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A Fresh Start to Bankruptcy Exemptions

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Bankruptcy has broadly failed to deliver "fresh starts" to debtors. Too often, debtors return to states of financial distress following bankruptcy. Although bankruptcy delivers a clean slate through the discharge of debts, the efficacy of a fresh start depends on a second factor: property exemptions. While discharge frees a debtor from her existing debts, property exemptions determine what property the debtor retains upon exiting bankruptcy. For many debtors, insufficient and suboptimal property exemption laws undermine fresh starts. In fact, under current bankruptcy law, each state can reject federal bankruptcy exemptions by opting out. Bankrupt debtors in "opt-out" states are forced to rely on general state exemptions—often stingy and focused on preserving homesteads—that were not designed for bankruptcy.

Existing literature explores two lines of criticism against the federal opt-out provision: (1) arguing that the law should be struck down as repugnant to constitutional notions of uniformity, supremacy, or both, and (2) making the case for repeal on normative and fairness grounds. For decades, neither solution has been forthcoming. The opt-out scheme, at first aberrant and controversial, has proved a perdurable feature of bankruptcy law.

This Article advances a different approach and proposes diffusive, state-based reform solutions. Under this approach, each opt-out state would undertake a meaningful review of its existing exemptions regime in light of the federally declared rehabilitative function of bankruptcy. I propose a model, to be used in this review, involving three factors—

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housing agnosticism, nominal sufficiency, and allocative flexibility—as a conceptual framework for reforms. Addressing constitutional concerns, this Article argues that these innovative "bankruptcy-specific exemptions" schemes should survive constitutional scrutiny. The Article ends with discussion of the model and proposed reform framework.

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INTRODUCTION

Exemptions play a prominent role in bankruptcy[1] by determining what property a debtor can keep. Traditionally creatures of state law, exemptions prevent unsecured creditors from seizing or forcing the sale of a debtor's property. In bankruptcy, exemptions operate in the same way by determining the types and amounts of property that can or cannot be sold by the trustee. In typical Chapter 7 cases, the trustee liquidates a debtor's interest in unencumbered non-exempt assets.[2] What is left over, the debtor retains.

Property exemptions implicate a strong federal interest when a debtor files bankruptcy. That interest is the "fresh start." The "fresh start" concept, now deeply entrenched in the bankruptcy psyche, was first discussed by the United States Supreme Court in *Local Loan Co. v. Hunt*, where the Court emphasized the rehabilitative function of bankruptcy.[3] Central to a "fresh start" is the discharge in bankruptcy, which frees a debtor's future income

1. This Article explores exemption policies in the context of an individual filing liquidation bankruptcy under Chapter 7 of the Bankruptcy Code.

2. Because exemptions cannot generally impair properly perfected security interests, only a debtor's equity in assets is protected by an exemption. Stated another way, exemptions protect assets from seizure by unsecured creditors. A simple example is illustrative. Assume there are two debtors living in a jurisdiction providing a $5,000 exemption for a motor vehicle. Each debtor owns a motor vehicle worth $7,500. Both debtors owe $10,000 in unsecured debt to Credit Card Corporation. Debtor *A* has no secured debt, while Debtor *B* has a single secured loan in the amount of $4,000 secured by a perfected security interest in his motor vehicle. Because exemptions protect a debtor's equity, Credit Card Corporation (or, in bankruptcy, the Trustee as proxy for the unsecured creditors) can use the legal process to seize Debtor *A*'s car (equity of $7,500 exceed exemption of $5,000) while it cannot seize Debtor *B*'s car (equity of $7,500 minus $4,000 equals $3,000, which is fully protected by the $5,000 exemption).

3. Local Loan Co. v. Hunt, 292 U.S. 234, 244 (1934) ("[Bankruptcy] gives to the honest but unfortunate debtor who surrenders for distribution the property which he owns at the time of bankruptcy, a new opportunity in life and a clear field for future effort, unhampered by the pressure and discouragement of preexisting debt.").

from existing creditor claims. As noted by Professor Thomas Jackson, a discharge preserves a debtor's "human capital."[4]

While discharge frees a debtor's future income from existing creditor claims, the discharge alone does not define the "fresh start." A related, and often coequal, component of the "fresh start" is property exemptions. What property should a debtor be entitled to keep to begin his post-bankruptcy trek toward rehabilitation? The answer to this question can determine the efficacy of the "fresh start." A debtor freed from creditor claims but left in an abject state of balance sheet poverty faces higher hurdles to rehabilitation than a debtor left with substantial property. This difference is particularly acute when the types of property held by the latter debtor enable him to seek and sustain employment. Simply put, a discharged debtor with a car, computer, and applicable "tools of the trade" is in a superior position to mount a "comeback" than a similarly situated discharged debtor retaining little to no property. While discharge enables a fresh start, exemptions determine the location of the starting line in the debtor's race toward rehabilitation following bankruptcy.

Congress weighed in on where the starting line should be in 1978. Following nearly a century of silence on the question of what specific exemptions should apply in bankruptcy,[5] Congress passed a detailed set of federal bankruptcy exemptions in § 522(d) of the Bankruptcy Code. These federal exemptions were more generous to debtors than most state exemptions, and they included a so-called "wild card" exemption mechanism making them even more favorable to debtors.[6] Categories of property

4. Thomas H. Jackson, *The Fresh-Start Policy in Bankruptcy Law*, 98 HARV. L. REV. 1393, 1396 (1985). "Our bankruptcy statutes have always taken 'discharge' to mean, essentially, that an individual's human capital (as manifested in future earnings), as well as his future inheritances and gifts, are freed of liabilities he incurred in the past." *Id*.

5. Under the bankruptcy law passed in the form of the 1898 Act, in effect from 1898 until 1978, Congress completely delegated exemptions policy to the states by simply incorporating state exemptions into bankruptcy. *See infra* Section I.C.2.

6. In order to provide a debtor with a certain amount of flexibility with respect to claiming exemptions, the Bankruptcy Code contains a "wild card" exemption codified at § 522(d)(5). 11 U.S.C. § 522(d)(5) (2012). This exemption is commonly referred to as a "wild card" exemption because it enables a debtor to essentially select any type of property to exempt up to $11,500, provided that the debtor has not used all of the homestead exemption contained in § 522(d)(1). *Id.* § 522(d)(1). *See* James C. Mordy, Brian H. Dunn & Melanie Mann Johnson, *Constitutionality of "Opt-Out" Statutes Providing for Exemptions to*

were included to protect certain dollar amounts in a debtor's homestead, motor vehicles, household goods and furnishings, jewelry, and the like.[7]

After clearly articulating its vision of the appropriate exemptions level in bankruptcy, Congress undermined it by allowing states the right to "opt out" of the federal exemptions.[8] The line was drawn, but Congress provided states with erasers. Predictably, this odd "line plus erasers" structure was the result of a political compromise between the House and Senate.[9] Since passage of the Code, exemptions are now determined under this concurrent system—federal exemptions apply in bankruptcy, unless the debtor's state has opted out, in which case exemptions are determined by state law.[10] Over two-thirds of states opted out of federal bankruptcy exemptions, leaving Congress's determination of appropriate exemptions available to residents of only thirteen states.

Following enactment of the Code, scholars and commentators leveled searing criticisms of the concurrent exemptions system in bankruptcy. Some attacked the constitutionality of the "opt out" provisions on the bases of the Bankruptcy Clause's call for "uniform Laws," the Supremacy Clause, or both. Prominent in these criticisms was the argument that debtors in "opt out" states

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Bankrupts, 48 MO. L. REV. 627, 630 (1983). The wild card exemption is applicable to any property the debtor has, and effectively allows the debtor to use any "unused" portion of the § 522(d)(1) homestead exemption. For example, if a debtor is unable to claim a homestead exemption under § 522(d)(1) because the debtor does not currently own a home, the debtor may apply the unused portion of that exemption to *any* property the debtor wishes to exempt. *See* WILLIAM HOUSTON BROWN, LAWRENCE R. AHERN, III & NANCY FRAAS MACLEAN, BANKRUPTCY EXEMPTION MANUAL § 5:6 (2012 ed.). "By utilizing the wild card provision, the non-homeowner, or the homeowner with minimal equity in his property, can avail himself of the homestead exemption by exempting valuable property to the extent of the unused portion of that exemption." Mordy, *supra*, at 630. Essentially, the unused homestead exemption "spills over" to other property in order to make up for the debtor's lack of ability to take advantage of the homestead exemption. Section 522(d)(5) may be applied to any property of the debtor and there is no limitation with regard to the type of property that may be exempt using this wild card exemption. *Id*. The main purpose of this wild card exemption, according to Congress, is to eliminate the prior discrimination against non-homeowner debtors. *Id.*

7. *See* 11 U.S.C. § 522(d).

8. *See id.* § 522(b)(2).

9. *See infra* Section I.C.2.

10. Most non-opt out states retained their own exemption schemes, permitting a debtor filing bankruptcy to choose federal exemptions or state general exemptions.

were being deprived of the same "fresh start" afforded to debtors in states permitting federal exemptions. In terms of solutions to this problem, two primary arguments were advanced: (i) advocating that the Court determine the opt-out provision unconstitutional (thereby rendering the federal exemptions available in every bankruptcy case) or (ii) calling on Congress to amend § 522 by removing the opt-out and imposing uniform federal exemptions on all states.

For over three decades since passage of the Code, neither solution has been forthcoming. The Court has shown no appetite for taking up arguments in favor of striking down the opt-out provision, and Congress has made no serious attempt to amend § 522 by making federal exemptions mandatorily available in bankruptcy.

This Article proposes a third solution: widespread state enactment and liberalization of exemptions specifically designed for debtors in bankruptcy. Using so-called bankruptcy-specific exemptions, states should provide tailored exemptions to flush the starting lines for debtor rehabilitation. This Article argues that each opt-out state should move toward providing a comprehensive set of exemptions for bankrupt debtors. The argument entails two fundamental points: (i) explaining how and why state bankruptcy-specific exemption schemes are constitutional under the Bankruptcy Clause and Supremacy Clause and (ii) proposing a conceptual model for state legislatures to follow in crafting reforms. The model includes three factors: eliminating or minimizing discrimination against non-homeowners, providing nominally sufficient dollar amounts, and reducing the rigidity of property classifications to permit debtors to protect more types of property.

I. EXEMPTIONS AND BANKRUPTCY

My basic thesis: General state exemption schemes largely fail to serve the rehabilitative function[11] of federal bankruptcy law

11. Ideally, an empirical study would be necessary to prove an actual causal relationship between the federal exemptions providing a more efficacious fresh start base than competing state exemptions providing less dollar amounts and less flexible categories. None has been published. To fill this gap, this Article relies on the premise that an

because they were designed for other purposes. This divergence in purposes is illustrated by examining the justifications for general state exemptions versus federal bankruptcy exemptions. Further support for this thesis is found in using the Contracts Clause as a lens through which to review the reasons states have general exemptions laws and the constitutional limits on states' power to achieve debtor rehabilitation.

A. Divergent Purposes

A common critique of the existing concurrent exemptions scheme is that many state exemptions are "less generous"[12] than the federal bankruptcy exemptions. Under general federalism principles, states can define property rights, including the contours of exemptions, as they see fit. Many states prefer generous homestead exemptions while others focus on protecting other asset classes such as retirement accounts, tax refunds, and the like.

When a resident of a state files bankruptcy, however, an important federal interest is triggered. The rehabilitative function of bankruptcy, ensconced in the "fresh start," arises. States choosing to veto federal exemptions leave bankrupt residents with existing bankruptcy-neutral state exemptions. Can these bankruptcy-neutral exemptions play an appropriate role in delivering a fresh start? Do they?

The divergent purposes of bankruptcy versus bankruptcy-neutral exemptions provide powerful clues to the answer.

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exemption scheme that permits a debtor to retain higher dollar amounts of more congruent types of property provides a stronger fresh start foundation than one that does not. By way of example, for two similarly situated debtors who have unencumbered interests in a motor vehicle and tools of the trade, an exemption scheme providing protection of these interests puts the debtor in a superior position for future rehabilitation than the competing scheme that permits the bankruptcy trustee to repossess and sell these items.

12. This phrase, used in much of the literature, is oversimplified. Assume an exemption regime that allows a debtor to keep an aggregate amount of $35,000 among items of personal property such as household goods, motor vehicles, computer equipment, tools of the trade, etc. Compare that regime to a competing regime that provides zero exemptions for personal property but a homestead exemption of $40,000. The oft-used "generous" measure would label the former scheme as "less generous." Perhaps it is. But with respect to the fresh start, the former is arguably more generous, as it protects types of assets which, retained, could enable a debtor to seek or advance employment in an effort to rehabilitate.

State exemptions are not constructed to enable a debtor's rehabilitation. Rather, state exemptions serve other purposes. Chief among these purposes: (i) preventing debtors from becoming wards of the state, (ii) providing a guarantee of some minimal level of subsistence, and (iii) serving the societal function of preserving families. These justifications and purposes, explored below, are collectively referred to as the "Independent Subsistence Function" of state property exemptions.

Preventing debtor dependence on state benefits is an important prong of the Independent Subsistence Function. Legislatures answer the question of whether losses from debtors unable to pay their bills should be allocated to unsecured creditors (prevented from seizing and selling exempt property) or to the state in the form of transfer payments and social welfare benefits. Maintaining some level of property exempt from creditor seizure favors the state by decreasing the number of debtors becoming public charges.[13]

In adopting exemptions, states typically seek to establish a subsistence "floor" for debtors. In Georgia, for instance, the "purpose and reason for the enactment of the exemption statutes was to allow the family of the debtor to retain at least some items . . . in order that the family might have the barest essentials for human existence."[14] Among state exemptions, homestead provisions are often connected to preservation of the family structure. In enacting homestead exemptions, state legislatures rely on public policy considerations, including maintaining the stability of families. The "preservation of the home is of paramount importance because there the family may be sheltered and preserved."[15]

In sharp contrast, the paramount justification for federal bankruptcy exemptions is the debtor's interest in retaining property to

13. *See, e.g.*, Cadle Co. v. Pegasus Ranch, Inc., 920 So. 2d 1276, 1278 (Fla. Dist. Ct. App. 2006) (citing Slatcoff v. Dezen, 76 So. 2d 792, 794 (Fla. 1954) (en banc)).

14. Rietz v. Butler, 322 F. Supp. 1029, 1031 (N.D. Ga. 1971).

15. *In re* Rutland, 318 B.R. 588, 590 (Bankr. M.D. Ala. 2004) (quoting First Ala. Bank v. Renfro, 452 So. 2d 464, 468 (Ala. 1984)). In Iowa, the homestead benefit seeks to secure the "social benefit which accrues to the state by having families secure in their homes." *In re* McClain's Estate, 262 N.W. 666, 669 (Iowa 1935).

enable a meaningful opportunity at a "fresh start."[16] This justification is the "Fresh Start Function."[17] Much of this justification has resulted from the evolution and maturation of bankruptcy law from a strictly creditor-centered liquidation procedure to a mechanism for individuals to seek relief and restoration. Concerns about providing debtors a path to "fresh starts" were of paramount importance in the debate leading to the enactment of the Bankruptcy Reform Act of 1978, now referred to as the Bankruptcy Code. The focus on "fresh starts" enjoyed a conspicuous start of its own.

Specifically, in 1970, Congress created the Commission on Bankruptcy Laws (the Commission) to "study, analyze, evaluate, and recommend" changes to the bankruptcy laws.[18] "The Commission's study, analysis, and evaluation shall include a consideration of the basic philosophy of bankruptcy . . . and all other matters which the Commission shall deem relevant."[19] Between the findings and recommendations of the Commission, and the legislative process that ensued, one consensus was clear: exemptions in bankruptcy were viewed as integral to the "fresh start."

In 1973, the Commission issued its report to Congress and recommended a revised Bankruptcy Act.[20] In that report, the Commission identified two equally important functions of bankruptcy law: (i) to continue the orderly credit economy in the event of a debtor's inability or unwillingness to pay his debts and (ii) rehabilitate debtors for "continued and more value-production

16. While the legislative record preceding enactment of the federal exemptions contains references to concerns that debtors in bankruptcy avoid complete destitution, the fresh start was the defining policy justifying federal exemptions in bankruptcy. *See infra* notes 41–44 and accompanying text.

17. To be sure, the legislative record in the debate about bankruptcy exemptions contains references to some congressional concerns about debtors avoiding destitution. In this sense, the Independent Subsistence Function and Fresh Start Function are not completely mutually exclusive. The concern about debtor rehabilitation is, however, a peculiarly federal policy.

18. S.J. Res. 88, 91st Cong. (1970).

19. *Id*.

20. H.R. DOC. NO. 93-137, pts. I, II, and III (1973) [hereinafter COMMISSION REPORT].

participation, i.e., to provide a meaningful 'fresh start.'"[21] Tellingly, the report observed that:

> The primary function of the bankruptcy system is to continue the law-based orderliness of the open credit economy in the event of a debtor's inability or unwillingness generally to pay his debts. . . . The second function of the bankruptcy process, on a par with the first, is to rehabilitate debtors for continued and more value-productive participation, *i.e.*, to provide a meaningful "fresh start."[22]

The Commission recommended "exclusive federal exemptions" because such uniformity would avoid "the unfairness of existing state exemption laws, most of which are archaic, some of which . . . are exceedingly niggardly, particularly as to urban residents."[23]

In many instances, the Commission drew explicit links between exemptions in bankruptcy and the "fresh start." Congress took note, and the legislative hearings surrounding the exemptions debate reflected a strong concern for the effect on "fresh starts."[24] The House version incorporated the recommendations of the Commission and included federal uniform bankruptcy exemptions. The House bill did not permit states to veto the federal exemptions.

Proponents of the competing Senate bill argued, however, that states should continue to control exemptions. The Senate bill backers saw the House bill and the attendant federal exemptions as bestowing "instant affluence" on bankruptcy debtors. The Senate bill carried forward the Bankruptcy Act provision deferring to "non-bankruptcy law" as the source of exemptions. The resulting compromise, later codified in § 522, provided uniform federal exemptions along with an "opt out" feature for states, a political settlement described as a "strange compromise . . . [leading] to a bizarre result."[25]

21. *Id.* at 71.
22. *Id.*
23. *Id.* at 171.
24. For a more thorough review of the Commission and related legislative history, see *infra* Section I.C.2.
25. Richard I. Aaron, *The Bankruptcy Reform Act of 1978: The Full-Employment-for-Lawyers Bill, Part II: Consumer Bankruptcy*, 1979 UTAH L. REV. 175, 183 (1979).

Some defenders of the opt-out provision assumed that as part of deliberating and arriving at the decision to opt out, states would be occasioned to "reexamine" their own exemption schemes. While it is unclear how many states undertook a reexamination, virtually no opt-out state undertook meaningful efforts at exemption reform as part of enacting opt-out legislation. As a result, exemptions justified by and seeking to serve the Independent Subsistence Function, rather than the Fresh Start Function, remain the only exemptions available to bankrupt debtors in many opt-out states.

B. States Without Power to Grant Fresh Starts

It is not surprising that state exemptions were not designed to advance the Fresh Start Function. In fact, states lack a fundamental constitutional power that would permit an exemption to serve this function: because states cannot impair contractual rights of creditors, states do not have the power to grant a discharge. Only the federal government has such power.

The Contracts Clause states that "[n]o State shall . . . pass any . . . Law impairing the Obligation of Contracts . . . ."[26] Chief Justice Marshall succinctly summarized the general purpose of the Contracts Clause:

> The power of changing the relative situation of debtor and creditor, of interfering with contracts, a power which comes home to every man, touches the interest of all, and controls the conduct of every individual in those things which he supposes to be proper for his own exclusive management, had been used to such an excess by the state legislatures, as to break in upon the ordinary intercourse of society, and destroy all confidence between man and man. This mischief had become so great, so alarming, as not only to impair commercial intercourse, and threaten the existence of credit, but to sap the morals of the people, and destroy the sanctity of private faith. To guard against the continuance of the evil was an object of deep interest with all the truly wise, as well as the virtuous, of this great

26. U.S. CONST. art. I, § 10, cl. 1.

> community, and was one of the important benefits expected from a reform of the government.[27]

While the prohibition against states impairing contracts is not absolute,[28] the Court has used the Clause to strike down state statutes on this basis.[29] Furthermore, it is clear that "a relatively strict standard of [Contracts Clause] review [extends] to legislative interference with private as well as public contracts."[30] State laws that render contracts "invalid, or releases or extinguishes them[,]" may impair obligations in the constitutionally proscribed sense.[31] Accordingly, any state law granting a debtor discharge from his creditor obligations could be challenged on the basis of a Contracts Clause violation.

As a consequence, states cannot grant debtors an essential ingredient of a fresh start—the discharge. This limitation further illustrates why general state exemptions are not designed to serve the Fresh Start Function. State exemptions do not—indeed, absent bankruptcy, cannot—provide debtors with the clean slate needed to pursue financial rehabilitation. Though exemptions can grant enhanced property rights, states cannot relieve debtors of their obligations to pay existing debts. [32]

27. Home Bldg. & Loan Ass'n v. Blaisdell, 290 U.S. 398, 428 (1934) (quoting Ogden v. Saunders, 25 U.S. (12 Wheat.) 213, 354–55 (1827)).

28. *Id.*

29. *See, e.g.*, *Rediscovering the Contract Clause*, 97 HARV. L. REV. 1414 (1984).

30. *Id.* at 1417.

31. *Blaisdell*, 290 U.S. at 431. Some scholars have discussed the Contracts Clause as prohibiting any law that permitted states themselves to escape paying creditors. For instance, in a recent article exploring the idea of allowing states to file bankruptcy, Professor Skeel noted that "[s]tate bankruptcy might … encounter turbulence under the Contracts Clause, because it would alter existing contracts, which the states themselves ordinarily cannot do." David A. Skeel Jr., *States of Bankruptcy*, 79 U. CHI. L. REV. 677, 707 (2012).

32. With rare exceptions, exemptions protect against claims by unsecured creditors, as most exemptions schemes do not allow impairment of a properly perfected lien held by a secured creditor. For example, 11 U.S.C. § 522(c)(2) reflects the long-standing state law principle that a security interest may not be impaired by a property exemption. One notable exception allows a debtor in bankruptcy to avoid non-possessory, non-PMSI liens that impair her exemptions in certain types of property. 11 U.S.C. § 522(f) (2012). Viewed broadly, when § 522(f) was enacted as part of the 1978 Code, it attempted to shift leverage away from certain secured creditors and toward debtors. This section has been a source of discontent among some academics and practitioners. While Congress amended the language of § 522(f) in 1994 to address some of the textual and functional concerns raised by courts and commentators, critics remained. *See* Lawrence Ponoroff, *Exemption Impairing*

C. Exemptions in Bankruptcy

The subject of exemptions has been addressed in each of the five bankruptcy acts Congress enacted from 1800 to 1978. The constitutional requirement of "uniform Laws" provides a textual signal that exemptions in bankruptcy should enjoy some dimension of uniformity. Early on, it was so. Over the span of the nineteenth century and four bankruptcy acts, the treatment of exemptions in bankruptcy morphed from basic uniform federal exemptions to a hybrid of federal and state exemptions, settling with the Bankruptcy Act in 1898 providing an exemption scheme with no federal exemptions that granted complete deference to exemption laws of the various states. This "state law only" exemption structure survived from 1898 until the 1978 Act. In 1978, Congress enacted the first set of detailed (and uniform) federal bankruptcy exemptions. Each state was, however, empowered to opt out of the federal exemptions. Over two-thirds of the states exercised this power.

1. Historical synopsis of exemptions in bankruptcy: The first four acts, 1800 to 1898

The first three bankruptcy acts were in response to national financial crises, and each was repealed within a few years of passage. Following ratification of the Constitution, the first century of the United States was marked by the general absence, interrupted by brief exceptions, of any national bankruptcy law. Indeed, until 1898, when Congress passed the first "permanent" bankruptcy law, no national bankruptcy law existed in 93 of the first 109 years following ratification.

The original congressional expression of bankruptcy law resulted in enactment of the Bankruptcy Act of 1800. Unsurprisingly, this Act was modeled on British bankruptcy law. The 1800 Act provided federal exemptions that were both limited and uniform.[33] The 1800 Act was repealed after three years[34] and was

Liens Under Bankruptcy Code Section 522(f): One Step Forward and One Step Back, 70 U. COLO. L. REV. 1, 34–37 (1999).

33. Act of Apr. 4, 1800, ch. 19, 2 Stat. 19, *repealed by* Act of Dec. 19, 1803, ch. 6, 2 Stat. 248. Exemptions were limited to necessities such as wearing apparel and bedding. *Id.* at 23.

followed next by the Bankruptcy Act of 1841.[35] The 1841 Act echoed the uniform federal exemptions of the 1800 Act by prescribing bankruptcy exemptions for necessities such as wearing apparel and household furniture not exceeding an aggregate value of $300.00.[36] Neither act permitted state law exemptions in bankruptcy.[37]

State exemptions made an entrance into bankruptcy exemption law with the enactment of the Bankruptcy Act of 1867, which for the first time referred to the exemption laws of states. The 1867 Act introduced a hybrid system of exemptions, providing a uniform set of federal exemptions that were supplemented by the exemption laws of the states. For the first time in American history, state exemption laws played a prominent role in determining the size of the bankruptcy estate available for distribution to creditors. The final nineteenth-century iteration of bankruptcy law was the Bankruptcy Act of 1898, in which Congress completely removed federal exemptions. The 1898 Act required that property exempt in bankruptcy be determined solely by reference to laws of the state of domicile of the debtor. This state-law-only structure for bankruptcy exemptions would continue until the adoption of the Bankruptcy Code in 1978.

2. The (optional) federal exemptions of the 1978 Code

In 1978, the Bankruptcy Code was enacted and included the concurrent federal-exemptions-plus-opt-out structure. This exemption system, never fully debated or vetted, resulted from a last-minute compromise between the House and Senate. The former required uniform federal exemptions as a floor to which states could add, while the latter continued the 1898 Act's deference to states to determine all exemptions in bankruptcy.

Congress essentially ignored the unanimous recommendation of the Commission for mandatory uniform federal exemptions. The

34. *Id.* at 19.

35. Act of Aug. 19, 1841, ch. 9, 5 Stat. 440, *repealed by* Act of Mar. 3, 1843, ch. 82, 5 Stat. 614.

36. *Id.*

37. *See, e.g.*, Rhett Frimet, *The Birth of Bankruptcy in the United States*, 96 COM. L.J. 160, 185–87 (1991).

Commission had recommended that the new federal exemptions displace state exemptions, rendering the latter irrelevant in bankruptcy. Although appealing in some ways, the idea of having an exclusive and uniform set of federal exemptions in bankruptcy poses its own significant challenges and limitations.[38]

a. The commission report and political compromise. An in-depth review of the Commission report (the Report) and legislative history behind the concurrent exemptions scheme provides context and a base from which the role of exemptions as integral to the "fresh start" is confirmed.

The review begins in 1970. In that year, Congress created a Commission on Bankruptcy Laws to study, analyze, and recommend changes in bankruptcy law.[39] The Commission identified two equally important functions of bankruptcy law:

> The primary function of the bankruptcy system is to continue the law-based orderliness of the open credit economy in the

38. Following years of scholarly criticism of the concurrent exemptions scheme of the Code, a second movement began to call for Congress to move to exclusive uniform federal exemptions in bankruptcy. NAT'L BANKR. REVIEW COMM'N, BANKRUPTCY: THE NEXT TWENTY YEARS (Oct. 20, 1997) [hereinafter BANKRUPTCY: THE NEXT TWENTY YEARS], http://govinfo.library.unt.edu/nbrc/reportcont.html. As with the recommendations from the 1970s commission, Congress did not act on the 1997 call for exemptions uniformity and exclusivity at the federal level. One of the basic arguments against forcing uniform federal exemptions on bankrupts relates to the differences in cost of living between the states. If Congress determined that a homestead exemption for a bankrupt is $15,000, is this generous enough in a high cost of living state like Rhode Island or New York? Is $15,000 too generous in a low cost of living state like Oklahoma or Mississippi? Such a uniform rule would be facially "uniform" but practically disuniform in application and outcomes, depending on where a debtor resides. Other costs of imposing a uniform federal set of exemptions are equally concerning, though perhaps less obvious to the casual observer. As explained by Professor Marcus Cole:

> The central point of recognizing the federalist character of bankruptcy law is to highlight the potential value of disparate substantive regimes across states, and the costs incurred by individuals and society when these differences are erased. If the purpose of federalist structures is to provide for a range of free choice among competing regimes for the benefit of individuals, harmonization imposes a cost upon individuals and, in the aggregate, on social welfare. This cost, referred to [] as the 'federalist cost' of harmonizing substantive law, is small when jurisdictions arrive at agreement as to substantive legal rules. The federalist cost is large, however, where the states vary dramatically, as in the case of property exemption law.

G. Marcus Cole, *The Federalist Costs of Bankruptcy Exemption Reform*, 74 AM. BANKR. L.J. 227, 230 (2000).

39. *See* COMMISSION REPORT, *supra* note 20, at 1.

> event of a debtor's inability or unwillingness generally to pay his debts. . . . The second function of the bankruptcy process, on a par with the first, is to rehabilitate debtors for continued and more value-productive participation, *i.e.*, to provide a meaningful "fresh start."[40]

The Commission found that the exemption provision of the state-exemptions-only feature of the Bankruptcy Act of 1898 was ineffective.[41]

The Commission ultimately recommended exclusive federal exemptions beginning with a nucleus of "kinds of property that traditionally have been treated as exempt by state governments" with "appropriate federal maximums."[42] According to the Commission, uniformity would prevent the unfairness of the existing state exemption laws.[43]

Public debate regarding the Commission's proposal brought comments from the National Bankruptcy Conference and the National Conference of Bankruptcy Judges.[44] Both organizations approved of federal uniformity in the exemption area but took the position that "the federal law should only establish a floor, 'leaving the states free to prescribe more generous exemptions for their domiciliaries if they see fit to do so.'"[45] The proposal by the National Conference of Bankruptcy Judges provided uniform federal exemptions as a *floor* with state exemptions available as an alternative.[46] However, the Commission rejected this idea, finding that the differences between generous exemptions states and others were too pronounced and could lead to imbalances among debtors.[47]

The Commission's proposal was introduced in Congress in 1973 and 1974. The subcommittees of the House and Senate

40. *Id.* at 71 (alteration in original).
41. *Id.* at 169.
42. *Id.* at 171.
43. *Id.*
44. *Id.*
45. J. Ronald Trost & Lawrence P. King, *Congress and Bankruptcy Reform Circa 1977*, 33 BUS. LAW. 489, 524 (1978) (quoting *Bankruptcy Act Revision: Hearings on H.R. 31 and H.R. 32 Before the Subcomm. on Civil and Constitutional Rights of the Comm. on the Judiciary*, 94th Cong. app., § 4-503, at 356 (1975–76)) [hereinafter *Bankruptcy Act Revision*].
46. *Id.*
47. *Id.* at 170 (statement of Professor Frank R. Kennedy).

Judiciary Committees held hearings, and witnesses appeared in support of both proposals. At the hearings, a representative of the American Bankers Association and the Consumer Bankers Association stated the following:

> I do not think that you are going to be able to get total uniformity [in exemptions], because I do not believe that States [with exemptions higher than those proposed] are going to be receptive to the reduction in that they feel that it will not afford the proper protection for the consumers or [sic] their States; and conversely I do not feel that some States with lower minimums are going to feel at all comfortable with the positions taken by the higher exemption status.[48]

Other witnesses agreed. "I know there is going to be a lot of opposition in States like Texas and California, where the exemptions are generous . . . ."[49]

The House and Senate completed their hearings, and the House Subcommittee drafted a new bill, introduced in the House in 1977 as H.R. 6.[50] Until this bill, most of the opposition to the federal exemptions had focused on the drawbacks of placing a *ceiling* on state exemptions. H.R. 6 set a federal *floor* for exemptions but permitted states to set higher exemptions. One Congressman noted, when introducing H.R. 6, that "federal exemptions were necessary because 'many states have not rewritten their exemption laws since the 19th Century, most are outmoded and hopelessly inadequate.'"[51] H.R. 6 was replaced by H.R. 8200, which contained essentially the same exemptions. H.R. 8200 set a federal floor for exemptions but permitted debtors to choose those exemptions provided by state and federal non-bankruptcy law as an alternative. The House Report on H.R. 8200 stated the following:

48. *The Bankruptcy Reform Act: Hearings on S. 235 and S. 236 Before the Subcomm. on Improvements in Judicial Machinery of the Comm. on the Judiciary*, 94th Cong. 135–36 (1975) (statement of Walter W. Vaughan).

49. *Bankruptcy Act Revision, supra* note 45, at 358 (statement of Vern Countryman)

50. H.R. 6, 95th Cong. (1977), introduced on January 4, 1977, 123 CONG. REC. 125 (1977).

51. 123 CONG. REC. H21 (daily ed. Jan. 4, 1977) (remarks of Rep. Don Edwards).

> Under current law, what property is exempt is determined under State law. However, some State exemption laws have not been revised in this century. Most are outmoded, designed for more rural times, and hopelessly inadequate to serve the needs of and provide a fresh start for modern urban debtors. The historical purpose of these exemption laws has been to protect a debtor from his creditors, to provide him with the basic necessities of life so that even if his creditors levy on all of his nonexempt property, the debtor will not be left destitute and a public charge. The purpose has not changed, but neither have the level of exemptions in many States. Thus, the purpose has largely been defeated.
>
> Though exemption laws have been considered within the province of State law under the current Bankruptcy Act, H.R. 8200 adopts the position that there is a Federal interest in seeing that a debtor that goes through bankruptcy comes out with adequate possessions to begin his fresh start. Recognizing, however, the circumstances do vary in different parts of the country, the bill permits the States to set exemption levels appropriate to the locale, and allows debtors to choose between the State exemptions and the Federal exemptions provided in the bill. Thus, the bill continues to recognize the States' interest in regulating credit within the States, but enunciates a bankruptcy policy favoring a fresh start.[52]

The Report further noted that an individual debtor may choose between exemption systems. The debtor may choose the federal exemptions or the exemptions that he is entitled to under other federal law or the law of the state of his domicile.[53] H.R. 8200 did not permit states to preempt or veto the federal exemptions.

The Senate introduced a competing bill, S. 2266. This bill provided that exemptions would be governed solely by non-bankruptcy law and thus omitted the House's proposed bill that included a federal exemptions floor. The National Bankruptcy Conference warned the Subcommittee that "S. 2266 would delete or seriously impair most of the provisions in H.E. [sic] 8200 that

52. H.R. REP. NO. 95-595, at 126 (1977), *as reprinted in* 1978 U.S.C.C.A.N. 5787, 6087 (footnote call number omitted).

53. 1978 U.S.C.C.A.N. 6316.

make the debtor's fresh start, a basic bankruptcy concept, more meaningful."[54]

> [One] aspect of a meaningful fresh start is exemptions. Presently, the Bankruptcy Act provides an ineffective System by incorporating the exemption laws of the various states. Many States provide little exemption benefits to a debtor. The House Bill also permits the use of State law, but contains a Federal alternative which assures at least uniform minimum benefits. The Senate Bill returns us to the present system which has proven unsatisfactory, as indicated in the previous hearings before the Senate and House Subcommittees and the Report of the Commission on the Bankruptcy Laws of the United States.[55]

However, proponents of the Senate Bill continued to argue that states should control exemptions.[56] The Senate Judiciary Committee stated in the report on S. 2266 the following: "The committee feels that the policy of the bankruptcy law is to provide a fresh start, but not instant affluence, as would be possible under the provisions of H.R. 8200."[57]

As enacted, § 522(b) was a compromise between the House and Senate proposals. Each state was allowed, ultimately, the power to "opt out" of the federal exemptions.[58] This scheme resulted from a fluky political compromise, under which Congress adopted a concurrent system.[59]

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54. *Id.*

55. *Bankruptcy Reform Act of 1978: Hearings on S. 2266 and H.R. 8200 Before the Subcomm. on Improvements in Judicial Mach. of the S. Comm. on the Judiciary*, 95th Cong. 835 (1977).

56. S. REP. NO. 95-989, at 6 (1978), *as reprinted in* 1978 U.S.C.C.A.N. 5787, 5792.

57. *Id.* ("H.R. 8200 would establish 11 categories of property for the Federal exemption, among which is a homestead exemption of $10,000. Such a provision in joint cases would result in a husband choosing State exemptions while a wife might choose Federal exemptions. Together, they could thus retain after bankruptcy, very substantial amounts of property while their debts would have been discharged.").

58. Technically, the federal exemptions are "bankruptcy specific exemptions," as they are only available in bankruptcy. In this article, "bankruptcy specific exemptions" refer to state law exemptions that apply only in bankruptcy. *See infra* Section III.B.

59. The legislative process resulting in the enactment of § 522 has, itself, attracted critics. For scholars viewing uniformity as a positive restriction on congressional power, deferring exemptions to the states is antithetical to the purpose of the Bankruptcy Clause. For instance, one scholar provided this critical characterization of the legislative process:

b. The 1994 reform effort. Nearly two decades after the Bankruptcy Reform Act of 1978 was passed, Congress faced another movement to enact further reforms and refinements to the Bankruptcy Code. The resulting legislation was the Bankruptcy Reform Act of 1994.

Although none of the 1994 reforms affected the concurrent exemptions scheme of § 522, the legislative process provided an opportunity to revisit the subject of bankruptcy exemptions. The National Bankruptcy Review Commission (the 1994 Commission) was an independent commission established pursuant to the Bankruptcy Reform Act of 1994.[60] The purpose of the Commission included a broad charge to "investigate and study issues relating to the Bankruptcy Code . . . ."[61]

The 1994 Commission issued its final report, entitled *Bankruptcy: The Next Twenty Years*[62] (the 1994 Report), and included

> The legislative history of section 522 reveals an overly deferential attitude to state power and a confused notion of uniformity that beclouded the deliberations of legislators.
>
> . . . .
>
> The opt-out proviso was part of neither the Senate nor House bill but appeared as an excrescence of the final draft of section 522. This draft resulted from a frenzied attempt by an informal conference committee to iron out the differences between the two bills. The conference committee apparently did not consider the constitutionality of the opt-out provision. Concerning the states' authority to reject federal exemptions, Senator DeConcini remarked that 'it was agreed that a Federal exemption standard will be codified but that the States could at any time reject them in which case the State exemption laws would continue to prevail.'
>
> . . . .
>
> History leaves little doubt that the parochial interests enshrined in state exemption laws were among the precise evils impending national commerce and credit addressed by the Framers and are better viewed as the intended victims of an exercise of the bankruptcy power than as its beneficiaries.

Judith Schenck Koffler, *The Bankruptcy Clause and Exemptions Laws: A Reexamination of the Doctrine of Geographic Uniformity*, 58 N.Y.U. L. REV. 22, 92–96 (1983) (emphasis omitted). While the opt-out has been challenged on constitutional grounds, the courts have declined to disturb the opt-out provision. *See In re* Sullivan, 680 F.2d 1131 (7th Cir. 1982), *cert. denied* Sullivan v. United States, 459 U.S. 992 (1982) (opt-out provisions of § 522 are constitutional under the Bankruptcy and Supremacy Clauses). *But see* Tracey Nicolau Bosomworth, *Federal Exemptions and the Opt-Out Provisions of Section 522: A Constitutional Challenge*, 58 IND. L.J. 143 (1982).

60. NAT'L BANKR. REV. COMM'N, *NBRC Fact Sheet*, GOVINFO (Aug. 12, 1997), http://govinfo.library.unt.edu/nbrc/facts.html.

61. *Id.*

62. BANKRUPTCY: THE NEXT TWENTY YEARS, *supra* note 38, at *Table of Contents*.

several reports prepared by various professors and government agencies.[63] One of the reports prepared and attached in the appendix of the 1994 Report was written by Judge William H. Brown and Professor Lawrence Ponoroff. That report, entitled *Analysis of Bankruptcy Exemption Policy*, argued in favor of a national, mandatory federal property exemption scheme, which would "[recognize] that the fresh start in bankruptcy is a matter of federal, not state, concern."[64]

One of the chapters of the 1994 Report, entitled *Property Exemptions*, revisited and discussed the purpose of allowing certain property to be exempted in bankruptcy.[65] Among other things, the report discussed some of the policy reasons supporting exemptions, noting that debtors cannot go to work without clothes nor can they perform their jobs without "tools of their trades."[66] The exemptions provided by the Bankruptcy Code "preserve citizens' ability and incentive to earn and pay taxes."[67] This ensures that citizens are able to be productive members of society.[68]

The 1994 Report traced the history of exemptions in bankruptcy and noted that the role of exemptions had evolved as bankruptcy law had matured.

> As the Bankruptcy Act [of 1898] weathered the evolution of debtor-creditor relations throughout the Twentieth Century, *the goals of the consumer bankruptcy system matured and diverged more sharply from those of state law creditor collection statutes. Although exemptions should not be unnecessarily generous, grossly insufficient state exemptions were inconsistent with rehabilitating failing families and encouraging work and self-sufficiency.*[69]

63. *See id.*

64. WILLIAM H. BROWN & LAWRENCE PONOROFF, *Analysis of Bankruptcy Exemption Policy*, *in* BANKRUPTCY: THE NEXT TWENTY YEARS, *supra* note 38, at app. G(1)(b), http://govinfo.library.unt.edu/nbrc/report/g1b.pdf.

65. NAT'L BANKR. REVIEW COMM'N, *Property Exemptions*, *in* BANKRUPTCY: THE NEXT TWENTY YEARS, *supra* note 38, at 117, http://govinfo.library.unt.edu/nbrc/report/05ccons.pdf.

66. *Id.*

67. *Id.*

68. *Id.*

69. *Id.* at 119 (emphasis added).

The 1994 Report was one of the first sources to note that bankruptcy served different purposes than state collection laws. This acknowledgement reflected the modern role of bankruptcy law in facilitating debtor rehabilitation and the important role exemptions play in furtherance of that goal.

II. LANDSCAPE OF EXEMPTIONS IN STATES

The extent to which exemption dollar amounts of categories still differ among states remains striking. In opt-out states, these state exemptions define what exemptions are available to bankrupt debtors.

Variations among state exemption schemes have a strong historical foundation and reflect, in some cases, "holdovers" from the nineteenth century when many of these schemes were enacted. Efforts to *nationalize* state general exemption standards have fallen flat. Very flat.[70]

The two common variables among state exemptions are the categories and dollar amounts of property protected. In general, the types of property protected by exemptions can be colloquially understood as "consumer property,"[71] with one common and notable exception—"tools of the trade."[72]

70. Organized national efforts to reform state property exemption laws have failed to gain any traction. For instance, in the 1970s, the National Conference of Commissioners on Uniform State laws proposed a Uniform Exemptions Act. Only one state, Alaska, adopted this Model Act. *See* ALASKA STAT. ANN. §§ 09.38.010, .015, .017 (West, Westlaw through Chap. 13 of 2018 Second Regular Legis. Sess.). Intrastate calls for exemption reform continue, though such calls are rare. *See generally* Lee Harrington, *Time for Change: Bringing Massachusetts Homestead and Personal Property Exemptions into the Twenty-First Century*, 4 S. NEW ENG. ROUNDTABLE SYMP. L.J. 1, 11–20 (2009).

71. Expanding Article 2 notions of "goods" to, here, include homesteads.

72. One "nonconsumer" category of an individual's or family's property commonly protected under exemption laws is "tools of the trade." This category is explicitly mentioned in both federal and some state exemptions laws. *See, e.g.*, 11 U.S.C. § 522(d)(6) (2016) (exempting a certain dollar amount of "any implements, professional books, or tools of the trade of the debtor or the trade of any dependent of the debtor"). Some state exemption statutes provide definitional parameters that are broad. For instance, the Texas definition includes "tools, equipment, books, and apparatus, including boats and motor vehicles used in a trade or profession . . . ." TEX. PROP. CODE ANN. § 42.002(4) (West, Westlaw through 2017 Regular Sess. and First Called Legis. Sess.).

A. General, Bankruptcy-Neutral State Exemptions

Most state exemption schemes assign specific dollar amounts to each protected category. For instance, in Wyoming, each person is entitled to exempt, among other things, $2,000 worth of "wearing apparel."[73] In terms of personal property exemptions, other states provide set dollar amounts and allow individuals to "spend" this amount electing items from an approved list of exemptible property. Texas, for instance, provides one of the most generous aggregations for personal property, allowing an individual $50,000 and a family $100,000 budgeted to exempt items from a list including home furnishings, wearing apparel, jewelry, firearms, and "athletic and sporting equipment, including bicycles."[74] Almost no state employs a "wild card" feature, which allows any unused dollar amount in one approved category to be applied to another.[75]

Homestead exemptions, in particular, vary wildly from state to state. For example, Wyoming allows a $20,000 homestead exemption, while Washington has a homestead exemption of $125,000.[76] Nevada has a homestead exemption of $550,000.[77] Famously, some states such as Texas and Florida have unlimited homestead exemptions. At the other end of the spectrum, Virginia's homestead exemption is only $5,000.[78] Similarly, Kentucky and West Virginia both have a homestead exemption of only $5,000.[79]

73. WYO. STAT. ANN. § 1-20-105 (West, Westlaw through 2017 Gen. Legis. Sess.).

74. *See* TEX. PROP. CODE ANN. §§ 42.001–.002.

75. Federal exemptions provide a particularly advantageous "wild card" option. For debtors living in states that have not opted out, a debtor who either (i) does not claim a homestead exemption (read: renters or homeowners with little to no equity) or (ii) claims but does not use the entire federal homestead exemption amount has the option of using the lesser of $11,500 or the amount of unused homestead to exempt "any property." 11 U.S.C. § 522(d)(5). This wild card amount is in addition to other specific categories and amounts listed in § 522(d)(1)–(4) and (6)–(12). *See supra* Section II.C.2.

76. WASH. REV. CODE ANN. § 6.13.030 (West, Westlaw through 2018 Regular Legis. Sess.); WYO. STAT. ANN. § 1-20-101.

77. NEV. REV. STAT. ANN. § 115.010 (West, Westlaw through 2017 Regular Legis. Sess.).

78. VA. CODE ANN. § 34-4 (West, Westlaw through 2018 Regular Legis. Sess. and Sp. Sess.).

79. KY. REV. STAT. ANN. § 427.060 (West, Westlaw through 2018 Regular Legis. Sess.); W. VA. CODE § 38-9-1 (West, Westlaw through 2018 Regular Legis. Sess).

Another important exemption—the exemption for motor vehicles—varies significantly among various states. Alaska has an exemption for motor vehicles of $3,000 if the value of the car is less than $20,000.[80] California's motor vehicle exemption only allows an exemption for vehicles up to $2,300.[81] Florida has one of the lowest, providing only a $1,000 motor vehicle exemption.[82] Georgia, on the other hand, does not have any motor vehicle exemption.[83] Nor does Pennsylvania.

As a general matter, there is neither continuity nor predictability with respect to the exemptions allowed by each state. For example, Rhode Island has large homestead and motor vehicle exemptions, with a $500,000 homestead and a $12,000 motor vehicle exemption.[84] By contrast, not only does Tennessee have a low homestead exemption of only $5,000, it does not have a motor vehicle exemption at all.[85] Pennsylvania does not provide any sort of homestead exemption, instead choosing to provide only a $300 exemption that may be applied to any property of the judgment debtor.[86]

B. State Bankruptcy-Specific Exemption Schemes

Since the passage of the Code, a small handful of states has engaged in marginal experimentation with bankruptcy-specific exemptions.[87] Most of these experiments resulted in modest and narrow bankruptcy-specific exemptions. For instance, Ohio, an opt-out state, enacted a law permitting debtors in bankruptcy to exempt four hundred dollars of "walking around" money in cash

80. ALASKA STAT. ANN. § 09.38.020 (West, Westlaw through Ch. 13 of 2018 Second Regular Legis. Sess.).

81. CAL. CIV. PROC. CODE § 704.010 (West, Westlaw through Ch. 13 of 2018 Regular Legis. Sess.).

82. FLA. STAT. ANN. § 222.25 (West, Westlaw through 2018 Second Regular Legis. Sess.).

83. *See* GA. CODE ANN. § 44-13-1 (West, Westlaw through 2018 Legis. Sess.).

84. *See* R.I. GEN. LAWS ANN. §§ 9-26-4, 4.1 (West, Westlaw through Ch. 30, Jan. 2018 Legis. Sess.).

85. *See* TENN. CODE ANN. § 26-2-301 (West, Westlaw through 2018 Second Regular Legis. Sess.).

86. *See* 42 PA. STAT. AND CONS. STAT. ANN. § 8123 (West, Westlaw through 2018 Regular Sess. Acts 1–27, 30). However, Pennsylvania permits its residents to use federal exemptions in bankruptcy.

87. *See infra* Appendix A for a summary of the state enactments of bankruptcy-specific exemptions and related cases.

or a bank account.[88] Other states provided enhanced exemption rights in bankruptcy for property held in certain legal forms, such as retirement accounts or pensions.[89]

Concerning bankruptcy-specific exemptions, states generally fall into one of two camps. Most states have never formally considered bankruptcy-specific exemptions. A much smaller group of states has enacted modest and narrow bankruptcy-specific exemptions that were later repealed or not expanded. The tepid experimentation of the latter group can be explained, in part, by legal challenges that chilled legislative action. In some cases, courts determined that state bankruptcy-specific-exemption schemes were unconstitutional. Some states responded by repealing the affected statutes. Others simply stopped experimenting with bankruptcy-specific exemptions. In fact, since the late 1990s, Michigan and Delaware stand alone as the only states to have undertaken an effort to pass meaningful, and somewhat comprehensive, reforms.[90]

Constitutional challenges have been leveled against state bankruptcy-specific exemptions on two bases: that such schemes (i) are preempted under the Supremacy Clause and (ii) run afoul of the Bankruptcy Clause's uniformity requirement. In the face of constitutional uncertainty, some states repealed their laws.[91] While impossible to predict or quantify with certainty, efforts in other

88. The pertinent section of the statute provides:

> Every person who is domiciled in this state may hold property exempt from execution, garnishment, attachment, or sale to satisfy a judgment or order, as follows:
>
> . . . .
>
> The person's interest, not to exceed five hundred twenty-five dollars in any particular item or ten thousand seven hundred seventy-five dollars in aggregate value, in household furnishings, household goods, wearing apparel, appliances, books, animals, crops, musical instruments, firearms, and hunting and fishing equipment that are held primarily for the personal, family, or household use of the person . . . .

OHIO REV. CODE ANN. § 2329.66(A), (4)(a), (17) (West, Westlaw through File 66 of 2017–18 Gen. Assembly, 2017 State Issue 1, 2018 State Issue 1).

89. *See, e.g.*, COLO. REV. STAT. ANN. 13-54-104 (West, Westlaw through Ch. 273 of 2018 Second Regular Sess.).

90. *See infra* Sections III.B and C.

91. *See infra* Appendix A.

states were suppressed by conflicting court decisions concerning whether bankruptcy-specific exemptions were constitutional.

III. STATE BANKRUPTCY-SPECIFIC EXEMPTION SCHEMES ARE CONSTITUTIONAL

Since the enactment of the Bankruptcy Code in 1978, state legislative efforts to enact or expand bankruptcy-specific exemptions have occurred in an environment attended by uncertainty. Much of this uncertainty springs from somewhat unresolved questions concerning the constitutionality of these schemes.[92]

A. Prevailing "Permissive" Conception of Uniformity

The text of Article I, Section 8, Clause 4 of the Constitution provides that Congress shall have the power to establish "uniform Laws on the subject of Bankruptcies throughout the United States."[93] The historical context surrounding the inclusion of this language in the Constitution is important, though not particularly enlightening. A fair characterization would stamp the Bankruptcy Clause as a late addition to the Constitution. The meaning and import of "*uniform* Laws" has been the subject of much debate. Does "uniform" expand the power granted Congress, or does it serve as a restriction on that power? In essence, the Court has adopted a construction of "uniform" consistent with the expanded power theory: Congress has the

92. One dynamic present in analyses of the constitutionality of these state laws is the fact that they are, in fact, state laws. In the context of uniformity scrutiny, the Bankruptcy Clause affects congressional actions, not state actions. For purposes of this article, a simplified method of viewing constitutional challenges to state laws involves framing the challenges as challenges to § 522 inasmuch as that section provides for the delegation of both the opt-out decision as well as determination of appropriate exemptions to states. Viewed this way, many of the attacks on state bankruptcy-specific exemptions actually challenge the constitutionality of Congress's delegation of these decisions to the states within the construct of § 522. This distinction, while important and necessary, has been glossed over by some courts. For instance, in determining that Indiana's law survived a uniformity challenge, a bankruptcy court simply concluded that the challenge "fails to recognize that the Uniformity Clause is not a restriction upon the states." *In re* Cross, 255 B.R. 25, 31 (Bankr. N.D. Ind. 2000). The court did not analyze whether the delegation in § 522 could constitutionally permit a state to pass a bankruptcy-specific exemption law. *Id.*

93. U.S. CONST. art. I, § 8, cl. 4.

power to impose uniform bankruptcy laws that displace state laws.

1. Doctrine of geographical uniformity

In 1902, the Court in *Hanover National Bank v. Moyses* pronounced geographic uniformity as the outer limit of any uniformity restriction posed by the Bankruptcy Clause.[94] Later cases eroded the efficacy of geographic uniformity as a limit, as the Court confirmed bankruptcy laws that appeared to violate the doctrine. Tellingly, the Court has only invoked uniformity to invalidate a bankruptcy law on a single occasion: striking down a bankruptcy law that, on its face, only applied to a single company. The construction of uniformity as a power[95] was recently invoked by the Court to rationalize excepting state claims of sovereign immunity from effect in bankruptcy proceedings.

Although the contours of uniformity have been meted out in a handful of cases, the Supreme Court has not directly addressed the effects of uniformity on bankruptcy exemptions since *Moyses* in 1902. Indeed, the Bankruptcy Clause's requirement of "uniform Laws" in the specific context of bankruptcy exemptions has seldom been probed.

Some early evidence supports the conclusion that the Framers intended "uniform Laws" to prohibit delegation of bankruptcy exemption determinations to the states.[96] The earliest bankruptcy acts (in 1800 and 1841) were consistent with this restrictive interpretation by providing uniform federal bankruptcy exemptions to the exclusion of state exemptions.[97] Soon after the Civil War, Congress passed the third bankruptcy act (in 1867) that included a provision incorporating the exemptions laws of the states for the first time.

94. Hanover Nat'l Bank v. Moyses, 186 U.S. 181, 188 (1902).

95. Formulating "uniform" as a source of enhancement to, rather than a restriction on, Congress's power under the Bankruptcy Clause has been explored by some commentators. For instance, Judge Randolph Haines argues in favor of the power enhancement conception. Randolph J. Haines, *The Uniformity Power: Why Bankruptcy Is Different*, 77 AM. BANKR. L.J. 129 (2003). In supporting his conclusion, Judge Haines focused on the text, structure, context, and history of the language of the Bankruptcy Clause. *Id.* at 165–70.

96. *See id.*

97. *See id.*

The 1867 Act introduced a hybrid system of base federal exemptions that added state law exemptions. The three earliest bankruptcy acts were short-lived, and each was repealed within a few years of being enacted.

In 1898, Congress passed a bankruptcy act that entirely omitted federal exemptions and relied completely on the exemption laws of the states. The 1898 Act continued in force until Congress passed the Code in 1978. In response to an early constitutional challenge to the 1898 Act, the Court in *Moyses* upheld the constitutionality of incorporation of state exemptions in bankruptcy,[98] establishing the doctrine of geographical uniformity as the standard for uniformity challenges.[99]

a. Moyses *sanctified non-uniform state laws in bankruptcy. Moyses* involved a constitutional challenge to a feature of the Bankruptcy Act of 1898 that incorporated state law exemptions of the state where a bankruptcy case was filed.[100] The debtor had moved from Missouri to Tennessee, and he filed bankruptcy in Tennessee claiming the property exemptions provided by that state's laws. The debtor was granted a discharge using Tennessee exemptions. The debtor's bank claimed that the Act was unconstitutional and violated the uniformity requirement by allowing incorporation of state exemption laws. The Court rejected the bank's "personal uniformity" argument and announced that "uniformity is geographical."[101] The Court explained that constitutional uniformity is satisfied "when the trustee [in bankruptcy] takes in each state whatever would have been available to the creditor if the bankrupt law had not been passed."[102] Uniformity is not destroyed by states having different exemption laws, as the "general operation of the law is uniform although it may result in certain particulars differently in different states."[103]

Because geographical uniformity is not "personal," Congress was liberated to pass bankruptcy laws acknowledging and

98. *Moyses*, 186 U.S. at 181.

99. *Id.* at 188.

100. *Id.* at 181.

101. *Id.* at 188.

102. *Id.* at 190. This language served as ammunition for attacks on bankruptcy specific exemption schemes passed after the 1978 Code and § 522.

103. *Id.*

incorporating differences in the laws of the various states, even when those differences are stark, as in the case of state exemptions. By requiring that bankruptcy laws merely ingrain procedural uniformity, the Court began defining the contours of constitutional uniformity in terms that were deferential to Congress.

As conceived in *Moyses*, and developed in later cases, uniformity became a permissive concept.[104] The Court signaled, and later ratified, the notion that bankruptcy laws will not fail under uniformity challenges absent a procedural disuniformity that treats members of the same class of debtors or creditors differently. Inherent in this doctrine is substantial deference given to Congress to define these "classes" of debtors and creditors. Because the 1898 Act provided a mechanism for incorporating exemption laws of the states, the base procedural uniformity requirement was satisfied in *Moyses*; all debtors in Tennessee could avail themselves of the Tennessee exemptions.

This permissive conception of uniformity finds some support in history. While the circumstances surrounding the addition of the Bankruptcy Clause during the Convention lend few clues to the meaning of "uniform Laws," some evidence suggests that proponents were primarily concerned with Congress having the power to impose uniform laws on the states.[105] Prior to the Constitution, many states had their own bankruptcy laws. Problems arose from the absence of a mechanism to force one state from recognizing a discharge granted by a sister state. Through the Bankruptcy Clause and Contracts Clause, the Framers empowered Congress to grant discharges and expressly withheld this power from States.

This historical evidence supports the idea that the constitutional concept of "uniform" was designed to enhance congressional power, not restrict it. As Justice Thomas noted in his dissent in *Central Virginia Community College v. Katz*, "the historical record thus refutes, rather than supports, the majority's premise that the Framers placed paramount importance on the enactment of a nationally uniform bankruptcy law."[106] As validated

104. *See infra* notes 107 and 111.
105. *See, e.g.*, Haines, *supra* note 95, at 168–70.
106. Cent. Va. Comty. Coll. v. Katz, 546 U.S. 356, 386–87 (2006) (Thomas, J., dissenting).

in *Moyses*, constitutional uniformity does not prevent Congress from incorporating non-uniform state laws into bankruptcy. In cases subsequent to *Moyses*, the Court confirmed that "geographical uniformity" is satisfied if certain defined groups of debtors or creditors receive uniform treatment. In fact, the Court upheld one challenged bankruptcy law that applied only in a statutorily defined geographic region as satisfying the geographical uniformity standard.[107] Not surprisingly, the as-evolved doctrine has been soundly criticized by scholars.[108]

b. Calcification of permissive uniformity as norm. The notion that uniformity is ineffective as a substantive restriction on Congress's ability to craft bankruptcy legislation has become increasingly unassailable. Outside of the exemptions context, Congress incorporating other non-uniform state laws and standards in bankruptcy has been attacked on uniformity grounds. In each such case, the challenge has been unsuccessful. One high profile example, often cited by scholars in discussing uniformity, is *Stellwagen v. Clum*.[109] In this case, the Court sanctified the incorporation of non-uniform state laws defining fraudulent conveyances into the 1898 Act.

In *Stellwagen*, the Court raised the uniformity issue *sua sponte* and disposed of the bank's argument summarily:

> Notwithstanding this requirement as to uniformity the bankruptcy acts of Congress may recognize the laws of the State in certain particulars, although such recognition may lead to

107. *See infra* notes 141–47 and accompanying text.

108. In a seminal article on this topic, Professor Judith Koffler called for a reexamination and, ultimately, the abandonment of the doctrine of geographical uniformity. Koffler, *supra* note 59. Joining other voices, Professor Koffler provides a thoughtful criticism of the doctrine and essentially calls for the abandonment of the permissive conception of uniformity and a return to uniformity as a real limit on congressional action. She rightly observes that the Court's treatment of uniform laws "comes dangerously close to suggesting that the constitutional language is surplusage." *Id.* at 76. In the present Article, uniformity is treated not as surplusage, but as an enhancement of congressional power: a power, not a restriction. While no sober analysis of uniformity could now question whether Congress has the power to impose uniform laws on the states, some historical evidence suggests that this was precisely the concern during the time of the Convention. In the exemptions context, this elicits an obvious question: Does uniformity permit Congress to pass uniform bankruptcy exemptions that displace all state exemptions in bankruptcy? Congress has and does.

109. Stellwagen v. Clum, 245 U.S. 605 (1918).

> different results in different States. For example, the Bankruptcy Act recognizes and enforces the laws of the States affecting dower, exemptions, the validity of mortgages, priorities of payment and the like. Such recognition in the application of state laws does not affect the constitutionality of the Bankruptcy Act, although in these particulars the operation of the act is not alike in all the States.[110]

Largely due to this passage, *Stellwagen* is often cited for the proposition that incorporating non-uniform state laws is allowable under uniformity analysis. [111]

This deferential concept of uniformity has been applied in contexts other than in challenges to bankruptcy laws that incorporate non-uniform state laws.[112] By way of example, uniformity was recently invoked to challenge the so-called eligibility test of § 707 of the Code. As part of the 2005 Amendments, Congress enacted a new "means test" to determine whether debtors were eligible to file Chapter 7. The idea behind the amendment was to subject above-median-income debtors to a formula to determine whether essentially they had "too much" discretionary income to file Chapter 7. For debtors failing the test, the formula left Chapter 13, under which the debtor's discretionary income is committed to bankruptcy for a period of thirty-six to sixty months, as the remaining consumer bankruptcy option.

Under this Chapter 7 eligibility formula, the primary variable for eligibility is the median income for a similar household *in the debtor's state*. Because median incomes vary state-to-state, similarly situated debtors in different states may have different eligibility outcomes. For instance, debtors with identical incomes, assets, and debts could find themselves in different positions: The debtor living in a high median income state may be eligible for Chapter 7,

110. *Id.* at 613.

111. Some scholars have criticized *Stellwagen* for failing to discriminate among types of state laws in terms, for instance, of whether those laws affect the size of the estate or simply the validity or priority of claims. *See* Koffler, *supra* note 59, at 71–72.

112. Daniel A. Austin, *Bankruptcy and the Myth of "Uniform Laws*," 42 SETON HALL L. REV. 1081 (2012). Professor Austin explains that several factors contribute to the lack of uniformity in bankruptcy, including incorporation of state laws, the existence of local rules and procedures adopted by courts and trustees, and differing interpretations of key Code provisions among the courts. *Id.*

while the identical debtor in a low median income state may be ineligible for Chapter 7.

In *Schultz v. United States*,[113] the plaintiffs filed for bankruptcy under Chapter 13 in the United States Bankruptcy Court for the Eastern District of Tennessee while simultaneously filing a complaint for declaratory judgment in the United States District Court for the Eastern District of Tennessee.[114] The complaint for declaratory judgment alleged that the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (hereinafter the Act or the BAPCPA) violated the uniformity clause set forth in Article I, Section 8, Clause 4 of the Constitution.[115] The district court granted the government's motion for summary judgment and the United States Court of Appeals for the Sixth Circuit affirmed.[116]

As the Sixth Circuit noted, Congress enacted a new eligibility standard in BAPCPA to require debtors in higher income brackets to make more funds available for unsecured creditors.[117] The Act requires debtors to demonstrate financial eligibility to file a Chapter 7 and allows a bankruptcy court to dismiss a debtor's petition filed under Chapter 7 or to convert the Chapter 7 filing to a Chapter 13 filing if it appears that the "bankruptcy filing is an abuse of the bankruptcy proceedings."[118]

> Under this test, the first step instructs the bankruptcy court to compare the debtor's annualized current monthly income to the median family income of a similarly sized family *in the debtor's state of residence*. If the debtor's current monthly income is equal to or below the median, then the presumption of abuse does not arise. If, however, it exceeds the median, the Act directs the court to recalculate the debtor's income by deducting certain necessary expenses specified by the statute. These reductions are derived from the national and local standards contained in the Internal Revenue Service's Financial Analysis Handbook.[119]

113. Schultz v. United States, 529 F.3d 343 (6th Cir. 2008).
114. *Id.* at 347.
115. *Id.*
116. *Id.*
117. *Id.*
118. *Id.*
119. *Id.* (emphasis added) (citations omitted).

The effect of the eligibility test was to push more above-median-income debtors out of Chapter 7 liquidation and force them into Chapter 13 reorganization. The fulcrum point is the median income for the state in which debtor resides.[120]

Plaintiffs filed a lawsuit against the United States challenging the five sections of the BAPCPA that utilize this eligibility "means test."[121] The plaintiffs asserted that the calculations, which are based in part on the state and county in which the debtor resides, are not uniform and thus are in violation of the Bankruptcy Clause.[122] The plaintiffs had an income of approximately $84,000, which was above the median family income for a family of five in Tennessee but below the median family income in several other states.[123] This impacted the expense deductions the plaintiffs could claim under the BAPCPA.[124] The district court concluded that the uniformity requirement set forth in the Constitution "does not proscribe different results in different states because of state law variations."[125] Thus, the district court granted the government's motion for summary judgment.[126]

> In response to the [Plaintiff's] argument that the BAPCPA amendments are unconstitutional because they create variations in different states based on federal instead of state law, the district court explained that there is "no principled reason for concluding that variations resulting from federal statistics create unconstitutional non-uniformity, whereas variations resulting from state law do not." The court concluded that "[d]isposable income might vary from place to place, but it is based on uniformly calculated national statistics. The variations in the results produced by these statistics are of no constitutional consequence."[127]

Plaintiffs appealed to the Sixth Circuit.[128]

120. *Id.*
121. *Id.* at 348.
122. *Id.* (citing U.S. CONST. art. I, § 8, cl. 4).
123. *Id.* (for example, Connecticut, Hawaii, Massachusetts, Maryland, New Hampshire, and New Jersey).
124. *Id.* at 349.
125. *Id.* (citing Schultz v. United States, 369 B.R. 349, 352 (E.D. Tenn. 2007)).
126. *Id.*
127. *Id.* (quoting *Schultz*, 369 B.R. at 353 (internal citations omitted)).
128. *Id.*

The main question resolved by the Sixth Circuit was whether the BAPCPA provision incorporating non-uniform state median income levels is a "uniform Law on the subject of bankruptcy."[129] "The Bankruptcy Clause of the Constitution grants Congress the power to 'establish . . . uniform Laws on the subject of Bankruptcies throughout the United States.'"[130] Quoting Chief Justice Marshall, the Sixth Circuit noted that "Congress is not authorized merely to pass laws, the operation of which shall be uniform, but instead to establish uniform laws on the subject throughout the United States."[131] The plaintiffs in this case argued that the scheme adopted by Congress, which takes into account a debtor's income compared to the median income of a particular state, violates the Bankruptcy Clause.[132] Specifically, the scheme results in debtors receiving different relief based on the state or country in which they reside.[133] The concept of personal uniformity is implicit in the plaintiff's argument—that is, the notion that the laws should apply to all debtors in the same way regardless of *where* the debtor resides.[134] However, the Supreme Court has "consistently described the Bankruptcy Clause's uniformity requirement as 'geographical, and not personal . . . .'"[135] This requirement is "satisfied when existing obligations of a debtor are treated alike by the bankruptcy administration throughout the country regardless of the State in which the bankruptcy court sits . . . ."[136]

This geographical uniformity requirement does not prohibit different effects in various states due to variations in state law, provided that the federal law applies uniformly among the classes of debtors.[137] Quoting *Moyses*, the court noted that "[t]he general operation of [a] law is uniform although it may result in certain

129. *Id.* at 350.
130. *Id.* (citing U.S. CONST. art. I, § 8, cl. 4).
131. *Id.* (quoting Sturges v. Crowninshield, 17 U.S. (4 Wheat.) 122, 193–94 (1819)).
132. *Id.*
133. *Id.*
134. *Id.* at 350–51.
135. *Id.* at 351 (quoting Hanover Nat'l Bank v. Moyses, 186 U.S. 181, 188 (1902)).
136. *Id.* (quoting Vanston Bondholders Protective Comm. v. Green, 329 U.S. 156, 172 (1946) (Frankfurter, J., concurring)).
137. *Id.*

particulars differently in different states."[138] Congress may pass non-uniform laws to address "geographically isolated problems" provided the law *operates* "uniformly upon a given class of creditors and debtors."[139] The uniformity requirement "does not deny Congress power to take into account differences that exist between different parts of the country, and to fashion legislation to resolve geographically isolated problems . . . appl[ied] equally to all creditors and debtors."[140]

The Sixth Circuit concluded that the Chapter 7 eligibility provision of BAPCPA is a constitutionally "uniform law."[141] Thus, Congress could constitutionally distinguish among different classes of debtors, and this may be accomplished "through the incorporation of varying state laws."[142] BAPCPA employs a means test that utilizes income calculations in accordance with the IRS Handbook's national and local standards.[143] As the court stated,

> BAPCPA is uniform in form: all debtors whose income is above the median family income are treated alike, as are all debtors whose income falls below. The resulting differences based on the state in which the debtor resides are analytically indistinguishable from the differences resulting from the incorporation of various state laws.[144]

The Bankruptcy Clause does not prohibit Congress from considering the differences that exist between various parts of the country.[145]

2. Limits of permissive uniformity: discriminatory regionalism through "private laws"

Although the constitutional call for "uniform Laws" has settled into the highly deferential doctrine of geographic uniformity,

138. *Id.* ("Geographic uniformity in this context, the Court observed, was satisfied 'when the trustee takes in each state whatever would have been available if the bankrupt law had not been passed.'") (quoting *Moyses*, 186 U.S. at 190).

139. *Id.* (citing Blanchette v. Conn. Gen. Ins. Corps., 419 U.S. 102 (1974)).

140. *Id.* (quoting *Blanchette*, 419 U.S. at 159, 160) (internal citations omitted)).

141. *Id.* at 352.

142. *Id.*

143. *Id.*

144. *Id.* at 353.

145. *Id.*

Congress does not enjoy complete discretion in enacting bankruptcy laws to its liking. The point at which the permissive construction yields to uniformity as a restriction on congressional action is illustrated by two railroad cases: (i) *Regional Rail Reorganization Act Cases* from 1974 and (ii) *Railway Labor Executives Association v. Gibbons* from 1982 (the *Rail Act Cases*).[146]

In the *Rail Act Cases*, the Court upheld against a uniformity challenge a bankruptcy law[147] that applied to a geographically exclusive area—"the midwest and northeast region."[148] The Rail Act had been passed in response to a congressional finding that then-existing bankruptcy law could not adequately address a transportation crisis precipitated by eight railroads from that geographic region entering bankruptcy. Congress created the Rail Act to allow these railroads to reorganize more expeditiously under a single entity, a Conrail. The Rail Act was challenged on the basis that it violated geographic uniformity by applying to only a specific statutorily defined geographic region.

Largely avoiding a discussion of *Moyses*, the 8–1 majority opinion acknowledged the "surface appeal" of the argument that the Rail Act facially violated geographic uniformity.[149] In rejecting this argument, however, the Court determined that the Bankruptcy Clause uniformity challenge "overlooks the flexibility inherent in the constitutional provision."[150] Invoking this "inherent flexibility," the Court upheld the Rail Act on two bases: (1) that no railroads outside the defined region were in bankruptcy and (2) that the Act operated uniformly with respect to all creditors.[151]

In a more recent case and the sole instance in which the Court found a violation of uniformity, the limit of the permissive norm

146. Reg'l Rail Reorganization Act Cases, 419 U.S. 102 (1974); Ry. Labor Execs.' Ass'n v. Gibbons, 455 U.S. 457 (1982).

147. Regional Rail Reorganization Act of 1973 (Rail Act), Pub. L. No. 93-236, 87 Stat. 985 (1974) (codified as amended at 45 U.S.C.A. §§ 701–797m (West Supp. 1982)).

148. *Id.* at § 701.

149. Justice Douglas provided the lone voice in the wilderness, by noting in his dissent that the Court had "never dreamed of allowing debtors in the same class and their creditors to be treated more leniently in one region than in another." *Reg'l Rail*, 419 U.S. at 102, 184 (Douglas, J., dissenting).

150. *Reg'l Rail*, 419 U.S. at 158.

151. *Id.* at 156–61.

of uniformity was illustrated when the Court struck down a bankruptcy law that applied to a *single debtor* in *Gibbons*.[152] In short, the Court held that while uniformity permitted Congress to make geographical distinctions based on regions, a bankruptcy law "must at least apply uniformly to a defined class of debtors."[153] With little analysis, the Court observed that "[a] bankruptcy law . . . confined as it is to the affairs of one named debtor can hardly be considered uniform."[154]

B. State Bankruptcy-Specific Exemptions Are Constitutionally "Uniform"

Congress can delegate exemptions in bankruptcy to the states. In *Moyses*, the Court provided a specific sanctification of Congress delegating exemptions in bankruptcy to the states. While the doctrine of geographic uniformity has been roundly criticized, cases subsequent to *Moyses* essentially eviscerated the notion that uniformity is a meaningful restriction on congressional action in the realm of bankruptcy legislation. The *Rail Act Cases* called into focus whether and to what extent facial geographical disuniformity is permissible, as the act applied only to certain areas of the country. The Court relied on the "inherent flexibility" of the Bankruptcy Clause and deferred to Congress when it perceived legislation was procedurally uniform and free from any hint of discriminatory regionalism. Though the challenged act applied exclusively to a defined region, application of the law was in fact agnostic to geography, as there were no bankrupt railroads outside the defined region at the time of the act. By contrast, *Gibbons* marked the extreme of the regionalism spectrum, in both form and application—a bankruptcy act applying to a single named railroad company and excluding other railroad companies in bankruptcy at the time of the act.

Since in *Moyses* the Court upheld delegating exemptions to states in bankruptcy under the 1898 Act, how is the existing concurrent system—including the opt-out—different, and do

152. *Gibbons*, 455 U.S. at 457.
153. *Id.* at 473.
154. *Id.*

those differences dictate a result contrary to *Moyses*? How does the post-*Moyses* distillation of uniformity as a failing source of restriction on Congress's power factor into the issue?

The most compelling uniformity argument against state bankruptcy-specific exemptions being allowed under § 522 relies on language from *Moyses* elaborating the standard for geographic uniformity. In upholding the provision of the 1898 Act delegating bankruptcy exemptions to the states, the *Moyses* Court explained that a bankruptcy exemptions scheme "is, in the constitutional sense, uniform throughout the United States, when the [bankruptcy] trustee takes in each [s]tate whatever would have been available to the creditors if the bankrupt[cy] law had not been passed."[155] A surface application of this rule to any state bankruptcy-specific scheme suggests constitutional infirmity. Under state laws that provide more generous exemptions in bankruptcy, a trustee would take less in bankruptcy than a creditor would take but for bankruptcy. In essence, the actual *purpose* of proposed state reforms is this result: allowing a debtor to keep the amounts and types of property to enable a fresh start.

The surface application of this rule from *Moyses* fails, however, for several reasons.[156] First and foremost, the notion of "uniform" has expanded since *Moyses*, and that expansion demonstrates that the delegation of exemptions policy in § 522 can constitutionally permit state bankruptcy-specific exemptions. In 1902, when Moyses was decided, the doctrine of geographic uniformity was announced. The fundamental principle of this doctrine was that the uniformity required by the Bankruptcy Clause is geographic and not personal. The *Moyses* Court specifically acknowledged that geographic uniformity permitted different outcomes in bankruptcy in different states. Indeed, by completely delegating bankruptcy

155. Hanover Nat'l Bank v. Moyses, 186 U.S. 181, 190 (1902).

156. A careful reading of *Moyses* calls into question whether the quoted language prohibits state laws that result in the trustee taking a different amount in bankruptcy than a creditor would take under state law but for bankruptcy. The Court explained that an exemptions system that adheres to this standard is constitutionally uniform. Absent, however, was any explicit determination that an exemptions system failing this standard would be unconstitutional. In this sense, the "trustee takes same as creditor" requirement can be viewed as sufficient but not necessary to establish constitutionality of a given exemptions system. At a minimum, this practical construction of the rule calls into question the efficacy of this language of *Moyses* as fatal to state bankruptcy-specific exemptions.

exemptions policy to the states, the 1898 Act essentially *required* different outcomes in different states. Those outcomes were determined by the state in which a debtor filed bankruptcy.

A strong case exists that applying *Moyses* to § 522 would invalidate the federal exemptions, not the opt-out provision.[157] Recall that a bankruptcy exemptions scheme "is, in the constitutional sense, uniform throughout the United States, when the [bankruptcy] trustee takes in each state whatever would have been available to the creditor if the bankrupt[cy] law had not been passed." Strict application of this rule would strike down the federal exemptions listed in § 522(d). Had the bankruptcy law, in this case the Code, not been passed, what the trustee takes would be determined *solely and exclusively* by state general exemptions laws. Hence, to the extent the federal exemptions conflict with the general state exemptions, *Moyses* would view the federal exemptions as lacking constitutional uniformity.

Since *Moyses*, the doctrine of geographical uniformity has been confirmed to be impotent as a means to challenge bankruptcy legislation. At each opportunity, the Court has consistently and substantially eroded any restrictions imposed by the doctrine. Bankruptcy laws can now apply to statutorily defined regions of the country to the exclusion of other regions. During this expansion, the "geography" component of uniformity has been debased and essentially replaced with the requirement that bankruptcy laws be procedurally uniform. Bankruptcy laws are not constitutionally uniform if they treat defined sets of creditors evenhandedly. Alternatively, uniformity is satisfied if defined sets of debtors are treated in a procedurally uniform manner.

The Court has signaled this deferential, indeed permissive, conception of uniformity through pronouncements not essential to holdings in several cases. Most notably, the Court in the *Rail Act Cases* took a significant step toward reading the restrictiveness of uniformity out of the Bankruptcy Clause altogether by

157. Several scholars have criticized the as-evolved doctrine of geographic uniformity as incoherent. I do not defend the coherence of the doctrine. Instead, I use the as-evolved doctrine to support a conclusion that state bankruptcy exemptions would survive a uniformity challenge.

announcing the "flexibility inherent."[158] While striking down a single-entity bankruptcy law as violating uniformity, the Court took occasion to continue to signal the deferential—even permissive—conception of uniformity.

C. State Bankruptcy-Specific Exemptions Are Not Preempted Under the Supremacy Clause

Although constitutional uniformity might not proscribe state bankruptcy-specific exemptions, what about the argument that such exemptions are "bankruptcy laws" that are preempted under the Supremacy Clause? The argument can be facially appealing. The Bankruptcy Clause grants authority to Congress to pass bankruptcy laws, and it exercised that authority by enacting the Bankruptcy Code. How can state laws that apply *only* in bankruptcy not be preempted?

The primary preemption argument against the concurrent exemption scheme draws strength from, and ascribes constitutionally significant meaning to, the detailed federal exemptions contained in § 522. Congress has determined what exemptions should be in bankruptcy. Preemption proponents urge that state exemptions that are "less generous"[159] than the federal counterparts are preempted, since Congress has determined appropriate exemption levels in bankruptcy. For example, concluding that California's bankruptcy-specific exemption was unconstitutional, a bankruptcy court in 2008 determined that Congress had preempted state bankruptcy-only exemption schemes that were inconsistent with § 522.[160] The court relied on an oft-quoted articulation of the rule of field preemption: "Congress's intent to supersede state law altogether may be found from a 'scheme of federal regulation . . . so pervasive as to make reasonable the

158. *See* Stellwagen v. Clum, 245 U.S. 605 (1918).

159. This preemption argument essentially requires a standard for determining whether a challenged state exemption scheme is, in fact, "less generous." States with high or unlimited homestead exemptions are certainly more generous to bankrupt homeowners than federal exemptions allow. How would this factor into determining whether the state's exemptions are "generous" enough? This Article recasts the question as one of the functionality of exemptions, rather than the degree to which they are generous. *See infra* Section IV.A.

160. *In re* Regevig, 389 B.R. 736, 740 (Bankr. D. Ariz. 2008).

inference that Congress left no room for the States to supplement it.'"[161] In the absence of Congress providing pervasive regulation[162] in a field, state laws remain unconstitutional to the extent they conflict with federal law under the "conflict preemption" doctrine. The bankruptcy court determined that in § 522 Congress had "pervasively defined the exemptions that a state may permit a debtor to claim only in a bankruptcy case."[163] This reasoning appears to ignore how the opt-out provision delegates to states the ultimate exemptions decision.

Given this context, should the federal opt-out provision (and resulting state laws) be subject to preemption challenges? The short answer is "no." This is especially true for any state undertaking the "meaningful review" process envisioned by this Article and the Model.

1. The genesis of preemption is state interference with the purpose and objectives of bankruptcy law

The beginning of any bankruptcy preemption issue is *Perez v. Campbell*.[164] In *Perez*, the petitioners challenged the constitutionality of an Arizona law that permitted the state to withhold a driver's license conditioned on payment of claim related to an automobile accident when that claim had been discharged in bankruptcy.[165] More particularly, petitioners asserted the Arizona

161. *Id.* (quoting Sherwood Partners, Inc. v. Lycos, Inc., 394 F.3d 1198, 1200 (9th Cir. 2005)).

162. The Court offers a succinct, yet more thorough, description of field preemption in *Pacific Gas & Electric Co. v. State Energy Resources Conservation and Development Commission*:

> Absent explicit pre-emptive language, Congress' [sic] intent to supersede state law altogether may be found from a "'scheme of federal regulation . . . so pervasive as to make reasonable the inference that Congress left no room to supplement it,' because 'the Act of Congress may touch a field in which the federal interest is so dominant that the federal system will be assumed to preclude enforcement of state laws on the same subject,' or because 'the object sought to be obtained by the federal law and the character of obligations imposed by it may reveal the same purpose.'"

461 U.S. 190, 203–04 (1983) (quoting Fid. Fed. Savs. & Loan Ass'n v. De la Cuesta, 458 U.S. 141, 153 (1982)).

163. *Regevig*, 389 B.R. at 740.

164. Perez v. Campbell, 402 U.S. 637 (1971).

165. In 1965, the petitioners were involved in an automobile accident in Tucson, and the automobile was not covered by liability insurance at the time of the accident. *Id.* The driver of the second car was the minor daughter of the Pinkertons, who sued the petitioners in state court. *Id.* The petitioners confessed judgment, and a judgment order was

law's requirement that the judgment be paid in order for the petitioner's driver's license to be reinstated directly conflicted with the Bankruptcy Act and was, therefore, in violation of the Supremacy Clause of the Constitution.[166] Stated differently, the issue in *Perez* was whether the state has the power to interfere with the bankruptcy discharge of an automobile accident tort judgment "insofar as such repayment may be enforced by the withholding of driving privileges [of the debtor] by the State."[167]

The Court articulated a two-step process for determining whether a state statute conflicts with a federal statute and thus is invalid under the Supremacy Clause.[168] First, the Court must ascertain the construction of the two statutes.[169] Next, the Court must determine whether the two statutes are in fact in conflict.[170]

entered against them in the amount of $2,425.98 plus court costs. *Id.* The petitioners filed a voluntary bankruptcy petition in 1967. *Id.* The District Court entered orders discharging the petitioners from all debts and claims against their estates, including the Pinkerton judgment. *Id.* at 639. While the Court noted that only one provision of the Arizona Motor Vehicle Safety Responsibility Act ("Arizona Act") is relevant to the issue at hand, the Court described the statutory scheme overall to give context to the statute at issue. *Id.* at 639–42. The substantive provisions of the Arizona Act begin in Article 3, which requires those involved in accidents to post financial security. *Id.* It furthermore provides that anyone who unlawfully fails to report an accident is subject to the suspension of his or her license. *Id.* Article 4 addresses the suspension of licenses and registrations for nonpayment of judgments, and this is the only provision of the Arizona Act at issue in *Perez*. *Id.* Under the Arizona Act, it is only when the judgment debtor in an automobile accident lawsuit fails to respond to a judgment that has been entered against him that "he must overcome two hurdles in order to regain his driving privileges." *Id.* at 637. When a judgment has remained unsatisfied for sixty days after entry of the judgment, the state court clerk must forward a certified copy of the judgment to the superintendent. The state court clerk in this case complied with this requirement, and the petitioners were notified that their drivers' licenses and registration were suspended. Article 4 further provides that a "discharge in bankruptcy following the rendering of any such judgment shall not relieve the judgment debtor from any of the requirements of this article." *Id.*

166. *Perez*, 402 U.S. at 643.

167. *Id.* ("What is at issue here is the power of a State to include as part of this comprehensive enactment designed to secure compensation for automobile accident victims a section providing that a discharge in bankruptcy of the automobile accident tort judgment shall have no effect on the judgment debtor's obligation to repay the judgment creditor, at least insofar as such repayment may be enforced by the withholding of driving privileges by the State.").

168. *Id.* at 644.

169. *Id.*

170. *Id.*

As noted in *Perez*, the Arizona statute at issue had been construed by Arizona courts.[171] The Supreme Court of Arizona determined, in *Schecter v. Killingsworth*, that the Arizona Act's principal purpose is the protection of the public using the highways "from financial hardship which may result from the use of automobiles by financially irresponsible persons."[172] The sole purpose of the Arizona Act, according to the United States Supreme Court, was to provide leverage to aid in collecting damages from drivers who either admit that they are at fault or are found to be at fault by a court.[173]

The construction of the Bankruptcy Act was clear:[174]

> This Court on numerous occasions has stated that "[o]ne of the primary purposes of the bankruptcy act [sic]" is to give debtors "a new opportunity in life and a clear field for future effort, unhampered by the pressure and discouragement of preexisting debt."[175]

Thus, Congress clearly intended that the "new opportunity" referenced above include "freedom from most kinds of preexisting tort judgments."[176]

The Court noted that "[w]ith the construction of both statutes clearly established," it would move to the constitutional question of whether a state statute that protects judgment creditors from drivers who are financially irresponsible conflicts with a federal statute that provides debtors a fresh start.[177] The Court's analysis referenced Chief Justice Marshall's 1824 statement in *Gibbons v. Ogden* that actions of the state legislatures that interfere with or

171. *Id.*

172. *Id.* (citing Schecter v. Killingsworth, 380 P.2d 136 (Ariz. 1963)).

173. *Id.* at 646–47.

174. *Id.* at 648.

175. *Id.* (alteration in original) (citing Local Loan Co. v. Hunt, 292 U.S. 234, 244 (1934)); *accord, e.g.*, Harris v. Zion's Sav. Bank & Tr. Co., 317 U.S. 447, 451 (1943); Stellwagen v. Clum, 245 U.S. 605, 617 (1918); Williams v. U.S. Fid. & Guar. Co., 236 U.S. 549, 554–55 (1915).

176. *Id.* at 648.

177. *Id.* at 649 ("With the construction of both statutes clearly established, we proceed immediately to the constitutional question whether a state statute that protects judgment creditors from 'financially irresponsible persons' is in conflict with a federal statute that gives discharged debtors a new start 'unhampered by the pressure and discouragement of preexisting debt.'").

are contrary to the laws of Congress are invalid under the Supremacy Clause.[178] Justice Black similarly wrote the following in *Hines v. Davidowitz*:

> [W]hile "[t]his Court, in considering the validity of state laws in the light of treaties or federal laws touching the same subject, ha[d] made use of the following expressions: conflicting; contrary to; occupying the field; repugnance; difference; irreconcilability; inconsistency; violation; curtailment; and interference[,] . . . [i]n the final analysis," our function is to determine whether a challenged state statute "stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress."[179]

Since the Court's decision in *Hines*, it has followed this articulation of the meaning of the Supremacy Clause.[180]

The *Perez* Court then addressed two previous cases that, despite the standard set forth by the Court in *Hines*, "ignored this controlling principle."[181] In *Kesler v. Department of Public Safety of Utah*, the Court had addressed the issue of whether Utah's Motor Vehicle Safety Responsibility Act conflicted with the Bankruptcy Act and was thus invalid under the Supremacy Clause.[182] The *Perez* Court, in addressing the *Kesler* decision, noted that "[t]he Court in *Kesler* conceded that Utah's financial responsibility law left 'the bankrupt to some extent burdened by the discharged debt,' made 'it more probable that the debt will be paid despite the discharge,' and thereby made 'some inroad . . . on the consequences of bankruptcy.'"[183] Essentially, Utah's statute "frustrated Congress' [sic] policy of giving discharged debtors a

178. *Id.* (citing Gibbons v. Ogden, 22 U.S. (9 Wheat.) 1, 6 (1824)).

179. *Id.* (second, third, and fourth alterations in original) (quoting Hines v. Davidowitz, 312 U.S. 52, 67 (1941)).

180. *Id. See, e.g.*, Nash v. Fla. Indus. Comm'n, 389 U.S. 235, 240 (1967); Sears, Roebuck & Co. v. Stiffel Co., 376 U.S. 225, 229 (1964); Colo. Anti-Discrimination Comm'n v. Cont'l Air Lines, Inc., 372 U.S. 714, 722 (1963) (dictum); Free v. Bland, 369 U.S. 663, 666 (1962); Hill v. Florida, 325 U.S. 538, 542–43 (1945); Sola Elec. Co. v. Jefferson Elec. Co., 317 U.S. 173, 176 (1942).

181. *Perez*, 402 U.S. at 650.

182. Kesler v. Dep't of Pub. Safety of Utah, 369 U.S. 153, 154–56 (1962) (overruled in part by *Perez*, 402 U.S. 637).

183. *Perez*, 402 U.S. at 650 (internal citations omitted).

new start."[184] Despite this conclusion, the *Kesler* Court upheld the statute, claiming that the statute was designed to enforce a policy against irresponsible driving and was not aimed at helping creditors collect debts owed to them.[185]

The *Kesler* Court did not focus on the effect of the Utah statute. Rather it concluded that because the purpose of the Utah statute was to promote safety on Utah's highways and not to circumvent the Bankruptcy Act, the statute did not conflict with the Act.[186] The dissent, on the other hand, reached the opposite conclusion.[187] The *Kesler* dissent stated that, while the purpose of the Utah statute may not have been to circumvent the Bankruptcy Act, the "'plain and inevitable effect'" of the Utah statute "'[was] to create a powerful weapon for collection of a debt from which [the] bankrupt [had] been released by federal law."[188] Upholding such a statute, according to the dissent, would allow the States to impair an important policy "embodied in [this Nation's] bankruptcy laws."[189]

The Court's previous decision in *Reitz*,[190] according to the *Perez* Court, similarly reached the wrong conclusion.[191] The *Reitz* Court focused on the *purpose* of the state statute at issue, rather than the fact that the statute "frustrated the operation of the Bankruptcy Act . . . ."[192] The New York statute at issue in *Reitz* provided for the suspension of the operator's license and registration if a judgment against him for injury to another person or property resulting from operation of a motor vehicle was not paid within fifteen days of judgment.[193] The *Reitz* Court noted that the purpose

184. *Id.*

185. *Id.* ("Utah's statute, in short, frustrated Congress' [sic] policy of giving discharged debtors a new start. But the *Kesler* majority was not concerned by this frustration. In upholding the statute, the majority opinion did not look to the effect of the legislation but simply asserted that the statute was 'not an Act for the Relief of Mulcted Creditors,' and was 'not designed to aid collection of debts but to enforce a policy against irresponsible driving . . . .'" (internal citation omitted)).

186. *Id.*

187. *Id.*

188. *Id.* (quoting Kesler v. Dep't of Pub. Safety of Utah, 369 U.S. 153, 183 (1962)).

189. *Id.* (quoting *Kesler*, 369 U.S. at 185).

190. Reitz v. Mealey, 314 U.S. 33, 36 (1941) (overruled in part by *Perez*, 402 U.S. 637).

191. *Perez*, 402 U.S. at 651.

192. *Id.*

193. *Reitz*, 314 U.S. at 35.

of the New York statute would be frustrated if drivers were permitted to escape the application of the statute simply by filing a voluntary bankruptcy petition.[194]

> The penalty which [the New York statute] imposes for injury due to careless driving is not for the protection of the creditor merely, but to enforce a public policy that irresponsible drivers shall not, with impunity, be allowed to injure their fellows. The scheme of the legislation would be frustrated if the reckless driver were permitted to escape its provisions by the simple expedient of voluntary bankruptcy, and, accordingly, the legislature declared that a discharge in bankruptcy should not interfere with the operation of the statute. Such legislation is not in derogation of the Bankruptcy Act. Rather it is an enforcement of permissible state policy touching highway safety.[195]

Thus, the majority in *Reitz* focused on the fact that the statute's purpose was aimed at creating safer highways rather than impairing the Bankruptcy Act.[196] The dissent, however, argued that the New York statute circumvented the Bankruptcy Act and effectively ensured that bankruptcy "[was not] the sanctuary for hapless debtors which Congress intended."[197]

After analyzing the *Kesler* and *Reitz* decisions, the *Perez* Court reiterated its position that *Kesler* and *Reitz* are no longer good law.[198] Applying a doctrine that focuses on the *purpose* of the state statute at issue rather than its effect would be at odds with nearly all previous decisions regarding the Supremacy Clause.[199] In addition, "such a doctrine would enable state legislatures to nullify nearly all unwanted federal legislation by simply publishing a legislative committee report articulating some state interest or policy—other than frustration of the federal objective—that would be tangentially furthered by the proposed state law."[200] The Court

194. *Perez*, 402 U.S. at 651 (citing *Reitz*, 314 U.S. at 37).
195. *Id.* (quoting *Reitz*, 314 U.S. at 37).
196. *Id.*
197. *Id.* (alteration in original) (quoting *Reitz*, 314 U.S. at 41).
198. *Id.* at 651–52 ("We can no longer adhere to the aberrational doctrine of *Kesler* and *Reitz* that state law may frustrate the operation of federal law as long as the state legislature in passing its law had some purpose in mind other than one of frustration.").
199. *Id.*
200. *Id.* at 652.

acknowledged that it is possible to make an argument that *Kessler* and *Reitz* are confined to bankruptcy cases or highway safety cases, but the Court quickly dismissed this argument by noting that there is no reason as to why the States should have "broader power to nullify federal law in these fields than in others."[201] As a result, the Court held that *Kesler* and *Reitz* have no authoritative effect because they are inconsistent with the application of the Supremacy Clause.[202]

Even accepting the analysis of the Supremacy Clause promulgated in *Kesler* and *Reitz*—that is, looking at the purpose of the law rather than the effect of the law—those decisions were not dispositive in *Perez*.[203] In both *Kesler* and *Reitz* the courts assumed, without supporting case law, that the purpose of the laws was to deter irresponsible driving rather than to provide relief to creditors.[204] Here, the Arizona Supreme Court declared that the purpose of the Arizona statute was to protect the public from financial hardship "resulting from involvement in traffic accidents with uninsured motorists unable to respond to a judgment."[205] The *Kesler* Court declared that the purpose of the Utah statute was not to aid in the collection of debts and therefore could be upheld, although the source of support for this declaration is "unclear."[206] In *Perez*, the Court noted that the Arizona statute has an express purpose of protecting judgment creditors from financial hardship by giving them a tool to force bankrupts to pay their debts despite their discharge in bankruptcy, which is "precisely the sort of statute that *Kesler* would have stricken down . . . ."[207]

> Whereas the Acts in *Kesler* and *Reitz* had the effect of frustrating federal law but had, the Court said, no such purpose, the Arizona Act has both that effect and that purpose. Believing as

201. *Id.*
202. *Id.* ("Thus, we conclude that *Kesler* and *Reitz* can have no authoritative effect to the extent they are inconsistent with the controlling principle that any state legislation which frustrates the full effectiveness of federal law is rendered invalid by the Supremacy Clause.").
203. *Id.*
204. *Id.* at 652–53.
205. *Id.* at 654 (quoting Schecter v. Killingsworth, 380 P.2d 136, 140 (1963)).
206. *Id.*
207. *Id.*

> we do that *Kesler* and *Reitz* are not in harmony with sound constitutional principle, they certainly should not be extended to cover this new and distinguishable case.[208]

Thus, the Court in *Perez* held the Arizona Safety Responsibility Act invalid under the Constitution.[209]

2. State bankruptcy-specific exemptions further, rather than interfere or conflict with, the purposes and objectives of bankruptcy law

Against this backdrop of preemption jurisprudence, is it likely that state bankruptcy-specific exemptions are repugnant to Supremacy? Does providing debtors in bankruptcy "more generous" exemption rights than debtors outside bankruptcy interfere with congressional objectives and purposes?

In thinking about preemption in this context, it is tempting to draw on conventional notions of cooperative federalism.[210]

208. *Id.*

209. *Id.*

210. Essentially, cooperative federalism programs allow the state agencies to "step into the shoes of the federal agency" in order to enact federal regulations. Philip J. Weiser, *Federal Common Law, Cooperative Federalism, and the Enforcement of the Telecom Act*, 76 N.Y.U. L. REV. 1692, 1696 (2001). One of the most imperative features of a cooperative federalism program is the careful balance struck between total preemption by the federal statute and "uncoordinated federal and state action in distinct regulatory spheres (a dual federalism)." *Id.* at 1697. The cooperative federalism model is a blend between these two extremes. *Id.* Under the cooperative federalism approach, Congress and federal agencies are charged with constructing the basic framework that defines the state agencies' authority, as well as determining a uniform minimum standard applicable to all states. *Id.* The state agencies are then given the power to supplement this framework. *Id.* at 1698. Generally speaking, cooperative federalism encourages the states to use discretion in determining how best to implement the federal laws, thereby allowing for diversity in the federal regulatory program. *Id.* at 1698 ("In particular, there are at least three related reasons why the federal government has decided to promote diversity in federal regulatory regimes: (1) to allow states to tailor federal regulatory programs to local conditions; (2) to promote competition within a federal regulatory framework; and (3) to permit experimentation with different approaches that may assist in determining an optimal regulatory strategy."). Congress has continued to endorse cooperative federalism throughout the years, beginning in the 1970s with the passage of key environmental statutes. Sarah C. Rispin, *Cooperative Federalism and Constructive Waiver of State Sovereign Immunity*, 70 U. CHI. L. REV. 1639, 1642 (2003). These federal statutes ultimately rely on state agencies to enact local regulations that comport with national standards. *Id.* at 1643. An example of such a scheme is the Clean Air Act, which sets national ambient air quality standards but allows the states to determine how best to reach such standards. *Id.* at 1643. Other cooperative federalism schemes include Medicaid, the Occupational Safety and Health Act, the Public Utility Regulatory Policies Act, and the Telecom Act. *Id.* at 1642–43. "By having the local government bodies

Cooperative federalism assumes and requires *uniform* federal standards being enforced by state agencies. If the specific exemptions listed in § 522(d) *are* the uniform standards, then state action adopting standards (*i.e.*, exemptions) different from the federal standards could be preempted. This analysis completely ignores the opt-out provision. Congress made a deliberate choice to permit states to preempt the federal exemptions by opting out of them. Traditional concepts of cooperative federalism simply don't fit. Attacks on the constitutionality of the opt-out provision have been uniformly unsuccessful. As a result, the treatment of exemptions under the Bankruptcy Code provide an unfamiliar structure.

The concurrent exemptions system presents, then, the somewhat unique case of Congress adopting a uniform standard and authorizing a state to preempt that standard with its own. By providing the opt-out, Congress has removed the federal exemptions as uniform standards *per se*. Instead, the specific federal exemptions serve two functions: (i) providing an alternative set of standards available to each state and (ii) signaling lineaments that Congress deems important for exemptions to fulfill the "fresh start" objective.

Because Congress has provided explicit authority for states to pass controlling exemptions standards, preemption under a cooperative federalism analysis is likely inapplicable—which leaves courts with the traditional bankruptcy preemption analysis from Perez.

Perhaps most critically, the Court in *Perez* confirmed the construction of the Bankruptcy Act.[211] "This Court on numerous occasions has stated that '[o]ne of the primary purposes of the bankruptcy act' [sic] is to give debtors 'a new opportunity in life and a clear field for future effort, unhampered by the pressure and

implement federal regulation locally, these statutes preserve a role for the states in areas that the federal political branches have decided it is in the nation's best interest to regulate according to a central design." *Id.* at 1643.

211. Construing the 1898 Act. All evidence suggests that the 1978 Act continues these fundamental purposes. *See supra* notes 41–49 and accompanying text.

discouragement of preexisting debt.'"[212] States enacting targeted exemptions could simply be viewed as picking up the federal baton by invigorating the "fresh start" through more appropriate exemptions in bankruptcy.

IV. A MODEL FOR STATE BANKRUPTCY EXEMPTIONS REFORM

Michigan stands as one of only two states[213] that have passed a somewhat comprehensive bankruptcy-specific exemptions scheme. Perhaps ironically, the Michigan experiment was actually a modest response, resulting from an opaque political compromise, to a bolder call for broader general exemption reform. In fact, the Michigan reforms were "bankruptcy-specific" almost by accident as an apparent result of the legislative trading process.[214]

This Article does not proffer Michigan as a model for other states to follow. Instead, the Michigan case is an example of state legislative reform effort that resulted in actual legislation: bankruptcy-specific exemptions becoming law. Indeed, the central features of the Michigan scheme fail to address the Fresh Start Function of exemptions in bankruptcy. The reform, while in some sense "comprehensive," did not result from a process and model resembling those proposed herein.

The most noteworthy feature of Michigan's reform is the substantial expansion of the homestead exemption for individuals in bankruptcy.[215] Outside of bankruptcy, a homeowner in Michigan can protect $3,500 in home equity. A debtor filing bankruptcy can protect $30,000 with the possibility of expanding that dollar amount to $45,000.[216] Categories of property other than homestead are also treated differently under the Michigan reform.[217]

212. *Perez*, 402 U.S. at 648 (citing Local Loan Co. v. Hunt, 292 U.S. 234, 244 (1934)); *accord, e.g.*, Harris v. Zion's Sav. Bank & Tr. Co., 317 U.S. 447, 451 (1943); Stellwagen v. Clum, 245 U.S. 605, 617 (1918); Williams v. U.S. Fid. & Guar. Co., 236 U.S. 549, 554–55 (1915).

213. The other state is Delaware.

214. *See, e.g.*, *In re* Sassak, 426 B.R. 680, 687–89 (E.D. Mich. 2010).

215. *See* Thomas R. Morris, *The Michigan Exemption Initiative*, MICH. BUS. L.J., Summer 2011, at 14; Thomas R. Morris, *The History and Future of Michigan Debtor Exemptions*, MICH. BUS. L.J., Summer 2010, at 57 [hereinafter *The History and Future of Michigan Debtor Exemptions*].

216. *The History and Future of Michigan Debtor Exemptions*, *supra* note 215.

217. *Id.*

Perhaps the most notable contribution of the Michigan reform is that it survived Uniformity and Supremacy challenges.[218] The importance of this survival cannot be overstated: A state-enacted bankruptcy-specific exemption that applied only to residents filing bankruptcy was determined to be constitutional by the Sixth Circuit.[219]

The Michigan reform and its vindication by the Sixth Circuit provide a powerful impetus for reform efforts by other states. Reforms resulting from the "meaningful review" process designed to serve the Fresh Start Function will stand on more solid constitutional ground than the Michigan reform, as those reforms were prompted by generalized concerns of "updating" and "liberalizing" exemptions. The Michigan reform resulted from opaque political wrangling and compromises, rather than from a deliberate process of enacting bankruptcy-specific exemptions for the express purpose of having exemptions designed to serve the Fresh Start Function.

States that have opted out of federal exemptions should undertake meaningful reexaminations of their existing exemptions to ensure that their schemes serve the Fresh Start Function of bankruptcy. This assertion begs, of course, the question of what qualities of exemptions further a debtor's "fresh start."

A. The Model

As discussed earlier, some may find it difficult to reconcile state bankruptcy-specific exemptions with federal bankruptcy law under the Supremacy Clause. The proposed reform model (the Model) settles this issue in two respects. First, it provides some factors that opt-out states can and should follow in serving the Fresh Start Function. The inquiry is recast not as a determination of generousness, but functionality. The factors inject a measure of objectivity that can be followed in the legislative process.

The second issue relates directly to preemption. A state that has reexamined its exemptions in light of the Model will have findings and a record that its exemption scheme, reformed or not,

218. *In re* Shafer, 689 F.3d 601 (6th Cir. 2012).
219. *Id.*

is designed to serve the Fresh Start Function. Such a record, ideally buttressed by smarter and more effective exemptions resulting from this review process, would seriously undercut any preemption attack. A state that has opted out but also undertaken a meaningful effort to provide exemptions to assist debtors in the Fresh Start Function would have fulfilled this purpose.

This purpose is in the nature of "cooperative federalism."[220] Unlike the traditional doctrine of cooperative federalism, however, the uniform bankruptcy exemptions set by Congress are viewed not as providing a concrete substantive standard but rather an illustrative set of standards based on the more fundamental purpose—fresh start—to be advanced. I label this federalism structure "quasi-cooperative federalism,"[221] as the actual standards can (and, perhaps, should) depend on variables

220. The Supremacy Clause empowers Congress to enact regulations in support of Congress's enumerated powers that "completely displace state regulation[s] and implement a purely federal regulatory scheme." Rispin, *supra* note 210, at 1642. Despite this power to enact preemptive federal laws, Congress may choose to partner with state governments in certain areas preempted by federal regulations when Congress deems such a partnership to be beneficial. *Id*. In fact, the Supreme Court has expressly recognized Congress's power to "offer States the choice of regulating [an] activity according to federal standards or having state law pre-empted by federal regulation." *See* New York v. United States, 505 U.S. 144, 167 (1992); *see also* Fed. Energy Regulatory Comm'n v. Mississippi, 456 U.S. 742, 764 (1982); Hodel v. Va. Surface Mining & Reclamation Ass'n, 452 U.S. 264, 289 (1981). The Supreme Court has called such an arrangement "a program of cooperative federalism." *Hodel*, 452 U.S. at 289. In such a program, rather than preempting the authority of state governments, Congress may instead choose to invite state agencies to administer federal law. Weiser, *supra* note 210, at 1695. Cooperative federalism programs provide uniform federal standards set forth in either a statute or federal agency regulation (or both), but such statutes or regulations also allow the state governments flexibility in implementing the federal law. *Id.* at 1696. For example, the states may choose to "supplement [the federal law] with more stringent standards," or possibly seek exemptions from the requirements set forth in the statute or regulation altogether. *Id.* These types of schemes allow Congress to employ diversity in the federal framework by permitting states to experiment with different approaches. *Id.* at 1695–96.

221. Admittedly, a limitation of this idea is that it has not yet been developed in other federal/state contexts. A few obvious, yet unanswered, questions arise: Does quasi-cooperative federalism impose an actual *duty* on the states to take any action? If so, what is the scope of the duty, and how would it be enforced? These questions are ripe for a subsequent article. The idea of quasi-cooperative federalism is proffered in the bankruptcy exemptions context for two narrow and specific purposes: (i) it is descriptive, since Congress has offered "uniform" standards along with a mechanism for state vetoes in the form of the opt-out; and (ii) it relates to the preemption analysis in the bankruptcy exemptions context by providing this two-step defense to preemption claims—a meaningful review in light of the purpose of the federal standard, followed by a state law designed to serve that purpose.

that differ widely among states, such as cost of living, labor market conditions, housing availability and costs, availability of state-based welfare benefits, and the like.

The most fundamental guiding principle of reform is that exemptions in bankruptcy should be designed to allow a debtor to retain the categories and amounts of property necessary to pursue future income. This principle derives from research showing that obtaining post-bankruptcy income is the key to debtor rehabilitation.

1. Justification

While bankruptcy scholars have long agreed that post-bankruptcy income is the key variable to debtor rehabilitation, this theory was recently tested in a study conducted by Professor Katherine Porter and Dr. Deborah Thorne.[222] Using original, longitudinal data, the researchers examined the "fresh start" assumption against the experiences of a group of Chapter 7 debtors one year after bankruptcy. For purposes of the study, the "fresh start" predicate was established by each debtor receiving a discharge.[223] The researchers discovered that one in three debtors was in the same or worse financial condition one year after Chapter 7 bankruptcy.[224]

For the families with continuing or exacerbated financial stress one year after receiving a discharge, the study concluded that the inability to sustain regular income was the primary cause of this continued distress.[225] The data established that triggers of income disruption included job problems, medical problems, and age.[226] "The major factor behind these families' continuing financial struggles is stagnant or declining income in the period following their bankruptcies. As [the study] demonstrate[s], *any factor that*

222. Katherine Porter & Deborah Thorne, *The Failure of Bankruptcy's Fresh Start*, 92 CORNELL L. REV. 67 (2006).

223. Porter and Thorne did not examine the effect of exemptions on the study subjects.

224. Porter & Thorne, *supra* note 222 at 67.

225. *Id.* at 70.

226. *Id.* at 99–114.

leads to reduced postbankruptcy income will severely handicap a family's prospects for a meaningful fresh start."[227]

The exemptions reform ideas address, most directly, the first of the income disruptions: job problems. The premise is that a debtor whose essential property—such as her motor vehicle, computer, or tools of the trade—is repossessed by the trustee will more likely experience job problems.[228] In this construct, job problems include both losing a job and being unable to obtain employment or advancement.

This premise is supported by data showing the types of assets typical bankruptcy debtors own. For instance, bankruptcy debtors are more likely than non-debtors to own a motor vehicle; those who have filed bankruptcy are also much less likely to own a home than non-debtors. Citing a 2004 survey that followed a major longitudinal study from 1979, one study noted that 92.4% of debtors who had filed bankruptcy owned motor vehicles versus an ownership rate of 89.5% for those who had never filed.[229] Non-debtors owned homes at a rate of 73.3%, versus a homeownership rate of 59.3% for those who had filed bankruptcy.[230] This data suggests that debtors are more reliant on motor vehicles than those who have not filed bankruptcy.

2. *Structuring reforms*

One assumption is that the federal exemptions were adequately designed and thoughtfully structured to serve the Fresh

227. *Id.* at 117 (emphasis added).

228. One note about a major limitation of the role of exemptions in the fresh start: Only debtors with protectable interests in would-be exempt property will benefit. The reality is that many debtors filing bankruptcy do not have equity in the types of property exemptions are designed to protect. Exemptions do not provide benefits to many debtors occupying the strata of the structurally poor, many of whom never accumulate assets. For this reason, the target and beneficiaries of exemptions reform should be the "working poor," defined imperfectly as employed or employable debtors whose incomes are above federal poverty guidelines but below median income levels. Many debtors in this seam have realistic opportunities to secure future employment and, thereby, future income. As post-bankruptcy income is the *sine qua non* of the fresh start, exemption policy should be designed to enable—or, at a minimum, avoid disrupting—a debtor's post-bankruptcy efforts to obtain or advance in employment.

229. Jay L. Zagorsky & Lois R. Lupica, *A Study of Consumers' Post-Discharge Finances: Struggle, Stasis, or Fresh-Start?*, 16 AM. BANKR. INST. L. REV. 283, 298 (2008).

230. *Id.*

Start Function. This Article does not posit that the federal exemptions are ideal or perfect. Instead, due regard is given to the lengthy and deliberative process undertaken by Congress in adopting the specific categories and dollar amounts of the federal exemptions. The fresh start was identified as the primary purpose of having exemptions in bankruptcy, and the resulting federal exemptions were enacted to meet this objective. What exemption levels in bankruptcy are optimal? Or, stated differently, what qualities of exemptions provide utility for a financially distressed debtor seeking post-discharge rehabilitation?

Three factors contributing to the Fresh Start Function can be teased out of the existing federal exemptions scheme: housing agnosticism, nominal sufficiency, and flexible allocation.

This Article's model of state exemption reforms envisions opt-out states undertaking deliberative reviews of existing exemptions in light of these factors.[231] Leveraging a primary strength of federalism, state legislatures can experiment with different formulas, amounts, and rates for bankruptcy-specific exemptions. The factors are not formulaic, but rather principled. Different conditions, such as cost-of-living differences among the states, will necessarily prevent the emergence of a monolithic set of exemptions resulting from this model. Harmonization of these factors will be driven by economic and practical factors in the states, including considerations related to the labor market, transportation infrastructure, tax policy, costs of housing, and the like.

a. Housing agnosticism. Most state general exemption schemes discriminate against non-homeowners. This discrimination should be eliminated, or at least significantly restricted, in bankruptcy.

By providing homestead exemptions to homeowners, with no corresponding exemption to non-homeowners, most state general exemptions grant elevated status to certain forms of housing—ownership is preferred over renting. While all debtors have an interest in having a place to live post-bankruptcy, there is no empirical evidence that owning a home aids in a debtor's quest to

231. Although most needed in many opt-out states, well-structured reforms could conceivably improve fresh starts even in states that permit the use of federal exemptions.

secure or advance future income. To be sure, there are important societal and governmental policy interests in incentivizing homeownership. As the recent financial crisis reminded us, however, owning a home is no panacea for building wealth or establishing financial security. To the contrary, recent trends suggest that many homeowners view their homes as ATMs (in the form of home equity lines of credits and refinancings) when home values improve and albatrosses when home values fall. The headlines concerning foreclosures and "short sales" are manifest. While exemption policy should not necessarily serve a paternalistic function of telling debtors not to buy homes, exemptions, at best, ought to be more agnostic toward debtors' choices of living arrangements and whether to own residential property.

The federal exemptions take a large step toward eliminating pro-homeowner discrimination in the form of the "wild card" exemption. To implement an exemption scheme reflecting housing agnosticism, states should follow the lead of Congress. In the federal bankruptcy exemptions, a "wild card" feature permits debtors[232] to apply unused homestead exemption dollars to exempt assets other than a home, such as tools of the trade, a motor vehicle, and the like. In fact, unlike other particularized categories of exempt property, a debtor may use the "wild card" exemption to exempt his or her "interest in *any* property."[233]

The effect of the wild card is to largely level the playing field between homeowner debtors (with protectable equity) and other debtors. Specifically, the federal exemptions include a homestead exemption in the amount of $23,675. [234] The wild card permits a debtor to apply up to $11,850 of unused homestead exemption[235] to protect other property.[236] This feature allows a debtor who

232. In states that have not opted out of the federal exemptions.

233. 11 U.S.C. § 522(d)(5) (2016) (emphasis added).

234. *Id.* § 522(d)(1).

235. While the effect of the wild card exemption is to even the playing field between homeowner and non-homeowner debtors, and thereby inject a degree of housing agnosticism, even homeowner debtors are eligible to use the "wild card." Eligibility for the wild card does not depend on ownership, but rather the extent to which the homestead exemption is actually *used*. Accordingly, a debtor with little to no equity in his home may still be able to use the wild card.

236. 11 U.S.C. § 522(d)(5).

chooses to rent,[237] rather than own, housing to enjoy an aggregate exemption level more in line with amounts for homeowners.

Almost all existing state exemption schemes continue to reflect this pro-home-ownership bias. This should not be surprising, as general state exemptions are justified, in part, by the idea that allowing a financially distressed debtor to keep her home serves important governmental and societal policies of maintaining the family. Indeed, this policy is an imperative component of the Independent Subsistence Function of state exemptions.[238]

There is no empirical evidence, however, that incentivizing home ownership furthers the Fresh Start Function. Because of the cyclical nature of home values, falling market conditions may, in fact, contribute to financial distress[239] by removing a potential source of cash and by preventing otherwise mobile debtors from being able to move to find better employment opportunities.

Since many bankrupt debtors do not own homes, or own homes with little to no equity, including a wild-card feature in opt-out states would serve three purposes. First, it would remove the incentive to own an asset not directly related to a debtor's ability to pursue future income. By leveling the playing field between homeowner and non-homeowner debtors, a wild-card exemption would acknowledge implicitly that the total costs of housing going forward may be more determinative in the fresh start equation than the form of those costs (*e.g.*, rent versus a mortgage payment). Second, a wild-card exemption would largely remove discrimination against non-homeowners, where that discrimination is justified by the Independent Subsistence Function but not the Fresh Start Function.

Last, and perhaps most importantly, a wild-card feature would free up a significant amount of exemption dollars for debtors to allocate in the way optimal for each. One debtor may prefer a larger allowance for keeping a motor vehicle, while another may use those exemption dollars to protect more tools of the trade

237. Or debtors who own homes that either have little equity or are under water.

238. *See supra* Part I.

239. The opposite may hold true in periods of rising home prices, with increased home values placing debtors in a superior financial position on a balance sheet basis.

related to their craft or industry. This flexibility would place debtors in a position to decide what property is most crucial.

In addition to enacting a wild-card provision to address housing agnosticism, state reforms should address the questions of what amounts of exemption dollars should be designated and how they should be designated among different classifications of protected property. These questions introduce, respectively, the interrelated factors of nominal sufficiency and allocative flexibility.

b. Nominal sufficiency. The concept of nominal sufficiency rests on the notion that providing sufficient *dollar amounts* of exemptions is necessary to serve the Fresh Start Function. At extremes, an exemption scheme that provides one dollar of protection would put a distressed debtor with protectable assets in a less favorable position to rehabilitate than the same debtor would enjoy under a scheme that provided unlimited dollar amounts for exemptions. For a debtor with a modest paid-for car, for instance, having a sufficient dollar amount of exemptions could be the difference between keeping her car after bankruptcy or having the car repossessed and liquidated by the trustee in bankruptcy. A debtor under the former scenario would be in a superior position.

The overall aim of the nominal sufficiency factor is to ensure protection, at a very minimum, for a typical debtor with protectable assets[240] to retain possession of as many of those assets as possible. On the margin, providing more generous dollar amounts of exemptions might also incentivize debtors to accumulate property. By allowing a debtor to retain a higher aggregate value of property following bankruptcy, the sufficiency factor will aid in serving the Fresh Start Function.

Congress has provided some meaningful guideposts to dollar amounts in the federal exemptions. An important threshold issue is that some types of property should, for policy reasons, be protected in *unlimited* dollar amounts. The federal exemptions

240. Essentially, assets purchased with cash or on unsecured credit and not otherwise encumbered by a perfected security interest. As part of the 2005 Amendments, the Code expanded rules to prevent a debtor from purchasing so-called "luxury items" on unsecured credit on the eve of filing bankruptcy.

include several "no dollar limit" categories, including unmatured life insurance contracts, professionally prescribed health aids, social security, unemployment, and veteran's benefits, among others.[241] While some of these items are currently protected under federal non-bankruptcy laws, as well as laws in some states, any meaningful exemption reforms by states should include a review of these categories and items to make sure that they enjoy unlimited dollar amount protections.

Outside the list of property that enjoys elevated status via unlimited exemptions, the dollar amounts for exemptions in bankruptcy should provide a guaranteed minimum of protection. For consumer property, the federal dollar amounts provide useful benchmarks expressed in nominal dollar amounts. Under the federal exemptions, each debtor is provided an exemption of $12,250 for basic consumer property, including household goods, household furnishings, and wearing apparel. Additional amounts are provided for specific property categories, including jewelry ($1,550) and motor vehicles ($3,675). "Tools of the trade" enjoy a separate category under the federal exemptions, and the current amount for this type of property is $2,300.[242]

c. Allocative flexibility. Determining what types of property should be protected by exemptions should be a central issue in structuring bankruptcy-specific exemptions. A simple example is illustrative. Assume after undertaking a meaningful review of existing exemptions, opt-out State *X* determines that $40,000 is an appropriate amount[243] to satisfy nominal sufficiency. Assume further that State *X* determines that an appropriate homestead exemption is $15,000 and that a wild-card exemption would permit any unused homestead exemption to be allocated dollar-for-dollar over other property categories. This illustration raises two interrelated issues: (i) other than homestead, what other categories of consumer property deserve exempt status in bankruptcy and (ii) how are dollar amounts assigned to each category.

241. *See* 11 U.S.C. § 522(d)(7)–(12).

242. *Id.*

243. As a multifactor model, this illustration assumes that State *X* determines that this amount is nominally sufficient in the context of all three factors.

A logical and useful starting point is a comparison between federal bankruptcy exemptions and State *X*'s existing general exemptions. The most straightforward method for determining the sufficiency of property categorization is to use the federal exemptions as a base structural template. For instance, if State *X* does not provide for an exemption category for "tools of the trade," then it should. The federal list of property categories is neither long nor particularly complicated.

There is ample evidence that Congress had the Fresh Start Function in mind when debating and structuring the federal exemptions. The individual property categories that resulted from the legislative process can and should serve as a useful guide that allows State *X* to avoid reinventing the "property categories" wheel.[244] Since the federal categories are viewed as a template, State *X* would have flexibility to add or massage categories. For instance, some rural states may want to maintain an exemption category for agricultural implements. Other states may want to preserve the so-called "family heirloom" category that exists in many bankruptcy-neutral schemes.

A related and equally important issue is how to allocate exemption dollars *among* property categories. As with property categories, the question of dollar allocation among categories is ripe for state-based customization. Take the example of an exemption for a motor vehicle. Should all opt-out states have a motor vehicle exemption available to debtors in bankruptcy? Given that the federal exemptions are proffered as a template, and those exemptions include a motor vehicle category, the answer is "yes." But to what extent? And at what cost to other categories? A small yet urbanized state with a highly developed public transportation system might allocate fewer dollars to a motor vehicle exemption than a geographically large and rural state. For large percentages of the population base in some states, owning a car might be a virtual necessity for most jobs. In states where most residents live in urban areas with reliable public transportation, motor vehicles may serve as more of a convenience than a necessity.

244. There is risk that Congress could add to or remove property categories from the federal exemptions list. This discussion assumes that this possibility is remote.

B. Parting Thoughts on the Political Calculus of Reforms

Some in Congress envisioned states reexamining their exemption schemes as part of deliberating whether to opt out of the federal exemptions. Though many states passed laws electing to opt out of the federal exemptions, too few failed to advance efforts at exemption reform. Several forces have suppressed efforts for broad exemption reforms in the states. Reform efforts pit familiar rivals against each other: On one hand, consumer advocacy groups push for states to liberalize exemptions in favor of debtors; on the other, creditor constituencies resist these efforts.

Enacting bankruptcy-specific exemptions, as opposed to reforming generally applicable exemptions, cuts through some of the political resistance to reform in a few important ways.

First, the scope and "cost" of bankruptcy exemptions are small relative to liberalizing general exemptions. General exemptions prevent unsecured creditors from seizing a debtor's property under state law collections suits. The number of individuals facing state law collection suits dwarfs the number of individuals filing bankruptcy. Thus, the group of beneficiaries of modernized bankruptcy exemptions is relatively small.

Nationally, the number of debtors potentially affected by general exemption reforms is unsettlingly high. Data on the numbers of Americans facing collection suits provide the picture. For instance, approximately "[o]ne in 10 working Americans between the ages of 35 and 44 are getting their wages garnished."[245] Almost all of these garnishments are filed by unsecured creditors, the group that would bear the "costs" of liberalizing general state exemptions. The enormous political resistance to general exemption reform is both understandable and predictable.

In addition to specific data on garnishments, more general data on collections reveals an epidemic in past-due accounts in America. For instance, a report released in July 2014 by the Urban Institute found that 35% of adults in America with a credit file

245. Chris Arnold & Paul Kiel, *Millions of Americans' Wages Seized over Credit Card and Medical Debt*, NPR (Sept. 15, 2014, 4:52 AM), http://www.npr.org/2014/09/15/347957729/when-consumer-debts-go-unpaid-paychecks-can-take-a-big-hit.

(about 77 million Americans) have a report of debt in collections.[246] On average, these adults owe approximately $5,178.[247] For a debt to be in collections, a non-mortgage bill—such as a credit card, medical, or utility bill—must be more than 180 days past due.[248] Furthermore, approximately 5.3% of those Americans with a credit file have a report of a past due debt (one that is not yet in collections), which means that they are between 30 and 180 days late on a non-mortgage payment.[249]

Liberalizing general exemptions could potentially impair the leverage and position of unsecured creditors in the cases of the 40.3% of American adults who are in default!

By contrast, bankruptcy-specific exemption reforms would affect a much smaller group of debtors—those filing bankruptcy—in a context in which existing exemption schemes are producing very small returns to unsecured creditors. In bankruptcy parlance, a Chapter 7 case is a "no asset" case when no funds are available for distribution to unsecured creditors. Once an individual files bankruptcy, the trustee sells a debtor's non-exempt, non-encumbered property to produce funds for distribution to unsecured creditors. With existing exemptions that apply in bankruptcy, the "no asset" case, producing zero return to unsecured creditors, is very much the norm.[250] In cases involving very small dollar amounts of exempt property, trustees may forego repossessing property because there is not enough value to justify the costs of sale. In June 2014, an American Bankruptcy Institute study reported that only approximately 8% of Chapter 7 cases nationwide are closed as asset cases.[251]

Accordingly, unsecured creditors are receiving small returns in existing Chapter 7 cases under existing exemption schemes. In many Chapter 7 cases, the distribution is literally zero. Given

246. CAROLINE RATCLIFFE ET AL., URB. INST., DELINQUENT DEBT IN AMERICA 4 (July 30, 2014), http://www.urban.org/UploadedPDF/413191-Delinquent-Debt-in-America.pdf.

247. *Id.* at 7.

248. *Id.* at 8.

249. *Id.* at 2.

250. *See, e.g.*, U.S. DEP'T OF JUSTICE, UNITED STATES TRUSTEE PROGRAM: PRELIMINARY REPORT ON CHAPTER 7 ASSET CASES 1994 TO 2000 (2001).

251. Ed Flynn, *Chapter 7 Asset Cases and Trustee Compensation*, AM. BANKR. INST. J., June 2014, at 48, 48.

these facts, state efforts to provide bankrupt individuals enhanced exemption rights should have, under the worst-case scenario for unsecured creditors, an almost unfelt effect on the current near-zero return. While broad exemption reforms would provide nearly one-half of debtors outside of bankruptcy increased leverage, the much smaller number of bankruptcy filings paired with the reality of near-zero returns should alleviate much of the rational political resistance to state reform efforts.

Finally, the Model acknowledges the role of federalism in bankruptcy exemption policy. States concerned with preserving states' rights should find reforms more palatable. Guided only by the factors in the Model, each state can make its own determination of the optimal dollar amounts and categories of exemptions in bankruptcy. Rural states might bring a heavier focus on exempting motor vehicles, for instance. The concurrent exemption regime is preserved and enhanced through the federalist system.

CONCLUSION

Properly tailored reforms by states can and should solve the longstanding quandary of property exemptions created by the bankruptcy opt-out provision. Using the proposed framework, state reforms would survive constitutional scrutiny. The Code and fresh start doctrine empower states to implement bankruptcy-specific exemptions that address state-specific circumstances in light of the federal rehabilitative function of bankruptcy. Armed with clarity and meaningful guideposts for reform, states can now take steps to ensure that residents electing bankruptcy have access to broader and more effective "fresh starts."

APPENDIX A

Select State Bankruptcy-Specific Provisions

State	BSE Statute	Date(s)	Date of Repeal and Citation	Notable cases
California	CAL. CIV. PROC. CODE § 703.140 (West 2013)	First Enacted: July 31, 1995	–	Held unconstitutional by *In re Regevig*, 389 B.R. 736 (Bankr. D. Ariz. 2008).
Colorado	COLO. REV. STAT. § 13-54-104(1.1)	First Enacted: May 31, 1979	June 1, 1991	Held unconstitutional by *In re Mata*, 115 B.R. 288 (Bankr. D. Colo. 1990). *But see In re Kulp*, 949 F.2d 1106, 1109 n.3 (10th Cir. 1991).
Indiana	IND. CODE § 34-2-28(1)(a)(5)	July 1, 1989	July 1, 1998	Held unconstitutional by *In re Cross*, 255 B.R. 25 (Bankr. N.D. Ind. 2000).
Kansas	KAN. STAT. ANN. § 60-2315 (2013)	April 14, 2011	–	Held constitutional by *In re Westby*, 486 B.R. 509 (B.A.P. 10th Cir. 2013).
Michigan	MICH. COMP. LAWS ANN. § 600.5451 (West 2013)	Current: Dec. 31, 2012 First Enacted: Jan. 3, 2005	–	Held constitutional by *In re Schafer*, 689 F.3d 601 (6th Cir. 2012).
Montana	MONT. CODE ANN. § 31-2-106 (2013)	Current: Feb. 10, 2009 First Enacted: April 23, 1991	–	Held constitutional by *In re Shumaker*, 124 B.R. 820 (Bankr. D. Mont. 1991).
West Virginia	W. VA. CODE § 38-10-4 (2013)	March 8, 2003	–	Held constitutional by *Sheehan v. Peveich*, 574 F.3d 248 (4th Cir. 2009).