APPENDIX G-1.b

Analysis of Bankruptcy Exemption Policy (Prepared by Hon. William H. Brown and Professor Lawrence Ponoroff)

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Elizabeth Warren
Leo E. Gottlieb Professor of Law
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Re: Bankruptcy Exemption Policy

Dear Professor Warren:

As you know, we both have urged the National Bankruptcy Review Commission to adopt in its final report a recommendation that Congress eliminate the present "opt-out" and "election" arrangements in § 522(b) of the Bankruptcy Code in favor of a single list of mandatory, uniform bankruptcy exemptions. The justification for this position includes recognition that the fresh start in bankruptcy is a matter of federal, not state, concern. It is also premised on our observation that the present approach to exemption policy has introduced an enormous level of uncertainty into the consumer bankruptcy system. That uncertainty has eroded public confidence in the system, increased the costs of administering bankruptcy cases, and, in many cases, undermined the ability of the system to afford effective relief to debtors and creditors alike. These points are developed in much greater detail in the papers we each have authored for publication in the *American Bankruptcy Law Journal*,[*] copies of which have previously been made available to the Commission.

Up until this time, in the interest of seeing if we could achieve consensus on the principle that federal bankruptcy exemptions are preferable to state law deferral, we have deliberately refrained from venturing any opinions concerning the dollar levels at which the uniform federal exemptions ought to be set under the Bankruptcy Code. You have, however, asked that we give you our collective thoughts on just that issue to provide a basis for further discussion and deliberation in both the Consumer Bankruptcy Working

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[*] Hon. William H. Brown, *Political and Ethical Considerations of Exemption Limitations: The "Opt-Out" as Child of the First and Parent of the Second,* 71 AM. BANKR. L.J. 149 (1997); Lawrence Ponoroff, Exemption Limitations: A Tale of Two Solutions, 71 AM. BANKR. L.J. 221 (1997).

Group and, eventually, at the full Commission level. This letter is a response to that request. We will begin by sharing with you a few guiding principles that influenced our specific recommendations:

First, with respect to most categories of property, we believe that the exemption ought to be stated in a single, lump-sum cash value allowance rather than by particular type of property. This would have the benefit of eliminating any incentive to change the form in which assets are held prior to filing a bankruptcy case, and also would allow individual debtors to protect those assets most essential to their fresh start in a manner that parentalistic, predetermined categories, limited by individual dollar maximums, could not. This approach also would permit important regional differences to be reflected in national exemption policy. For example, it would allow the Alaskan fisherman to protect his fishing license and the Minnesota homeowner to protect her snowblower—items that would be difficult (albeit not impossible) to protect under the present bankruptcy exemption scheme contained in § 522(d) of the Code.

Second, and operating as a qualification on the first principle, we believe that the homestead, certain special categories of personalty (such as prescribed medical aids and appliances) and income, as distinguished from asset, exemptions should each be treated separately. This is generally consistent with the pattern now found in the § 522(d) exemptions as well as the exemption laws of most states. We also believe that the underlying policy reflected in current § 522(d)(5) should be retained in order to avoid unfair discrimination against non-homeowning debtors.

Third, while we are less concerned than some about the potential for a uniform system of federal exemptions to operate unfairly because of regional differences in cost of living, we believe that the problem would be adequately addressed by adjusting the exemption levels by regional CPI in much the same manner that § 104(b) of the Code now adjusts aggregate exemption levels every three years based on national CPI. If the Commission were to adopt that approach, you should consider the specific dollar amounts referenced below as the base to which the CPI adjustments could be made.

Fourth, we should mention that in formulating our proposal regarding mandatory federal bankruptcy exemptions we were to some extent influenced by a desire to simplify for courts and litigants the operation of § 522(f) concerning avoidance of liens impairing exemptions. Thus, these proposals would obviate the need for the current limitation on the debtor's avoiding power under § 522(f)(3), and also eliminate the continuing confusion in the case law over the extent to which the states can control the definition of when a lien impairs an exemption after the Supreme Court's decision in *Owen v. Owen*, 500 U.S. 305 (1991).

Finally, in setting specific dollar amounts, our bias was to select levels that were more-or-less on the high side of "average" among the states. That effort was complicated, of course, by the wide variation among the states, but our thinking was that, on the one hand, keeping the federal bankruptcy exemptions within range of most states would minimize the threat that uniform exemptions would increase the absolute number of

bankruptcy case filings, voluntary and involuntary. On the other hand, we believe that the high-end is appropriate because specific federal policies, particularly fresh start, obviously are implicated in a bankruptcy case in a way that simply is not the case in routine state collection actions.

Against the backdrop of this conceptual framework, our preliminary suggestions for the Commission's consideration follow:

Homestead We recommend an individual homestead exemption, applicable also to an interest by the debtor as a tenant by the entirety or joint tenant, of $40,000 (more than twice the current level) for debtors with no dependents. Like the proposal offered by the first National Bankruptcy Review Commission, however, we think this number should be adjusted upward by $3000 to $5,000 for each dependent supported by the debtor to a maximum of $55,000. While we recognize that this number may seem high to some (and perhaps low to others), in point of fact few debtor are likely to have this much equity, over and above the sum of nonavoidable liens, in their home. However, we think the ability to retain one's regular dwelling, or at least have the downpayment to purchase something almost comparable, is an important pragmatic and psychological component of the fresh start. By the same token, the level is more than low enough to prevent the kinds of abuses that have caught the attention of the popular press. Finally, we would note that we see no particularly compelling reason to limit, by acreage, the size of the homestead that can be exempted so long as the aggregate dollar limitation is not exceeded.

Tangible Personal Property We recommend a single lump sum cash allowance of $15,000 for tangible personal property of any kind (including cash and deposit accounts) to be selected by the debtor at the time of filing. Note that a debtor would have to use this exemption to preserve the cash value of an unmatured life insurance policy—presently exempt without limitation under the Code—as well as to exclude from administration any motor vehicle. We also intend that this "bushel-basket" exemption might include property rights represented by an symbolic or essential writing, such as stock certificates and other types of negotiable instruments.

Additional Exemption for Unused Homestead We urge continuation of the approach taken in current § 522(d)(5) of the Code to allow up to one-half of the unused amount of the homestead exemption to be applied by the debtor to any other property interest, real or personal. While this provision would primarily be aimed at the non-homeowning debtor, as under present law, it would not be so limited. However, because of the recommendation regarding a lump sum allowance for personalty there would be no need to retain the the $800 wildcard unrelated to use of the homestead amount.

Special Kinds of Personalty We recommend an unlimited exemption for

prescribed health aids and durable medical appliances more-or-less along the lines of current § 522(d)(9) of the Code. We also believe that a "burial plot" exemption of some sort may be justified, not to exceed a specified amount.

Income Exemptions We recommend continuation of the income-based exemptions in current § 522(d)(10) & (11), subject to the following modifications. We propose a significant increase, if not elimination, of any dollar limitation on a payment in respect of a personal injury claim. The current limitation is $15,000. *See* § 522(d)(11)(D). In addition, note that the exemption for a payment under a stock bonus, pension, profitsharing, etc. plan may need to be reworked as a combination asset/income exemption depending on whether the Commission decides to recommend that Congress overrule *Patterson v. Shumate*, 504 U.S. 753 (1992) (essentially excluding the corpus of most retirement plans from the property of the estate). In that event, a portion of the debtor's interest in or rights under such as plan may require independent exemption protection in order to make the exemption for payments under the plan meaningful. In addition, even if the *Patterson* exclusion is continued, because of uncertainty as to the scope of that decision as it relates to non-ERISA and other kinds of plans, a separate exemption for rights under a retirement or similar benefit plan may be appropriate, even if potentially redundant in some cases.

We would reiterate that we propose these exemptions as a "closed" system in bankruptcy cases, in lieu of both state and other non-bankruptcy federal exemptions. As under current law, however, in a joint case each debtor would be entitled to his/her own exemptions. Of course, there would no longer be any issue over the question of "stacking" state and federal exemptions, now precluded by § 522(b) of the Code.

We wish to stress that the above proposals are very preliminary in nature, probably still incomplete to some extent, and certainly in need of further refinement before amenable to adoption in final form. We hope that they do provide a basis for further discussion and study of this important issue.

Sincerely,

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