflect increases in the Consumer Price Index. When an adjustment is called for, the Administrator\textsuperscript{174} will issue a rule announcing the adjustments.\textsuperscript{175} This provision would insure that the exemption laws keep pace with the economy and


\textsuperscript{174} Proposed Act § 1-102(3). The Administrator is the chief executive officer of the proposed United States Bankruptcy Administration; an agency in the executive branch which many of the now dispersed functions and responsibilities of bankruptcy administration would be centralized. See Commission Report, supra note 29, at 117-26.

\textsuperscript{175} Id. § 1-105(b).
do not become ineffectual because of inflation.176

2. Exemptions Granted Without Debtors' Timely Claim Thereof

The Proposed Act insures that bankrupts and their families will realize the benefits of the exemption provision. The bankrupt, his spouse, his dependents, or anyone acting in his behalf may claim them;177 if none of these persons claim the benefits the Administrator presumably sets them aside for the bankrupt.178 This provision is directed against cases decided under Section 6 of the present law denying bankrupts exemptions because the bankrupts had not filed timely declarations of the exemptions as required by state law.179 This problem is already obviated, however, because the Proposed Act does not rely on state law to determine exemptions. The provision is also designed to protect against loss of exemptions due to a bankrupt's failure to comply with technical bankruptcy procedures180 or to make a timely claim of exemptions.181 Under this provision, bankrupts will be allowed all of the exemptions to which they are entitled. This provision is necessary to realize the exemption policies of rehabilitation and family protection and to insure—as a practical matter—the equal treatment of all bankrupts.

3. Limitation on Enforceability of Waivers and Liens

Waivers of exemptions and liens on exempt property have presented a variety of procedural problems under the current Bankruptcy Act.182 More importantly, waivers of exemptions frequently undermine the policies of the exemption laws. To overcome these adverse effects the Proposed Act renders unenforceable waivers of exemptions unless the

176. Inflation has rendered some state laws ineffective. It may be necessary to change provisions in the Proposed Act to reflect the changes in economic conditions since the Act was drafted in 1973; in January 1973 the Consumer Price Index was 133.1, by August 1975 it had increased over 22% to 162.8. WALL ST. JOURNAL Sept. 22, 1975, at p. 1, col. 5.
177. Proposed Act § 4-503(j).
178. Id. § 4-503, n.17; COMMISSION REPORT, supra note 31, at 170.
179. White v. Stump, 266 U.S. 310 (1924); see Myers v. Matley, 318 U.S. 622 (1943); Schultz v. Mastrangelo, 333 F.2d 278 (9th Cir. 1964) (Arizona law).
181. The magnitude of this problem has been investigated:

The bankrupt may claim as exempt, at the first meeting, property that he neglected to list previously. Such omissions had been encountered by 65 percent of the referees we interviewed. Thirty-five percent attributed this to the ineptitude of the bankrupts' attorneys, but only 20 percent had intervened to see that the exemptions were properly claimed and not waived. Here again the debtors' interests are not fully protected either by their lawyers or by the referees.

D. STANLEY & M. GIRTH, supra note 7, at 83.
waivers are accompanied by enforceable security interests in the exempt property. In addition, nonpurchase money security interests in clothing, household goods and health aids are invalid—in other words, nonpurchase money security interests are valid only against less essential items such as autos, securities, the home, life insurance, livestock and jewelry.

To a certain extent, the Commission's proposal reflects extant policies. State and bankruptcy courts have frequently, but not always, held on grounds of public policy that waivers of state exemptions are ineffectual. In many instances, state exemption legislation explicitly prohibits waiving exemptions of essential items. The Proposed Act conforms with state laws which validate nonpurchase money security interests in homes and purchase money security interests in all exempt items. The Bill recognizes the need for the use of certain assets as collateral and defers to the special interests of purchase money creditors, thereby insuring the availability of credit. The Commission's proposal goes farther than most state laws and court decisions, but the proposal is desirable, if not necessary, to insure that the exemption policy is not undermined.

In addition to limitations on the recognition of waivers and security interests, the Proposed Act provides that all liens obtained by legal and equitable proceedings are invalid against the bankrupt's exempt property. This provision becomes especially important in connection with the Proposed Act's separate bankruptcy exemptions, because property that is exempt under the Proposed Act but not under state law might be levied upon; in such cases, prior to bankruptcy, the bankrupt himself would be unable to avoid the lien. However, select statutory liens are valid against exempt property. These include mechanics liens, artisans liens, warehousemen's liens, and ad valorem tax liens. The claims secured by these liens are directly related to the exempt property and,

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188. Proposed Act § 4-503(e).

189. Id. § 4-606(a); § 4-503, and Note 13 to the Section.

190. Id. § 4-606(a).
given the nature of the claims, are reasonable exceptions to the exemption policy.\textsuperscript{191}

4. Bankrupts' Right to Redeem Property Subject to Security Interests

Section 4-504 of the Proposed Act has drawn a substantial amount of criticism from creditor groups.\textsuperscript{192} The section allows bankrupts to "redeem property from a lien securing a dischargeable consumer debt, provided the property is exempt or has been abandoned by the trustee, by paying the holder of the lien the fair market value of the property or, if less, the amount of his claim."\textsuperscript{193} Such a provision is new in the bankruptcy context. The Uniform Commercial Code generally allows debtors to redeem collateral at any time before it has been sold by paying the creditor the full amount of the claim plus any costs incurred in repossessing, storing, and preparing to sell the collateral.\textsuperscript{194} The innovative feature of the Proposed Act is the bankrupt's right to pay only "the fair market value of the property" if that is less than the balance due the creditor.\textsuperscript{195} The Commission explains the policy of this feature of the law:

[I]t does little good to allow the debtor an exemption of wearing apparel, household goods, or health aids subject to an indefeasible security interest securing a purchase-money obligation, if the debtor must pay more than the property is worth for the privilege of continuing to use the property. The fair market value of such property is often substantially less than the amount owed and little if anything can be realized upon forced disposition of the property. What the creditor really has is leverage to force payment under the present Act, since continued use is conditioned on forbearance by the creditor and forbearance is exacted at a high price.\textsuperscript{196}

The Commission's redemption proposal is strongly supported by the bankruptcy judges.\textsuperscript{197} However, creditor groups object to the provi-

\begin{itemize}
\item\textsuperscript{191} See text accompanying notes 212-20 infra.
\item\textsuperscript{192} See Hearings on Commission and Judges' Bills, supra note 28, at 128, 132, 133-34, 141-42, 168.
\item\textsuperscript{193} Proposed Act § 4-504(a) (emphasis added). The Judges' Bill does not limit the right to consumer debts. Judges Bill § 4-504(a).
\item\textsuperscript{194} \textsc{Uniform Commercial Code} § 9-506.
\item\textsuperscript{195} Cf. the following rule proposed by the Federal Trade Commission:
In connection with the extension of credit to consumers . . . , it is an unfair act or practice . . . for a lender or retail installment seller . . . (a) To take or receive from a consumer an obligation which . . . (b) Fails to provide that if the creditor retakes encumbered property from the consumer, the fair market retail value of the property so taken will be credited toward the balance due under the obligation. . .
\item\textsuperscript{196} \textsc{Commission Report}, supra note 31, at 174.
\item\textsuperscript{197} See Hearings on Commission and Judges' Bill, supra note 28, at 62-63. Also consider note 193 supra.
\end{itemize}
sion as written. They would make it inapplicable to purchase money obligations on the theory that in such cases "the collateral is obtained in an arms-length transaction and is of a value equal to the debt at the outset and the creditor has attempted to match the loan payments to collateral depreciation." As to nonpurchase money claims, the creditor groups would accept the Commission's idea but would place upon bankrupts the burden of proving the fair market value of collateral.

The Commission's position, however, is sound. Presently, when the fair market value of the collateral is less than the debt owed, the bankrupt must pay the amount owed to retain the property. The debtor would be better off surrendering the collateral to the creditor. If this were done, the creditor would realize, by hypothesis, the amount the Proposed Act allows for the bankrupt's redemption. No deficiency assessment against the bankrupt would be possible because the debt would be discharged. Thus the creditor's interests would not be affected adversely by the Proposed Act.

Nonetheless, section 4-504 might be improved by two additions. First, to preserve the bankrupt's right of redemption, the law should prohibit both repossession and sale once creditors are given notice of bankruptcy. Second, bankrupts should be given the additional and alternative right to *cure* defaults in all cases where the collateral has not been sold. To cure, the bankrupt would pay all delinquent installments, any allowable penalties, and any reasonable costs incidental to repossession. Upon such payment, the bankrupt's rights would be fully restored as if he had not defaulted. This right would be especially valuable both in cases involving larger assets such as automobiles and in cases involving poorer debtors, since in such cases, the right to redeem is either meaningless or the exercise of the right to redeem creates substantial hardship. Moreover, creditors would not be prejudiced by such a provision since they would still receive what they bargained for. The Commission contemplates that a situation similar to the one suggested here will, as a practical matter, develop in many cases, and it recog-

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199. *Id.* at 128, 132.
200. *Id.* at 128, 132.
202. The Commission has stated:

In order to make more effective the right of redemption an exception is made to the recommendation . . . that reaffirmation of debt not be allowed. Thus, it is recommended that an agreement between the debtor and the secured party whereby the debtor agrees to pay the fair market value of the property be enforceable. Hopefully, this will enable debtors to work out the gradual payment of the amount owed, but not in excess of the fair market value of the property.

nizes the enforceability of a bankrupt's executory promise in connection with redemption as an exception to the general prohibition against the reaffirmance of discharged debts. It would be desirable to provide an explicit provision allowing bankrupts to cure deficiencies.

5. Exceptions to Exemptions

The Proposed Act contains fewer express exceptions to exemptions than do most state and federal exemption laws. The only class of express exceptions in the Proposed Act involves the bankrupt's familial obligations—claims for alimony, child support, and property settlements. Exceptions for alimony and child support are recognized by most state statutes and by the federal restriction on garnishment. Even in the absence of an express exception, many courts hold that claims for family support create exceptions to the exemption laws on the ground that the exception is necessary to attain the exemption law's goal of family protection. The Commission's further exception for liabilities "under a property settlement in connection with a separation agreement or divorce decree" is effectively recognized by state decisions holding that exemptions do not apply to such liabilities.

As previously discussed, the effect of the disparity between the proposed bankruptcy exemptions and state exemptions will result in treating some nondischargeable claims as an additional group of exceptions to the extent that applicable state law does not exempt property that the Proposed Act does exempt. In addition, some of these nondischargeable claims—for example, claims for state and federal taxes—would not be exempt under state law.

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203. Id.; Proposed Act §§ 4-504(b), 4-507(a).
204. Proposed Act § 4-503(a), § 4-506(a)(6).
208. Proposed Act § 4-503(a), § 4-506(a)(6).
210. See text accompanying notes 76-88 supra.
are debts commonly excepted from state exemption laws; to this extent, they may be enforced against all property and may be considered exceptions to the exemptions in the Proposed Act.

Moreover, the Proposed Act validation of certain statutory liens on exempt property and purchase money security interest in exempt property indirectly incorporate common state exceptions to some degree. Most states except debts for the purchase price of exempt property. The state exceptions apply even though no security interest exists in the property, which means that the Proposed Act actually limits the applicability of the state exception. However, because all credit sales of any significance are secured, the practical difference between the state laws and the Proposed Act is minimal in this respect. Many state laws also except debts owed mechanics and materialmen for the improvement of exempt property and tax debts. These state exceptions are reflected in the Proposed Act by the validation of statutory liens for the repair or improvement of property and for ad valorem taxes.

Consequently, although a number of common state exceptions are not explicitly made exceptions to exemptions in the Proposed Act, many will be exceptions indirectly. The recognition of these exceptions is generally sound. Purchase money creditors, materialmen, and laborers for whom exceptions are recognized will have increased the value of the bankrupt's exempt assets. It would be inequitable if these creditors were not allowed to enforce their claims against the exempt assets they had sold or improved.

The exceptions for state and federal taxes are not as easily justified,
however. These exceptions are justified in collection proceedings outside of bankruptcy because they are necessary to effective tax collections.\textsuperscript{221} In bankruptcy, however, different considerations come into play. To the extent governments are allowed to take otherwise exempt property to satisfy tax liabilities, the basic bankruptcy policy of providing debtors with a "fresh start" is defeated. The government's exemption goals of rehabilitation and family protection are sacrificed to the government's collection rights. This accommodation of governmental interests may be economically desirable, but it appears that the slight loss in tax revenues should be tolerated in order to insure the realization of the government's bankruptcy goals.\textsuperscript{222}

A few claims excepted by some states are not excepted in the Proposed Act. These include debts for "necessaries,"\textsuperscript{223} claims founded in tort,\textsuperscript{224} and claims which exist prior to the debtor's acquisition of homestead property.\textsuperscript{225}

6. Treatment of Negligence Claims

The treatment of tort creditor claims raises difficult issues, especially in the context of the Commission's philosophical view of what a bankruptcy law should accomplish.\textsuperscript{226} The handful of states which deny exemptions against tort creditors do so presumably because tort creditors do not have the same opportunity as contract creditors to insure the collectibility of their claims. Tort creditors cannot choose their debtors and cannot secure collection-facilitating concessions such as security interests and waivers of exemptions. It is also likely that states denying exemptions against tort creditors recognize, as courts and legislatures

\textsuperscript{221} See Vukowich, supra note 12, at 862-63.

\textsuperscript{222} The Proposed Act would reduce somewhat the present advantages accorded tax debts by limiting their priority and nondischargeability. Proposed Act § 4-506 & nn.5-6; \textsuperscript{223} Commission Report, supra note 31, at 78-79, 176. The reduction of the priority favors creditors and the limitation on the nondischargeability favors bankrupts. For most consumer-bankrupts, the nondischargeable taxes would be income and ad valorem taxes incurred within the year before the petition was filed and taxes for which a required return was not filed not more than one year prior to the date of the petition. Proposed Act § 4-506(a)(1).

\textsuperscript{224} See also CAL. CODE CIV. PRO. § 690.6(c)(1) (West Supp. 1975).


\textsuperscript{226} See Commission Report, supra note 31, at 61-84.
generally have, that personal injury merits greater legal protection than does purely economic loss.

Under the Proposed Act, no exception to exemptions is allowed for negligence claims. Under both the present act and the Proposed Act, "wilful and malicious" tort claims are nondischargeable. The Proposed Act would change the treatment of negligence claims by making them more readily dischargeable. Under the current act, negligence claims are dischargeable only if reduced to judgment or if an action to enforce the claim is pending at the time of filing the petition and the damages are estimable without causing undue delay in the bankruptcy proceedings. The Proposed Act would make all negligence claims dischargeable, regardless of whether an action had been filed to enforce them or whether they presented complicated issues of liability and damages. The reason why the present act does not discharge unfiled and complex negligence claims is not to further the interest of negligence creditors, but rather to avoid "undue delay in the administration" of bankrupts' estates. The Commission believes that resolution and liquidation of such claims will not cause serious delay.

The Commission's handling of negligence claims, however, is inconsistent with its general philosophy of bankruptcy law. Unfortunately, the Commission's analysis centers "attention on the values involved in the 'open credit economy' as the principal process, or aggregate of processes, with which the bankruptcy process interrelates." It mentions "tort liabilities" and "tort claims" a few times, but the discussion—contrary to the position adopted by the Commission—supports the nondischargeability of negligence claims and their treatment as exceptions to exemptions. Thus:

[T]he bankruptcy process affects the overriding goals of the open credit economy process insofar as most of the debts scheduled in the bankruptcy process arise from transactions between debtor and cred-

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227. See Uniform Commercial Code § 2-719(3); Restatement (Second) of Torts § 406A (1965).


230. Id. §§ 17(a); 57(d); 63(a), (d); 11 U.S.C. §§ 35(a); 93(d); 103(a)(d) (1970).

231. Proposed Act § 4-506(a); § 4-403 and Notes 2, 18-19 to the Section.

232. Bankruptcy Act §§ 57(d), 17(a), 63(d), 11 U.S.C. §§ 93(d), 35(a), 103(d) (1970).

233. Proposed Act § 4-403 and Note 19 to the Section; COMMISSION REPORT, supra note 31, at 213.

234. COMMISSION REPORT, supra note 31, at 68.
itor participants in the open credit economy. Such exceptions as debts for family support obligations, *tort liabilities*, taxes, fines and penalties, and the like represent for the most part the state's protection of special values. To a large extent they are minimally affected by the bankruptcy process because part of the protection is their nondischargeable status.235

And:

[M]any other claims serve specialized values, e.g., family support and tax claims, or have not arisen from voluntary transactions, e.g., *tort claims*. For this class the bankruptcy process must take into account the allocation of the economic burden of the debt.236

The nontort claims that are listed in the above-quoted sections are nondischargeable, and the family support claims mentioned are exceptions to exemptions.237 Finally, the Commission states: "As discussed in the preceding section, nondischargeability should be limited to debts incurred through fraud or similar conduct and to debts, such as family support obligations, the creditors of which as a class can ill afford the loss."238 The Commission's previous discussion referred to here deals with a standard for the allocation of loss which "imposes the burden of a debt on the party better able to bear it."239 In many cases, tortfeasors or their insurers might well be better able to bear the losses caused by their negligence.

Although the Commission does not explain why negligence claims are discharged, it does state why certain claims are nondischargeable.

Family support obligations should be excepted from discharge not only because of the social primacy of family welfare but also because the claimants are unable effectively to pass on the loss. Claims arising from conduct of the debtor egregiously violating community standards, such as claims for fraud, larceny, embezzlement, willful and malicious wrongs, and civil penalties, should not be discharged because social policy directs, impliedly at least, that the debtor should not be able to escape his responsibility through the bankruptcy process.240

But these reasons for nondischargeability might be equally true for negligence creditors. Negligence creditors who are not protected by insurance are not necessarily better able to "pass on the loss" than are dependent family members. And, although negligence may not be as

235. *Id.* at 70 (emphasis added).
236. *Id.* at 78 (emphasis added).
237. *See text accompanying note 204 supra.*
239. *Id.* at 78.
240. *Id.* at 79.
reprehensible—if reprehensibility should even be relevant to this issue in a bankruptcy law—as willful and malicious wrongs, the public policy of tort law clearly makes the negligence tortfeasor liable for his wrongs.

The Commission's emphasis on the role of bankruptcy in our "open credit economy" plus the current act's treatment of negligence claims as dischargeable explains the Commission's approach to negligence claims. To be consistent with the Commission's philosophy, however, negligence claims should be nondischargeable to the extent that the creditors are not compensated by their own or the bankrupt's insurance; insurers of tort creditors should have no rights of subrogation against bankrupt tortfeasors. The bankruptcy court should be given the power to order otherwise exempt property to be taken to satisfy the claim, to reduce the amount of liability to the extent that full payment would cause greater hardship to the bankrupt and his family than to the creditor, and to provide for an exclusive method by which the liability should be discharged—for example, by monthly payments. This course would accommodate the interests of tort creditors and would fulfill the general objective of bankruptcy, insuring a fresh start for debtors. There are instances when a pure "fresh start" concept would contravene other important policies, and it is the opinion of the author that the plight of negligence creditors is often one such instance.

7. Bankrupts With Dependents

Under many state exemption laws, debtors who are the heads of families enjoy substantially greater exemption rights than other debtors enjoy. The "head of family" status may therefore currently mean greater exemptions for bankrupts, depending on the laws of their state. The Proposed Act generally omits the "head of family" distinction, and it grants most exemptions to all bankrupts equally. However, bankrupts with dependents qualify for a greater homestead (or property in lieu of the homestead) exemption; in addition to the basic $5,000, bankrupts are entitled to $500 for each dependent. Moreover, the exemptions of retirement benefits and the proceeds and benefits of life insurance are measured by the extent to which they are "reasonably necessary for the support of the debtor and his dependents." Presumably, bankrupts with dependents will have greater needs than those with none.

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241. See Vukowich, supra note 12, at 844-45.
242. See, e.g., In re Statham, 483 F.2d 436 (9th Cir. 1973); Rietz v. Butler, 322 F. Supp. 1029 (N.D. Ga. 1971). In both of these cases the bankrupts, who were not "heads of families," unsuccessfully argued that denial to them of exemptions granted to heads of families constituted a denial of equal protection.
243. Proposed Act § 4-503(b).
244. Id. §§ 4-503(c) (5)-(6).
8. Creation of Exempt Property on the Eve of Bankruptcy

A problem that has plagued bankruptcy courts in the past is whether a bankrupt may claim an exemption in property exempted under applicable law when that property was procured through an exchange of nonexempt assets in contemplation of bankruptcy. Advising clients to thus take full advantage of exemption laws is common practice in some districts. As a general rule, the cases allow bankrupts exemptions in property so obtained unless the property or assets used to purchase such property were procured through a scheme to defraud creditors. The problem is likely to become accentuated under a uniform bankruptcy exemption law because items of property exempt under state law might not be exempt under the federal law. Debtors might ward off creditors under state law by having property that is exempt under state law and then exchanging it for property exempt under the bankruptcy law on the eve of bankruptcy.

The text of the Proposed Act does not deal with this issue, but a note states that all listed property is exempt “regardless of when acquired or the source of the consideration paid for the property.” The italicized portion will be troublesome in cases where debtors obtain money or other assets on credit with the intention of converting them into exempt property and then filing for bankruptcy. Although any defrauded creditors would likely have a nondischargeable claim against the debtor, the failure to deny an exemption under such circumstances— at least as to the defrauded creditors—may necessitate needless, costly litigation for such creditors. Taking a more sensible approach, the Judges’ Bill expressly provides that “conversion . . . of nonexempt property before the filing of a petition . . . shall not be grounds for denying a claimed exemption, in the absence of actual fraud.” The judges’ approach is preferable because it expressly treats the problem in the law and denies exemptions made possible by fraud. To allow debtors to transform their own assets so as to take full advantage of the exemption law is one thing; to allow them to procure assets from others for that purpose is another.

246. E.g., Wudrick v. Clements, 451 F.2d 988 (9th Cir. 1971); Love v. Menick, 341 F.2d 680 (9th Cir. 1965); In re Dudley, 72 F. Supp. 942 (D. Cal. 1947), aff’d per curiam, Goggin v. Dudley, 166 F.2d 1023 (9th Cir. 1948).
247. E.g., Kangas v. Robie, 264 F. 92 (8th Cir. 1920); In re White, 221 F. Supp. 64 (N.D. Cal. 1963); see S. Riesenberg, Creditors’ Remedies and Debtors’ Protection 566 (2d ed. 1975); Kennedy, supra note 6, at 477-79 & nn.144-45.
248. Proposed Act § 4-503 n.2 (emphasis added).
249. See cases cited note 247 supra.
250. Proposed Act § 4-506(a)(2)-(3).
251. Judges’ Bill § 4-503(f).
9. Preferential and Fraudulent Transfers of Exempt Property

Presently, transfers of exempt property to a creditor in satisfaction of a debt and to a third party without fair consideration are neither preferences nor fraudulent conveyances. The rationale given for this result is that creditors, and therefore the trustees in bankruptcy, have no grounds to complain about such transfers since the collectible assets in the debtor’s estate have not been diminished. The Proposed Act is designed to change this situation. The Commission’s position is sound. First, the results reached by the cases which will be overruled by the Proposed Act are mandated by neither preferential transfer nor fraudulent conveyance statutes. Second, these cases rely upon a factor that is irrelevant: the policy reason for granting exemptions is not to deny creditors collection rights; rather it is to protect debtors and their families. Once the debtor has transferred the property, however, the policies of debtor rehabilitation and family protection can no longer be achieved.

Being fraudulent conveyances and preferential transfers under the Proposed Act, the otherwise exempt assets will be recoverable by the trustee. Property so recovered may not be claimed as exempt by bankrupts. These provisions make assets which were previously beyond the trustee’s reach available for creditors.

A troublesome situation is presented, however, in the common case of a fraudulent conveyance to a dependent. In such cases, the debtors’ action comports with the policies of the exemption laws. Frequently, such conveyances might be made by debtors in ignorance of their exemption rights, the conveyance having been seen as the only way of preserving the asset for the family’s protection. In such a situation, the exemption policy would be served by allowing the exemption to the

252. E.g., In re Smith, 366 F. Supp. 1213 (D. Idaho 1973); Cross v. Commons, 336 Mich. 665, 669, 59 N.W.2d 41, 43-44 (1953); see 3 Collier on Bankruptcy ¶¶ 60.13, 60.25.


255. See Proposed Act § 4-607 and Note 9 to the Section; § 4-608 and Note 2 to the Section; Commission Report, supra note 31, at 204.


257. See V. Countryman, supra note 228, at 162-63.


259. Proposed Act § 4-503(h). An exception to this is if the exempt property was transferred as security for a debt. The exemption may then be claimed “only to the extent the value of the property exceeds the debt” and the trustee succeeds to the rights of the transferee-creditor.
debtor notwithstanding the conveyance or by allowing the dependent to retain the property.

10. "Practical" Exemptions Curtailed

Under current law, bankrupts often are entitled to retain interests in property beyond their exemption rights. This occurs because the property interest of the bankrupt is of such a nature that the trustee does not succeed to the interest under Section 70(a) of the current act. The two most common types of interests bankrupts retain are benefits under a spendthrift trust and property held as tenants by the entirety. The result generally is that debtors who own such assets and reside in states whose laws prohibit the assignability and attachment of such assets are entitled to these assets in addition to their exempt assets.

The Proposed Act would alter the current law. It provides that the trustee succeeds to "all property of the debtor," with certain minor exceptions. This would include the undivided interest of a spouse who is a tenant by the entirety. It also includes interests in spendthrift trusts, but bankrupts would be allowed to retain interests in such trusts "to the extent of the income reasonably necessary for the support of the debtor and his dependents,..." "This equates the treatment of beneficial interests which the debtor did not create and could not transfer...."

260. See Plumb, supra note 6, at 96-137.
262. The proposed law provides for the trustee's succession to the "community property of the debtor and his spouse which is generally liable for the debtor's postnuptial contractual debts (other than those incurred for necessaries or as agent for his spouse) and other community property of the debtor and his spouse to the extent it is liable for any allowable claim (other than a debt for necessaries or one incurred as agent for his spouse) in the case." Proposed Act § 4-601(a)(A); see Plumb, supra note 6, at 104-13.
264. In re Kearns, 8 F.2d 437 (4th Cir. 1925), cert. denied, 269 U.S. 587 (1926); see Harris v. Manufacturers Nat'l Bank, 457 F.2d 631 (6th Cir. 1972); Shipman v. Fitzpatrick, 350 Mo. 118, 164 S.W.2d 912 (1942); S. Riesenfeld, supra note 247, at 536-37. However, the trustee succeeds to the property when both husband and wife are adjudicated bankrupts in consolidated proceedings. Roberts v. Henry V. Dick & Co., 275 F.2d 943 (4th Cir. 1960).
Unliquidated claims for personal injury have also been held not to pass to the trustee. In re Schmelzer, 350 F. Supp. 429 (S.D. Ohio 1972); In re Budn, 323 F.2d 748 (7th Cir. 1963). If state law allows the assignment or creditors' attachment of such claims, however, they do pass to the trustee. Carmona v. Robinson, 336 F.2d 518 (9th Cir. 1964); In re Calestini, 321 F. Supp. 1313 (N.D. Cal. 1971). Personal injury claims are expressly exempted by the Proposed Act. Proposed Act § 4-503(c)(8).
266. Id. § 4-601(b).
with related exemptions, \textit{e.g.}, pensions.\textsuperscript{267} Thus, the practical exemptions of realty held as tenants by the entirety would be terminated; of course, the interest in the realty might be exempt under Section 4-503 as a homestead, but it would be subject to Section 4-503's value limitation. The interest in spendthrift trusts might be exempt, depending on the needs of the bankrupt and his dependents, other exemptions, and other sources of income.

Bringing these assets into the estate and providing an exemption for them if and to the extent they comply with the exemption policy represents a desirable change. The effect will be to make more assets available to creditors but in doing so will not upset the rehabilitative and family protection goals of the bankruptcy law.

\section{Conclusion}

The Commission's proposed uniform exemption provision represents one of the major reforms of the Proposed Act. Although the proposal contains some weaknesses, it is generally sound and should be adopted by Congress. The exempt property bankrupts would be allowed to retain is generally reasonable in quantity and kind. The Commission's limitation of the life insurance exemption by reference to the cash value actually available to bankrupts is an improvement over state law treatment of this exemption; furthermore, the size of the exemption properly reduces the exorbitant or unlimited exemption given by most states. The need and desirability of a homestead exemption are doubtful, but the Commission's homestead proposal is modest. A variety of other provisions are designed to better achieve the goals of rehabilitation and family protection.

The most positive aspect of the proposal, however, is that it will apply to all bankrupts. The disparate treatment of bankrupts because of their different residences under the present act will cease. For bankrupts in states with exemptions that are less than those in the Proposed Act, this will mean that bankrupts would have more assets with which to begin a "fresh start." In states with exemptions that are greater than the Proposed Act, creditors will have more assets to satisfy their claims. These effects are desirable and proper, for bankruptcy is designed to provide debtor rehabilitation and family protection as well as to insure fair treatment of creditors.

Despite its strengths, the Proposed Act could be improved by changes and clarifications. Most importantly, the law should clarify what rights creditors with nondischargeable claims should have against

\textsuperscript{267} \textit{Id.} \ § 4-601 and Note 5 to the Section.
Section 4-503 assets and how those rights should be enforced. In addition, the treatment of negligence claims should be reconsidered—if it was ever separately considered at all.

The Proposed Act may also have effects beyond bankruptcy. Because the Commission's exemptions vary from state exemptions, states might conform their exemption laws more closely to the Proposed Act. Otherwise, the disparity between bankruptcy and state exemptions may be a separate, additional cause of bankruptcies. In fact, efforts are under way for the formulation of a "Uniform Exemption Act" by the National Conference of Commissioners on Uniform State Laws. In addition to possible reform on the state level, it is hoped that consideration of an exemption policy in bankruptcy will move Congress to evaluate all of the federal exemptions, many of which appear to be unjustified. Some exemptions present policy conflicts with others, and the Internal Revenue Code exemptions are unduly harsh on debtors. Even if this broader reform is not forthcoming, however, Section 4-503 warrants enactment.