

The Exemption Opt-Out: Does It Violate the Constitutional Requirement of Uniformity?

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After enactment of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA), courts began examining the constitutionality of various provisions in the new law. Several courts have determined that the debt relief agency provision does not meet constitutional muster.¹ One question that has not yet surfaced is whether the exemption opt-out violates the uniformity requirement that appears in the U.S. Constitution. This article examines the new exemption opt-out provision and argues that it violates the uniformity requirement appearing in the U.S. Constitution, Article I, §8, Clause 4.

Exemptions Generally



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Exemptions in bankruptcy cases serve the purpose of assisting a debtor in obtaining his “fresh start” after filing a bankruptcy case. The bankruptcy estate consists of all of the debtor’s legal and equitable interests that exist at the time of

filing the bankruptcy case.² An exemption is an interest withdrawn from the estate, and thus, not available for liquidation to pay creditors. This allows the debtor to prevent the liquidation of certain property by claiming it as exempt.³ Property that is properly exempted under the Code is insulated from liability for pre-bankruptcy debts.⁴ Thus, exemptions play an important role in balancing the interests of creditors, who seek to achieve orderly liquidation of the bankruptcy estate, against the debtor’s goal of obtaining a fresh start.⁵

The Exemption Opt-Out

Congress has enacted a Bankruptcy Code that allows the debtor to utilize a federal exemption scheme. States are

¹ *Zelotes v. Martini*, 2006 WL 2321423 (D. Conn. Nov. 7, 2006); *Hersh v. U.S.*, 347 B.R. 19 (N.D. Tex. 2006); *Olsen v. Gonzales*, ___ B.R. ___ 2006 WL 2345503 (D. Ore. Aug. 11, 2006).

² 11 U.S.C. §541.

³ *Taylor v. Freeland and Kronz*, 503 U.S. 638, 642, 112 S.Ct. 1644, 1647, 188 L.Ed.2d 280 (1992).

⁴ *Owen v. Owen*, 500 U.S. 305, 308, 111 S.Ct. 1833, 1835, 114 L.Ed.2d 350 (1991).

⁵ *In re Beezley*, 994 F.2d 1433 (9th Cir. 1993).

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allowed to opt out of the federal exemption scheme.⁶ The proper state law under which to claim exemptions depends on the debtor’s residence and whether the debtor has recently changed his state of domicile. Thus, a debtor may utilize exemptions under federal law “or state or local law that is applicable on the date of the filing of the petition at the place in which the debtor’s domicile has been located for the 730 days immediately preceding the date of the filing of the petition.” If the debtor’s domicile has not been located in a single state for the 730-day period, the debtor may elect that law from his place of domicile for the 180 days preceding the 730-day period.

The changes made under BAPCPA

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increased the residency requirement for determining the proper state law election from 180 days to 730 days.⁷ Previously, the 180-day requirement worked harmoniously with the statute that designates the proper venue for filing bankruptcy cases. Venue for the bankruptcy case is appropriate in the district where the debtor has been located for the 180 days immediately preceding the

⁶ 11 U.S.C. §522(b)(3)(A). That section provides in pertinent part: Subject to subsections (o) and (p) any property that is exempt under federal law, other than subsection (d) of this section, or state or local law that is applicable on the date of the filing of the petition at the place in which the debtor’s domicile has been located for the 730 days immediately preceding the date of the filing of the petition or if the debtor’s domicile has not been located at a single state for such 730-day period, the place in which the debtor’s domicile was located for 180 days immediately preceding the 730-day period or for a longer portion of such 180-day period than in any other place.

⁷ Formerly, 11 U.S.C. §522(b) stated: (b) Notwithstanding §541 of this title, an individual debtor may exempt from property of the estate the property listed in either paragraph (1) or, in the alternative, paragraph (2) of this subsection... Such property is—

(1) property that is specified under subsection (d) of this section, unless the state law that is applicable to the debtor under paragraph (2)(A) of this subsection specifically does not so authorize; or, in the alternative; (2) (A) any property that is exempt under federal law, other than subsection (d) of this section, or state or local law that is applicable on the date of the filing of the petition at the place in which the debtor’s domicile has been located for the 180 days immediately preceding the date of the filing of the petition, or for a longer portion of such 180-day period than in any other place.

commencement of the case.⁸ Thus, the changes under BAPCPA created a conflict between two statutes that had previously worked harmoniously together. Previously, the exemptions required that they be claimed under the law of the same district that was the proper venue for the case. The changes under BAPCPA now provide that appropriate venue may be in one district while requiring the exemption scheme from a different district for certain cases, depending on the timing of the debtor’s change in domicile.

Uniformity Is Geographic

The U.S. Constitution grants Congress the power to enact uniform bankruptcy laws. Congress has the power “to establish a uniform rule of naturalization in uniform laws on the subject of bankruptcies throughout the United States.”⁹

The framers of the Constitution sought to address the disparity of insolvency laws among the states. Recognizing that the

effect of discharge varied from state to state, the Constitutional requirement of uniformity was put into place. The framers sought to provide Congress with the power to enact uniform laws to prohibit private bankruptcy laws and circumvent questions about whether one state had to recognize the relief given to a debtor by another state.

The U.S. Supreme Court has recognized:

The laws passed on a subject, must, however, be uniform throughout the United States, but that uniformity is geographical and not personal, and we do not think that

⁸ 28 U.S.C. §1408 provides in pertinent part: Except as provided in §1410 of this title, a case under title 11 may be commenced in the district court for the district—

(1) in which the domicile, residence, principal place of business in the United States, or principal assets in the United States, of the person or entity that is the subject of such case have been located for the 180 days immediately preceding such commencement, or for a longer portion of such 180-day period than the domicile, residence or principal place of business, in the United States, or principal assets in the United States, of such person were located in any other district; or (2) in which there is pending a case under title 11 concerning such person’s affiliate, general partner or partnership.

⁹ U.S. Const. art. I, §8, cl. 4.

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revision of the act of 1898 as to exemptions is incompatible with the rule.¹⁰

The *Moyses* Court interpreted the uniformity requirement by holding that a statute passes constitutional muster if the bankruptcy law treats the trustee, as a hypothetical judicial lien creditor, in the same fashion as he would be treated outside the bankruptcy case under state law. The Court stated that the law could operate differently in different states, but that the trustee must take in each state whatever would have been available to him if the bankruptcy law had not been passed. Thus, the uniformity requirement requires that the trustee be treated in the same fashion, in or out of the bankruptcy forum.¹¹

The *Moyses* Court recognized that contracts that create debts are made under existing state exemption laws and that “no creditor can reasonably complain if he gets his full share of all that the law, for the time being, places at the disposal of creditors.” The Court reiterated that “it is quite proper, therefore, to confine its operation to such property as other legal process could reach.”¹² Thus, the *Moyses* Court recognized that uniformity was achieved, in a geographical sense, when the trustee and the creditors may avail themselves of exemption laws that exist within a geographical region.

The new §522(b) does not meet the requirement of geographical uniformity. In

a case where a debtor has not lived within the district of proper venue for the requisite 730-day period, he must utilize the exemption scheme from the state of his prior residence. In a case where a debtor has not lived within the district for the 730-day period, he must utilize the exemption scheme from a foreign district, the district of his former domicile. By requiring that a debtor take his exemptions with him as he changes domicile, the exemptions become personal rather than geographic. This denies the trustee recourse to the property of the debtor that he would take by “other legal process” and abridges the uniformity requirement.

States have enacted opt-out provisions that have been deemed constitutional. The fact that exemption results are different from state to state does not in itself make the opt statute unconstitutional.¹³ Rather, it is the changes made under BAPCPA that require that the trustee look to separate state’s law and apply it in his own district that make the statute unconstitutional. Those changes place the trustee in a position of having the burden of using a law completely foreign to the district and creates an unconstitutional tension between the exemption opt-out and the venue requirement. A fundamental tenet of uniformity is that a state is not empowered to make or enforce any law governing bankruptcies that impairs obligations under contracts, extends to persons outside of its jurisdiction, or conflicts with national bankruptcy laws.¹⁴

Thus, the statute violates the uniformity clause by denying the trustee the benefit of geographical uniformity, which would guarantee that he would not have to apply exemption laws from a foreign jurisdiction.

Finally, no legislative history exists upon which any court considering the issue may determine the justification for enacting a non-uniform law.¹⁵ Simply put, courts have nothing to rely on to determine congressional intent in changing the domiciliary requirement.

The Opt-Out Statute Defeats the Policy Underlying Uniformity Requirement

Several different policy interests were met by the former exemption opt-out provisions that are not met under the opt-out as amended under BAPCPA. An exemption is a property interest. Uniform treatment of property interests, by state and federal courts, serves to reduce uncertainty and discourage forum-shopping. Uniform treatment of property interests by both state and federal courts prevents a party from receiving a windfall merely by “happenstance” of bankruptcy.¹⁶ Property interests are determined under state law. It defies the policy underlying uniformity to

¹⁴ *International Shoe v. Pinkus*, 278 U.S. 261, 49 S.Ct. 108, 73 L.Ed. 318 (1929).

¹⁵ At least one commentator hypothesizes that Congress was targeting debtors who move to states with more generous exemptions. See Howard, “Exemptions Under the 2006 Bankruptcy Amendments: A Tale of Opportunity Lost,” 79 Am. Bankr. L.J. 397, 411 (2005). In fact, no legislative history exists that supports this theory. The House report dealing with this section only explains its application. House Report No. 109-31, Pt. 1, 109th Cong., 1st Sess. 72 (2005).

¹⁶ *Butner v. United States*, 440 U.S. 48, 99 S.Ct. 914, 59 L.Ed.2d 136 (1979).

¹⁰ *Hanover National Bank of the City of New York v. Moyses*, 186 U.S. 181, 188, 22 S.Ct. 857, 861, 46 L. Ed. 1113 (1902).

¹¹ *Moyses* at 190.

¹² *Moyses* at 189.

¹³ *Stellwagon v. Clum*, 245 U.S. 605, 38 S.Ct. 215, 62 L.Ed. 507 (1918).

require application of a foreign state's law in the district of the bankruptcy filing, because it may create just such a "windfall" if the foreign exemptions are different from the forum state's exemptions. Requiring application of a different state's exemption laws within the forum state any time that a debtor changes domicile increases uncertainty, encourages forum-shopping, and gives the debtor the windfall that should be discouraged.

The policy of the geographic uniformity also recognizes the benefit of leaving matters to local judges relying on the state law that they are familiar with. Judges are denied this in cases where they are required to look to a foreign state's law. Under this new statute, bankruptcy courts could be called on to interpret exemption laws from all over the country.

Conclusion

Courts will recognize that the exemption opt-out provision no longer

works hand-in-hand with the venue statute. In those cases where debtors have changed their domicile within the 730 days preceding the filing of the bankruptcy, the uniformity requirement is abridged because of the mandate that a foreign district's exemption law be applied. Courts should determine that this violates the uniformity requirement, therefore the statute is unconstitutional. ■