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LIEN AVOIDANCE ON EXEMPTIONS: THE FALSE CONTROVERSY OVER OPT-OUT

LAWRENCE KALEVITCH*

In Owen v. Owen1 and Farrey v. Sanderfoot,2 the Supreme Court recently limited the ability of individual debtors3 to avoid4 judicial liens5 on their

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* Professor of Law, Shepard Broad Law Center of Nova University. LL.M., 1970, New York University; J.D., 1969, St. Louis University; B.A., 1966, University of Massachusetts. The author appreciates the assistance in the preparation of this article of Mr. Andrew Kessler, Nova class of 1992.
3. An individual debtor is a natural person as distinguished from partnerships and corporations. 11 U.S.C. § 101(36) (1988). Only the former receive exemptions of their property from creditor remedies.
   No property can be exempted . . . unless it first falls within the bankruptcy estate. Section 522(b) provides that the debtor may exempt certain property "from property of the estate"; obviously, then, an interest that is not possessed by the estate cannot be exempted. Thus, if a debtor holds only bare legal title to his house — if, for example, the house is subject to a purchase-money mortgage for its full value — then only that legal interest passes to the estate; the equitable interest remains with the mortgage holder, 11 U.S.C. § 541(d). And since the equitable interest does not pass to the estate, neither can it pass to the debtor as an exempt interest in property. Legal title will pass [to the estate], and can be the subject of an exemption; but the property will remain subject to the lien interest of the mortgage holder. This was the rule of Long v. Bullard . . . codified in § 522.
5. Owen, 111 S. Ct. at 1835-36 (emphasis in original). Section 522(f) provides:
   Notwithstanding any waiver of exemptions, the debtor may avoid the fixing of a lien on an interest of the debtor in property to the extent that such lien impairs an exemption to which the debtor would have been entitled under subsection (b) of this section, if such lien is —
   (1) a judicial lien; or
   (2) a nonpossessory, nonpurchase-money security interest in any —
      (A) household furnishings, household goods, wearing apparel, appliances, books, animals, crops, musical instruments, or jewelry that are held primarily for the personal, family, or household use of the debtor or a dependent of the debtor;
      (B) implements, professional books, or tools of the trade of the debtor or the trade of a dependent of the debtor; or
      (C) professionally prescribed health aids for the debtor or a dependent of the debtor.
exempt property in bankruptcy. Along with commentators and lower courts, the Supreme Court improperly assumed that section 522(f) of the Bankruptcy Code (the Code) applies to bankruptcy cases in which state exemptions apply. However, section 522(f) should apply only when a debtor in bankruptcy chooses federal exemptions. As section 522(f) was originally proposed by the Bankruptcy Commission in 1973, it would have never applied to cases in which the debtor in bankruptcy used state exemption law. Had the courts

6. Exempt property traditionally means that property of a debtor which creditors may not seize to satisfy their claims against the debtor. Under the bankruptcy law prior to 1979, the Bankruptcy Act of 1898, as amended, incorporated the exemption law of the states to determine which property of a debtor could not be administered for the benefit of creditors. Report of the Commission on the Bankruptcy Laws of the United States, H.R. Doc. No. 137, 93d Cong., 1st Sess., pt. 1, at 180 (1973) [hereinafter Commission Report], reprinted in W. Collier, Collier on Bankruptcy, 2d ed. (L. King ed. 15th ed. 1991) [hereinafter Collier on Bankruptcy]. As originally proposed by the Bankruptcy Commission in its Bankruptcy Act of 1973, exemptions in bankruptcy would have been determined solely by reference to section 4-503 of the proposal. Under that (unadopted) proposal, state exemption law would not have applied in bankruptcy cases. Id. at 125, reprinted in Collier on Bankruptcy, 2d ed. (L. King ed. 15th ed. 1991) [hereinafter Collier on Bankruptcy]. Whether or not the “opt-out” provision is constitutionally valid remains uncertain, and this paper excludes that issue. See In re Sullivan, 680 F.2d 1131 (7th Cir.1982), cert. denied, 459 U.S. 992 (1982). Cf. United States v. Security Indus. Bank, 459 U.S. 70 (1982).

7. See infra note 18.

8. See infra note 19.

9. The recent decisions in Farrey and Owen did not require the Court to decide the issue addressed in this paper. Both recent cases raised narrower issues which assumed the applicability of the subsection to state exemptions. Although the Court in either case might have considered the more general issue, its consideration was limited to logically subordinate propositions on which the lower courts had ruled. Farrey ruled that under § 522(f), a lien which arises on exempt property prior to, or contemporaneously with, the debtor’s interest is not avoidable. Farrey, 111 S. Ct. at 1830. Owen ruled that a lien on otherwise exempt property is voidable under § 522 even though the state exemption law denies such property exempt status because of the lien. Owen, 111 S. Ct. at 1836. The earlier decision of United States v. Security Industrial Bank, 459 U.S. 70, 82 (1982), ruled that § 522(f) did not apply retroactively to liens which had been perfected prior to the enactment of the Bankruptcy Code.

10. Commission Report, supra note 6. “Subdivision (f) is new . . . . The right to exemptions under this section cannot be affected by a judicial lien or any agreement other than an indefeasible security agreement.” Id. at 130, reprinted in Collier on Bankruptcy, 2d ed. (L. King ed. 15th ed. 1991) [hereinafter Collier on Bankruptcy]. The analysis presented in this paper asserts that the stated right to exemptions under “this section” meant the right to the federal exemptions which the Commission’s proposed bankruptcy code provided. Because Congress adopted an alternative exemption system resting on state law, and a set of federal exemptions similar to the Commission proposal, Congress might
noticed how and why the provision was enacted, the recent controversy about judicial liens on property exempt under applicable state law might have been averted. The general question which has been repeatedly asked is whether section 522(b)(2)(A) of the Code, the provision which permits permitting states to opt-out of the "federal exemptions" provided in section 522(d), includes an opt-out of the section 522(f) lien avoidance mechanism. This question assumes that section 522(f) applies when state exemption law is applicable. This article disputes that assumption.

Section 522(f) has become controversial for two reasons. First, many states "opted-out" of the federal exemptions, which meant that debtors of such states could not choose the federal exemptions provided by section 522(d), and instead were required to use the exemptions provided by the law of their domicile. States chose to opt-out because the federal exemptions were widely viewed as too generous.

This widespread opt-out movement had two consequences. First, several states limited their exemption laws so that property generally exemptible in that state became nonexempt if the property was subject to liens. Second, those liens which would inhibit the exemption of property under state law were the liens which could be avoided under section 522(f). This state development seemed to strangle the effect of section 522(f) and no doubt was intended to have that effect. The courts have differed on the effec-

have made clear that subsection (f) applies only to cases in which the debtor chose the federal exemptions. Part II explains this in more detail.

11. As Justice Scalia noted in Owen, the bankruptcy courts have been, for the most part, harmonious in their rulings on the application of § 522(f) to cases in which the debtor chose the federal exemptions. Owen, 111 S. Ct. at 1836-37. The inter-circuit conflict which led the Court to grant certiorari in both Sanderfoot and Owen came from cases in which the courts differed on how § 522(f) applied when the debtor used state exemptions in the bankruptcy. See infra notes 19-20.

12. See supra note 6.


14. State exemption law must apply in cases arising in the 36 states which have opted-out of the federal exemptions. See supra note 6. In the remaining states, state exemption law may be chosen by the debtor. Thus, the question raised here does not depend at all on the applicable state's opting out of the federal exemptions.


17. See supra note 16 and accompanying text. The property which otherwise would be exempt under such statutes would not be exempt if encumbered by liens. Id.

tiveness of such state exemption statutes. Some courts held these exemption statutes to be invalid in bankruptcy because they conflicted with the general policy of the paramount federal bankruptcy law, and specifically with section 522(f). Other courts upheld the state exemption laws, reasoning that the opt-out opportunity provided by the Code includes opt-out from section 522(f). Because of the conflict on the issue in the circuits, the Supreme Court granted certiorari21 and repudiated the view that the opt-out provision includes section 522(f).22

A second and particular effect of section 522(f)(1) became notorious in the domestic relations field because of cases like *Sanderfoot*.24 Section 522(f)(1) apparently upset legitimate expectations produced by judicially ordered property settlements.24 In such divorce matters, property retained

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19. See Dominion Bank of the Cumberlands, NA v. Nuckolls, 780 F.2d 408 (4th Cir. 1989); *In re Thompson*, 750 F.2d 628 (8th Cir. 1984) (refused to avoid nonpurchase-money security interest under § 522(f)(2) under opt-out use of state exemptions though state livestock exemption, Iowa Code § 627.6.11(b), permitting exemption for farming operation, because § 522(f)(2)(A) only includes "animals ... held primarily for the personal, family, or household use of the debtor. . ."); *In re Leonard*, 866 F.2d 335 (10th Cir. 1989); see also *In re Brown*, 734 F.2d 119 (2d Cir. 1984) (properly ruling state exemption law inapplicable to case in which debtor chose federal exemptions).

20. See *Owen v. Owen*, 877 F.2d 44 (11th Cir. 1989), rev'd and remanded, 111 S. Ct. 1833 (1991); *In re Pine*, 717 F.2d 281 (6th Cir. 1983); *In re McManus*, 681 F.2d 353 (5th Cir. 1982).


23. The controversy boiled over to the popular press after the Court of Appeals for the Seventh Circuit decided in favor of lien avoidance in *Farry v. Sanderfoot*, 899 F.2d 598, 606 (7th Cir. 1990), rev'd and remanded, 111 S. Ct. 1825 (1991). See *Maus v. Maus*, 837 F.2d 935 (10th Cir. 1988) (holding lien imposed by divorce decree a "judicial lien" for purposes of § 522(f)(1)).

24. E.g., *In re Pederson*, 875 F.2d 781 (9th Cir. 1989); *Maus v. Maus*, 837 F.2d 935 (10th Cir. 1988). *Contra* *Boyd v. Robinson*, 741 F.2d 1112 (8th Cir. 1984); *In re Borman*, 886 F.2d 273 (10th Cir. 1989); *In re Donahue*, 862 F.2d 259 (10th Cir. 1988).

25. The sharpest management of the problem specifically before the Court in *Owen* and *Sanderfoot* would have been the inclusion or exclusion of judicial liens arising out of divorce decrees and settlements. Unpopular as the former view would appear, there is no reason in principle, nor legislative direction otherwise, than to assume that Congress intended to permit the avoidance of judicial liens on exempt property including those which grew out of a divorce proceeding. In principle, former spouses with the security of a court-ordered lien are no different from other creditors whose claims are secured by a judicial lien. Each party has taken security for a claim through judicial action. Each supposes that some protection came from the lien. No such party has eliminated the risk of loss, diminution of value or other dissipation of the property. Inherent in the lien and debt is risk. A former spouse is not entirely similar to a secured creditor who willingly bargains for some such degree of risk in everyday transactions. Interestingly, a former spouse given a lien to protect a claim is far more like an unsecured creditor who involuntarily is forced by a debtor to impose judgment and lien on debtor's property because debtor has become delinquent. Because most debtors do pay creditors, an unsecured creditor forced to take judicial action is not undertaking a routine transaction. Surprising as it may seem, some creditors take such action no more
by one of the parties would, by court order, secure debt owing to the former spouse or to creditors. Such a lien imposed by the court, rather than created consensually by the divorcing parties, is a judicial lien and is clearly within the scope of section 522(f)(1). The party awarded the property subject to the judicially created lien might use section 522(f)(1) in a subsequent bankruptcy to avoid the lien if the encumbered property were exempt in bankruptcy from creditors. The avoidance of the judicial lien under section 522(f)(1) wrecks the presumably fair and equitable split of property or debt achieved in the divorce proceeding, because the property held may usually discharge the underlying debt as well.

Furthermore, divorce and bankruptcy are not linked solely because section 522(f)(1) appears to present the opportunity Sanderfoot sought. Congress specifically reconsidered the question of domestic relations and bankruptcy and reconstructed the nondischargeability section (11 U.S.C. § 523(a)(5)) to meet such problems they foresaw. That Congress missed the arguably inequitable effect on matters such as Sanderfoot is undoubted. Yet its having considered the special place of “divorce debt” perhaps should have led the Court to say what it often has: Congress should address the matter if our result is unsatisfactory. I suppose politically there is to be little question that Congress would exclude Sanderfoot and like cases from the judicial lien avoidance section. Perhaps forcing Congressional reconsideration would have been better than the Court’s troubled decision because of other provisions in the Code under which such divorce liens may come under attack. Politically it should be easier to insulate domestic relations matters from bankruptcy than it has been through the principles of the present Code. For a suggested amendment, see infra part IV.

26. Many divorce liens have no risk of avoidance under § 522(f) because they are neither judicial liens (§ 522(f)(1)) nor nonpossessory, nonpurchase money security interests (§ 522(f)(2)). Thus, where the parties agree to the creation of a mortgage on the homestead, for example, to secure a claim, the consensual lien created suffers no risk under the subsection. If a divorce court ordered the debtor spouse to agree to a mortgage in favor of a creditor spouse, it is unclear whether a judicial lien or a consensual lien would thereby arise for purposes of § 522(f). It is said that divorce courts have refrained from that tactic in order to preclude a later bankruptcy avoidance of the lien.

27. The need for security for the debt created in the divorce is, of course, produced largely by the dischargeability in bankruptcy of property settlements under § 523(a)(5). 11 U.S.C. § 523(a)(5) (1988). The rule is otherwise as to debt for alimony, maintenance or child support, but the line is never as clear as the creditor spouse would prefer. Id.

28. In settlements which the parties voluntarily agree, the hazard of § 522(f) is untroublesome because the parties may create a consensual lien, typically in the form of a mortgage on the realty, which is not affected by § 522(f) which applies only to judicial liens (on real or personal property) and nonpossessory, nonpurchase money security interests on defined personality. Although divorce courts might suggest that the parties “voluntarily” agree to a mortgage to secure a promise, and thus avoid the problem in a future bankruptcy, it is doubtful that these courts can compel an unwilling party to agree. Thus, the involuntary lien is created to protect the promisee.

29. See supra note 5.

30. The view taken here, however, is that no judicial lien on property which a debtor has exempted under state exemption law “impairs an exemption to which the debtor would have been entitled,” which is the material language of the body of § 522(f). See infra notes 64-72 and accompanying text.

31. The need for avoidance arises from a traditional bankruptcy rule: that liens on exempt property survive bankruptcy unless avoided in the bankruptcy case. See supra note 4.

32. Although debt owed to a former spouse is nondischargeable if for alimony, maintenance
Thus, bankruptcy subverted the equitable property division of the divorce court. Farrey v. Sanderfoot is a typical case. The other recent decision of the Supreme Court, Owen v. Owen, is atypical and less problematical in divorce matters, but its apparent limitation on a state’s opt-out power presents grave implications.

I. The Two Cases: Sanderfoot and Owen

A. Farrey v. Sanderfoot

In Farrey v. Sanderfoot, the divorce court ordered Sanderfoot to make payments to Farrey in order to equalize the property division that awarded Sanderfoot the family home, which had previously been jointly owned by the parties. The court awarded Farrey a judicial lien on the family home. Shortly thereafter, and before performing the payment promised under the decree, Sanderfoot filed chapter 7, listed the home as exempt property under the applicable state exemption law, and moved to avoid Farrey’s lien. The bankruptcy court denied Sanderfoot’s attempt to avoid the lien under section 522(f)(1). The district court reversed, and the Seventh Circuit affirmed, despite a vigorous dissent from Judge Richard Posner. On the rationale of that dissent, the Supreme Court reversed the Seventh Circuit decision and held that “§ 522(f)(1) of the Bankruptcy Code requires a debtor to have possessed an interest to which a lien attached, before it attached, to avoid the fixing of the lien on that interest.”

The Court relied on the expression “fixing of a lien on an interest of the debtor,” which appears in the body of section 522(f). A lien cannot fix on one’s interest in property, said the Court, until one has an interest in

or support, new or continuing responsibility for other debt, such as the common apportionment in a property settlement is dischargeable. 11 U.S.C. § 523(a)(5) (1988).

33. Bankruptcy has further effects or subversions of divorce settlements, of course, just as bankruptcy subverts most of the law regarding property and money. Whether it should or should not depends on the proper weighing of interests and policies. When Congress has weighed the various factors, at least the subversion is politically justifiable. When the subversion arises from legislative ignorance and accident, as in the matter under discussion, bold courts may rationalize to the right result, as in these recent Supreme Court cases. However, their rationalizations will march later litigants into deeper mischief. Better courts might have thought the matter out fully and seen that full consideration of the matter would have tamed the mischief completely. See infra part II.

35. Sanderfoot, 111 S. Ct. at 1827.
36. Id.
37. Id. at 1828.
38. Id.
39. Id.
40. Id.
41. Id.
42. Id. at 1831.
property.\textsuperscript{43} If one had no interest in the property when the lien attached, there was no fixing on one’s interest under section 522(f).\textsuperscript{44}

Thus, chronology answered the question presented. Because the parties had stipulated that debtor Sanderfoot’s interest in the property did not antedate the attachment of the judicial lien on the property, the Court could swiftly dispose of the case under state law.\textsuperscript{45} Unfortunately, state law was thought by the Court to determine that question, and more than likely neither state precedent nor statute will have any direct message on the issue in future cases.\textsuperscript{46} Yet more state law and analogy will busy the bankruptcy dockets for no purpose other than the Court’s fixing the issue under section 522(f) in this manner.

B. Owen v. Owen

Similarly, the companion case of Owen v. Owen\textsuperscript{47} was reversed and remanded for the application of state law. In Owen, the state law issue was thought to be whether the judicial lien attached simultaneously with the debtor’s interest in homestead property and thus was not a “fixing” on the debtor’s interest in the property.\textsuperscript{48}

Ms. Owen had obtained a judicial lien on Mr. Owen’s condominium prior to amendment of the Florida homestead exemption, which first permitted Mr. Owen the exemption.\textsuperscript{49} However, Florida case law limits the homestead exemption: Judicial liens on the property antedating the homestead interest are valid.\textsuperscript{50} The lower courts barred the avoidance of this judicial lien

\textsuperscript{43} Id. at 1830.

\textsuperscript{44} Id. at 1829.

\textsuperscript{45} The majority opinion bears one paragraph in which it is asserted that the same result would have occurred without the stipulation of the parties. Id. at 1831. Justices Souter and Kennedy rejected this dictum in a concurring opinion. Id. at 1832-33.

\textsuperscript{46} Justice Scalia repudiated the Court’s paragraph ending with note 4 without comment. Id. at 1831. That paragraph utters bald dicta about the case had the parties not stipulated as noted in the accompanying text. Id. The dicta leaves no doubt as to the determinative effect of state law in such cases. As a result divorce counsel must draft the court order creating the divorce decree with the “prior interest” theory in mind so that the judicial lien attaches only to the portion of the property representing the lien holder’s prior undivided share of the property. Though such a draft seems safe from the Sanderfoot issue, it risks leaving the lien holder unsecured to the extent that one-half the property liened has or may later yield less than the claim it secures.

The question of the effect to be given state or federal nonbankruptcy law in bankruptcy widely plagues bankruptcy. Bankruptcy stumbles on nearly every controversial question on the uncertainty of how the interests of nonbankruptcy and bankruptcy law should mesh under the Code. At root, most of these controversies present a clash of complex and different policy points on which the courts must identify the stronger interest for lack of legislative direction.

\textsuperscript{47} 111 S. Ct. 1833 (1991).

\textsuperscript{48} Id. at 1838.

\textsuperscript{49} Previously, the homestead protection only applied to a “head of family” which the expression “natural person” replaced. Fla. Const. art. X, § 4.

\textsuperscript{50} See Bessmer v. Gersten, 381 So. 2d 1344 (Fla. 1980); Aetna Ins. Co. v. LaGasse, 223 So. 2d 727 (Fla. 1969); Volpitta v. Fields, 369 So. 2d 367 (Fla. Dist. Ct. App. 1979); Nationwide Fin. Corp. v. Thompson, 400 So. 2d 559 (Fla. Dist. Ct. App. 1971); In re Valdes, 81 Bankr. 141 (Bankr. S.D. Fla. 1987).
because Florida's opting out of the "federal exemptions" brought the issue down to the state law. Because Mr. Owen held no exemption as to the judicial lien of his former spouse under Florida case law, the lower courts barred his avoidance of this judicial lien in his bankruptcy.

The circuit courts have differed about whether states may deny exemption status on property subject to the kind of liens apparently avoidable under section 522(f). Under Sanderfoot, a debtor in bankruptcy may avoid a lien which attached to the property while the debtor held the same interest in the property that is brought into the bankruptcy. However, when state exemption law applies in the bankruptcy and denies an exemption only because of a lien covered by section 522(f), the courts have been troubled over whether the state law conflicts with section 522(f).

Owen, like Sanderfoot, fundamentally overlooks the necessity for, and the limited purpose of, section 522(f) lien avoidance which can only sensibly apply to cases in which the federal exemptions apply.

II. Why Section 522(f) Exists

The Owen opinion found no reason to distinguish the uniform results of the bankruptcy courts' decisions on the application of judicial lien avoidance in federal exemption cases from cases, like Owen, in which the debtor used state exemptions. Without evidence of some cardinal difference between the use of state exemptions rather than federal exemptions in a bankruptcy, courts should apply subsidiary exemption-protecting subsections such as section 522(f) to cases involving either set of exemptions. However, a cardinal difference justifies applying the section 522(f) lien avoidance provision differently.

52. See supra note 49 and accompanying text.
53. Owen, 86 Bankr. at 694-95.
54. Two schools of thought had arisen about the validity of state exemption laws which denied exemption of property on which § 522(f)(1) & (2) liens had attached prior to bankruptcy: One line of cases had ruled such exemption limitations invalid due to conflict with § 522(f).
55. Sanderfoot, 111 S. Ct. at 1829-30.
58. Owen, 111 S. Ct. at 1837-38.
59. The case of In re Thompson illustrates the lack of logic in applying lien avoidance to state exemptions. As noted, the court in this case refused the debtor's request to avoid a nonpurchase-money security interest in pigs the debtor primarily held for farming use. In re Thompson, 750 F.2d 528, 631 (8th Cir. 1984). The applicable exemption law permitted the exemption of livestock held for farming use. Id. However, § 522(f)(2)(A) permits avoidance of nonpurchase-money and nonpossessory security interests only if "animals", here pigs, are held primarily for personal, family or household use, such as the family pets. 11 U.S.C. §
A. The Federal Exemptions of Section 522(d)

A debtor who chooses to the federal exemptions in a bankruptcy case will have created exempt property which may not have been exempt prior to the filing of bankruptcy. Unless the federal and state exemptions are identical, a debtor who chooses the federal exemptions will have different exempt property in bankruptcy than prior to bankruptcy. When the federal exemptions apply, some property will become exempt only because of the operation of bankruptcy law.

On the other hand, a debtor choosing state exemption law or forced by a state opt-out statute to use state exemption law has the same exempt property prior to bankruptcy as during bankruptcy. If section 522(f) were drafted on a premise of normal state judicial lien law, a safe premise, the need is present for this judicial lien avoidance only in federal exemption cases and not state exemption cases. Judicial liens which arise on property not exempt (or not as generously exempt) under a debtor’s state law would be enforceable against the nonexempt property prior to bankruptcy. During bankruptcy, these liens would not be enforceable because of the automatic stay. Yet unless avoided during the bankruptcy case, these liens would be enforceable after bankruptcy because of the rule that liens on exempt property survive bankruptcy and section 522(c)(2)(A), which permits en-

522(E)(2)(A) (1988). Not surprisingly for the thesis that lien avoidance on exempt property per § 522(f), the wording of § 522(f)(2)(A) reiterates § 522(d)(3), part of the federal exemptions. Id. Likewise, the same reiteration occurs for the other subsections. Id. § 522(f)(2)(B), (d)(6), (f)(2)(C), (d)(9). Clearly, § 522(f) is drafted to coordinate with the federal exemptions of § 522(d) and not state exemption law as at issue in Thompson.

60. Under § 522(b) a debtor may choose the federal exemptions stated in § 522(d) or the exemptions provided by the state, unless the state has opted out of the federal exemptions of § 522(d). Id. § 522(d). See supra note 6.

61. For example, in Florida exemption law (Fla. Const. art. X, § 4) there is no monetary limit to the homestead exemption which gave rise to the problem in Owen. However, the federal homestead exemption, § 522(d)(1), provides a debtor only $7500 for such property. 11 U.S.C. § 522(d)(1) (1988). Florida opted out of the federal scheme. See Fla. Stat. § 222.20 (West 1989). Likewise, Florida exemption law provides no specific exemption for an automobile. However, § 522(d)(2) provides a debtor up to $1200 in equity in an automobile. 11 U.S.C. § 522(d)(2) (1988).

62. Unless, of course, the state and federal exemptions are identical. Florida, for example, has adopted one of the federal exemptions, § 522(d)(10), while denying Floridians the remainder of the precise exemptions of § 522(d). See Fla. Stat. §§ 222.20, 222.201 (West 1989).

63. See supra note 6.

64. The premise is undoubtedly fair in that section 522(f) comes from the labor of the Bankruptcy Commission which undoubtedly had the competence. See Commission Report, supra note 6, at § 4-503, reprinted in COLlier ON BANKRUPTCY app. II (Bankruptcy Act of 1973).

65. For example, the judicial lien at issue in the Owen case.


67. See supra note 4. It might usefully be noted, however, that the post-bankruptcy enforceability of a lien on exempt property, which is not avoided in bankruptcy, is merely permitted by the Bankruptcy Code (§ 522(c)(2)) on the assumption that applicable state law

The Code generally bars prepetition creditors from seizing exempt property of a debtor during or after the bankruptcy case. 11 U.S.C. § 522(c) (1988). However, liens on the exempted property which are not avoided during the bankruptcy case, may be enforced post-bankruptcy against the exempted property. Id. §§ 522(c)(2)(A)(i), (ii). Judicial liens typically attach to a judgment debtor’s after-acquired property. See E. WARREN & J. WESTBROOK, supra note 13, at 64. Thus, a judicial lien which survives bankruptcy may appear to attach to property acquired by the debtor during or subsequent to the bankruptcy case. Whether such a lien attaches to after-acquired property may depend on whether the debt was discharged in the bankruptcy case. Were the debt discharged, the attachment of the lien to post-bankruptcy property of the debtor should be a legal impossibility. Liens exist only to secure debt. Thus, to the extent debt is discharged, there is nothing for a lien to secure.

Unfortunately, the Code's recognition of the continuing validity of judicial liens on exempt property held by the debtor at the commencement of a bankruptcy regardless of any discharge of the debt securing the lien, may confound the issue of the post-bankruptcy effect of a lien not avoided in the bankruptcy. Per § 522(c)(2)(A), a judicial lien may continue to be enforceable against pre-bankruptcy exempt property once the bankruptcy case ends, regardless of the discharge of the underlying debt. Id. § 522(c)(2)(A). So, too, one might consider that judicial lien also enforceable against property acquired after the bankruptcy. The Code does not address this issue. Although § 524 prescribes rules on the effect of a discharge of debt, the only generally applicable rules provided in § 524 are addressed to personal liability of a debtor. Section 524 voids judgments of personal liability of the debtor and bars creditor action “as a personal liability of the debtor”. Id. § 524(a)(1), (2). However, the former cannot also void the judicial lien effect of any judgment given the recognition of such avoided liens in § 522(c)(2)(A).

Thus, state law may provide what appears to be the correct answer: that a judicial lien which survives bankruptcy is ineffective against property acquired by a debtor during or after the case and is enforceable only against property which became property of the estate. As noted above, some states purported to resolve this issue by the adoption of statutes permitting the discharged debtor to discharge the judgment under state law. Presumably, a debtor could obtain such relief from any assertion of lien rights against subsequently acquired property by judicial action to establish that, aside from the code exceptions, no judicial liens could come into existence given a discharge of debt. This on the principle of no debt, no lien.

On the other hand, there is strong authority for the proposition that a bankruptcy discharge of debt does not extinguish the debt but merely renders the debt unenforceable personally against the debtor. As under the Statute of Frauds, a court might approve the attachment of a judicial lien to property subsequently acquired because the debt remains valid, though unenforceable. And, the pre-bankruptcy judgment remains valid and enforceable against a debtor's later acquired property.

As well, a lien which is not avoided in a bankruptcy case, might still be avoided under federal nonbankruptcy law. For example, the Federal Trade Commission has made an unfair trade practice the taking of certain nonpossessory, nonpurchase money security interests. 16 C.F.R. § 444.1 (1985). The coverage of this trade regulation rule overlaps substantially with § 522(f)(2). Id. Thus, even if the latter has no application to state exemptions in bankruptcy, the FTC rule would protect the debtor.
property. 68 Without a provision like section 522(f), a debtor might take no benefit from federal exemptions if the debtor's federally exemptible property had been subjected to judicial liens prior to bankruptcy. The federal exemptions would be useless to debtors. Ironically, the federal exemptions have become useless to debtors in the majority of states because these states have opted out of the federal exemptions. 69 Yet the provision, section 522(f), which the Bankruptcy Commission created merely to protect the federal exemptions, became highly controversial in application to cases in which state exemptions applied. In state exemption cases, section 522(f) could hardly have avoided becoming controversial because it never had any application in such cases.

Cases involving state exemptions do not require section 522(f) lien avoidance in order to protect a debtor's exemptions from impairment after the bankruptcy case. Under normal exemption law, a judicial lien either cannot attach or cannot be foreclosed against exempt property. 70 After all, such a state rule is merely another way of expressing the meaning of exempt property: creditors cannot seize that property to satisfy their claims. State exemption law would apply before, during, and after a bankruptcy case when a debtor chooses the state exemption. The state exemption law would bar creditors from foreclosing their judicial liens on exempt property. 71 If

68. Section 522(c)(2)(A) bars the enforcement of liens securing pre-petition debt against exempt property but excepts from that general rule, inter alia, section 522(f) liens not avoided in the bankruptcy which remain enforceable. Id. § 522(c)(2)(A)(i).

69. See supra note 6.

70. See S. REISENFELD, CREDITORS' REMEDIES AND DEBTORS' PROTECTIONS 301-03 (West 4th ed. 1987). For example, the exemption law of Florida under which a preexisting judicial lien is effective against a later acquired homestead, though a subsequent lien is not. See supra note 49 and accompanying text. The distinction noted in the text is interesting and perhaps merely procedural: a state may bar foreclosure of a judicial lien against an exemptible homestead, but only on the debtor's having taken appropriate action to claim the exemption. Dicta in the early case of Smith v. St. Petersburg Novelty Works suggested that judgments may be liens against the homestead prior to judicial recognition of the homestead: "[L]iens of the judgment . . . are apparently enforceable against [homesteads], thereby impairing the sale and loan value thereof . . . ." Smith v. St. Petersburg Novelty Works, 113 So. 769, 777 (Fla. 1927). Undoubtedly the dicta remarks about the practical effect of a judgment lien, as that statement can cause problems in the issuance of title opinions. Another of what one can regard as procedural aspects of judicial liens and homesteads caused problems in California some years ago: there a judgment creditor had to use a particular procedure to subject the debtor's surplus equity interest (value of debtor's interest less the monetary amount of the exemption) in an exempt homestead. Thus, a recorded judgment, alone, created no lien on the homestead property. Yet the possibility of a lien arising by the proper procedure undoubtedly would inhibit the marketability of the property. However, if the judgment creditor does not create a lien by the proper procedure, the judgment merely represents a personal liability and is dischargeable in bankruptcy. See Songer v. Cooney, 214 Cal. App. 3d 387, 264 Cal. Rptr. 1 (1989); Swearingen v. Byrne, 67 Cal. App. 3d 580, 136 Cal. Rptr. 736 (1977).

71. Not surprisingly, the general state exemptive effect rule regarding judicial liens is the same as that of § 522(f)(1): If the lien antedates the exemption, leaving aside procedural issues about how the debtor claims the exemption, the lien is valid. See supra note 67. That is obviously the source of the principle the Bankruptcy Commission used in creating § 522(f)(1). See supra notes 4, 6. This makes the numerous bankruptcy decisions and discussions about
that is all the protection the state would accord the debtor, then the Owen refusal to accept the Code’s opt-out policy to this matter of judicial lien avoidance is misplaced. The Court refused to do so because of the seemingly sweeping language of section 522(f) and the lack of any indication that it has application only to federal exemption cases.\footnote{72}

However, the Court overlooked what is meant by saying, in a case involving state exemptions, that a judicial lien “impairs the exemption.”\footnote{73} Judicial liens cannot impair a state exemption. Either a state recognizes the lien but limits its enforceability by barring judicial foreclosure or simply does not recognize any lien at all. In the latter, there cannot be any impairment of the exemption by the presence, so to speak, of an invalid lien. In the former, the only effect on the judicial lien relates to its enforceability whenever the property to which it has attached loses its exempt character, as for example, by sale to a party without an exemption claim to the property. Nor does a judicial lien impair an exemption when the lien has limited effect: the debtor’s use and enjoyment of the exempt property continue.\footnote{74} However, the judicial lien may limit the debtor’s opportunity to

application of § 522(f)(1) so sorrowful.

The same was not true for the avoidable security interests under § 522(f)(2). Nonpurchase money and nonpossessory security interests on exempt property could be foreclosed under state law under a theory that debtor waived the exemption. Section 522(e) vitiates such a waiver only as against unsecured claims. 11 U.S.C. § 522(e) (1988). That is the reason why § 522(f)’s prefatory phrase, “Notwithstanding any waiver of exemption . . .” is not superfluous, as Justice Scalia apparently assumed in Owen. Owen, 111 S. Ct. at 1837. A waiver of an exemption in favor of a secured claim is valid under § 522(e) and the prefatory phrase is critical to § 522(f)(2).

Thus, § 522(f)(2) security interests may be avoided even if the debtor had previously waived the exemption. If that section is not applicable to a case involving the use of a state exemption, as asserted in this paper, other law protects the debtor. See supra note 67.

\footnote{72.} Owen, 111 S. Ct. at 1838.

\footnote{73.} Id. at 1836.

\footnote{74.} It is evident that the states, whose exemption laws provided an exemption of particular kinds of property but no exemption for the same property if subject to certain liens, acted to preserve their traditional exemptive effect rules: first, to preserve the lien but prevent enforcement until the property lost its exempt status by sale or otherwise; and second, to preserve their waiver of exemption rules. Neither of these motives offends the congressional policy when properly construed. Under proper construction of § 522(f), these state exemptive effect state rules would be unnecessary as the subsection would never apply in cases in which state exemption law applied. The impetus for the creation of such statutes after the subsection became law laid in either the fear of, or reaction to actual, court’s applying the subsection to state exemptions. The circuit level cases finding such state exemptive effect statutes invalid overreacted to what was perceived as state manipulation of federal statute and policy. For, it appeared as though the avoidance of “waiver of exemption” rule of the Bankruptcy Code had particularly been offended by such action. However, the general provision of the code on such waivers applies only to unsecured creditors. 11 U.S.C. § 522(e) (1988). The lienors protected by the post-Code state exemptive effect legislation are unaffected by that provision. The anti-waiver rule of § 522(f) (“Notwithstanding . . . ”) affects § 522(d), the federal exemptions, by voiding any state waiver rule based on the debtor’s pre-bankruptcy grant of a lien. Id. § 522(f).
market the property. That is, the property is worth less if it is encumbered. However, the state has determined that the exemption is all that a debtor, so situated, gets. And, in section 522(b), the Code leaves that to the state. Using section 522(f) against such a judicial lien, under the guise of relieving a debtor from impairment due to the lien, may present a windfall to the debtor.

Nevertheless, if that result is what Congress sanctioned for federal exemptions, one might argue that the windfall should be present even where state exemptions are used. But that is to argue that when section 522(f) is properly used, only in federal exemptions, the lien should be avoidable only to the extent that a judicial lien under the applicable state law is ineffective against state-created exempt property: no windfall should befall a debtor in any event. For these reasons, the Court missed an opportunity to clearly settle the problems generated by the cases before it: both Sanderfoot and Owens arose from an attempt to avoid a judicial lien on state-created exempt property. The Court could have alleviated the controversy over divorce-created judicial liens by simply ruling that there cannot be an impairment of state exemptions by judicial liens, because section 522(f) only applies to cases in which the federal exemption is chosen.

B. Owen's Doubtful Textual Analysis

The Court in Owen assumed that nothing in the applicable language of section 522(f) precluded the use of section 522(f) in state exemption cases. If that were true, no matter how correct the claim that section 522(f) was not designed to apply to state exemption cases might be, a court might reasonably favor the express language. However, even the language of section 522(f) accepts limitation to federal exemption cases.

Owen errs about the breadth of the subjunctive-mood phrase, "exemptions . . . to which the debtor would have been entitled . . . under 522(b)." The Court stated that this phrase includes the exemptions to which the debtor "is" entitled, such as exemptions already applicable under state law when the lien attached. This assumes that the reference to section 522(b), which grants debtors federal or state exemptions, is intended to include both sets of exemptions under subsection (f). However, if the drafters meant to include both federal and state exemptions of subsection (b) within the scope of lien avoidance under subsection (f), the use of the subjunctive "would have been entitled" is strange indeed, as Owen claims, if the time for measuring the entitlement is at bankruptcy as Owen holds. The exemptions available to

75. Owen, 111 S. Ct. at 1838.
77. Owen, 111 S. Ct. at 1837.
78. See supra note 6.
79. Owen, 111 S. Ct. at 1837.
80. Id. at 1838 n.6.
the debtor at bankruptcy are those to which the debtor is entitled, the federal or state exemptions, or only the latter if the state has opted out.

Owen seems to regard the language as unfortunate and an example of poor drafting. However, the text is well chosen, for it states that "the fixing of a lien . . . may be avoided when the . . . lien impairs an exemption to which the debtor would have been entitled." The time period of the clause is the time when the lien attached to the property. At that time, the state exemption law may provide that the lien is either effective or ineffective, depending on the state exemption law. If the property were exempt, the lien would not impair the exemption. If the property were nonexempt, the lien would impair the exemption which the federal exemption of sections 522(b) and 522(d) may provide in the future. From the standpoint of the time when there was the "fixing" of the lien, the only exemption that is in the subjunctive future is the federal exemption. Only to that could "would have been entitled" speak.

C. "Fixing . . . Interest": Farrey v. Sanderfoot

The Court's "prior interest" limit to the applicability of section 522(f) of the Code comes from regarding the "fixing of a lien on an interest of the debtor in property" as excluding the case in which the debtor's interest in the property arose after a lien had been fixed upon the property. Presumably, this reading, and the drafter's wording, is designed to exclude the avoidability of a judicial lien which had already attached to the property before the debtor acquired the property. A less cautious draft might have permitted a debtor in bankruptcy to avoid a judicial lien imposed upon the property by a judgment creditor of the debtor's seller. The latter might

81. The Court's opinion correctly states the effect of the subjunctive expression, "would have been entitled." Id. at 1837. It denotes a contrary-to-fact state of affairs. Id. At the time the judicial lien attached to the debtor's property, sometime before the debtor's bankruptcy case, the federal exemptions did not protect the debtor's property. Id. But for the judicial lien, says Justice Scalia, the debtor would have been entitled to exempt the property. Id. The correct causal reason, however, is "but for" the lack of any exemption when the lien attached because the federal exemptions do not take effect until bankruptcy.


83. Remarkably, the companion case, Farrey v. Sanderfoot, holds that the gerund, "fixing," deliberately sets the time period as the time when the lien attached to the property. Sanderfoot, 111 S. Ct. at 1829. Only Justice Stevens dissented in Owen and this point forms the basis of his analysis. Owen, 111 S. Ct. at 1839.

84. As well, the notwithstanding prefatory clause is no mere aside, as Owen asserts, duplicating the general provision on waiver of exemptions, § 522(e). The latter does not apply to waivers in favor of secured claimants, such as section 522(f) lienors and secured creditors, but only to unsecured claims.

85. Sanderfoot, 111 S. Ct. at 1828-29.

86. Preexisting liens are problematical for a buyer only where the liens are effective against the buyer's newly acquired interest. In a properly planned purchase the buyer will not suffer from the presence of the lien because the purchase price will discount the value of the property encumbered by the lien.
have permitted the avoidance of judicial liens by conveyances to imminent bankrupts.

However, this assumes that such a problem would not have been cured by the language which follows: "to the extent such lien impairs an exemption to which the debtor would have been entitled under subsection (b) of this section..."87 This language may well be the more appropriate limitation on the destruction of prior-to-debtor's-acquisition judicial liens. A debtor who never had any equity, because a preexisting judicial lien consumed the value of the property, would have no exemption impaired by the judicial lien. The same would be true for a debtor who merely had as much equity as lien avoidance would yield. In the case of a homestead, as present in Sanderfoot, subsection 522(b) provides debtors with two options: either the state homestead law or the federal homestead amount of $7500.88 Although the latter is now more or less obsolete, because so many states have opted out of the federal homestead and other section 522(d) exemptions, for the purpose of explanation it is helpful to imagine a debtor like Sanderfoot entitled to use the $7500 federal homestead provision.

If a debtor held $7500 in equity notwithstanding a judicial lien fixed before debtor acquired the homestead, the judicial lien would not impair that homestead under the federal exemption. If the debtor held $7500 in equity a moment before filing bankruptcy, avoidance of a preexisting judicial lien to any extent would not protect the debtor's exemption. Rather, avoiding a preexisting judicial lien to any extent would have the effect of presenting the debtor with a windfall.

The Sanderfoot chronological test precludes such a windfall. It might be better to say that there never was an impaired exemption. For the debtor to have had the exemption impaired, he or she would have had to at some point had the right to hold the property free of this preexisting judicial lienor's claim. The prior judicial lienor cannot impair the exemption, but the later lienor surely may if the property was not exempt when the lien attached.

The contemporaneous judicial lienor is likely to evoke controversy. However, the contemporaneous judicial lien is most likely to be present in the controversial divorce cases. The Court's concentration on the "fixing" phrase rather than the "impairs" phrase is unfortunate because the problematical divorce cases are more cleanly resolved by impairment analysis than by chronological analysis. Under the latter, the divorce cases may continue to cause some controversy depending on the state law characterization of when the judicial lien fixes on the debtor's interest in the property. On the other hand, impairment analysis has no difficulty with this issue because the divorcing party who received the property has no legitimate expectation of holding the property free of the spouse's judicial lien.

88. Id. § 522(b)(1), (b)(2)(A), (d)(1).
III. Legislative Proposal and Policy: Congress Should Amend the Body of Section 522(f) to Replace (b) with (d)

Whether judicial lien avoidance should occur in cases involving divorce decrees or settlements is popularly answered in the negative. The Court’s recent decisions leave too much to state law when issues arise concerning whether the federal or state exemptions apply to a bankruptcy case. The test under Owen and Sanderfoot is whether the lien attached to the property prior to the time the debtor’s interest arose.\(^8^9\) In the controversial divorce cases, such as Sanderfoot, the test will prove problematical. Section 522(f) did not aim to disturb abnormal debtor-creditor relations such as are occasionally produced in the domestic relations field. That was the view of the economic theorist, Judge Posner, whose Seventh Circuit dissent the Supreme Court borrowed. Indeed, Justice White’s majority opinion adopts the premise that judicial lien avoidance per this section rests on the normal creditors and debtors setting, in which some creditors will have taken judgment and obtained liens on exempt property as debtors slide into bankruptcy. Section 522(f)(1) would “thwart a rush to the courthouse” by rescinding the effect, if any,\(^9^0\) of judicial liens which attached to property.

This “prior interest” theory of the section fails to sever the problematical domestic relations judicial liens from the peril of the section. Rather, the rationale will invigorate lawyers’ fees by requiring research on putatively mordant issues of state law regarding the effect on prior property interests of divorce decrees which transform a jointly held interest into a single interest. Does, for example, the prior interest disappear and the new interest appear, or does the prior interest continue expanded?\(^9^1\)

Yet did Congress truly intend such subtle issues of state law to control its mandate in the section? The Court’s support for the “prior interest” limitation to the section arises solely from its inference of debtor/creditor normality and the statutory expression, “fixing.” No legislative history supports the “prior interest” thinking, though it may support the exclusion

89. Sanderfoot, 111 S. Ct. at 1829.
90. States themselves may preclude the effect of judicial liens on exempt property.
91. These cases will prove problematic under state law both because the Court has incorrectly ruled that § 522(f) applies to state exemptions and because of the unclear line between prior, contemporaneous and subsequent liens. If the test in general cases such as Sanderfoot is whether the judicial lien imposed by the divorce court was a “fixing” of a lien on the exempt property of the debtor, how can a bankruptcy court find help in state law in the typical case: The spouses jointly own homestead property which the divorce court awards to one, and grants the other a lien to secure the property settlement. The date the lien fixed is the effective date of the decree. That is the date the debtor obtained an additional interest in the property, the switch from joint to single ownership. That is the date, as well, that the former spouse of the debtor obtained a judicial lien. This lien attached simultaneously with the debtor’s new form of ownership. However, the lien attaches on that date not only to the additional ownership rights the debtor acquired that day, but the lien may also attach to whatever equity interest the debtor held prior to the decree. Depending on what “interest” the lien need attach to for purposes of the “fixing” of section 522(f), the lien is within the section or outside the section. To the extent the divorce court imposed the lien on any equity the debtor held prior to the divorce decree, will the lien impair the exemption?
of divorce decrees or settlements on the broad normality theory. No helpful parallels exist in bankruptcy jurisprudence for the peculiar chronological interpretation the Court gave the word "fixing." Leaving the "prior interest" issue to state law will promote only diverse results and legal fees.

Nearly every important bankruptcy issue, if not all bankruptcy issues, may be left to state law determination. No bankruptcy statute can declare concepts which are not easily referable to state law. Indeed, no federal statute can preclude that. Yet diversion of issues to state law, under the guise of federal statutory interpretation, produces diverse results and presumes congressional intent to produce such diversity. To be sure, that is sometimes the evident intention of Congress, as in the issue of what property may be exempted in a bankruptcy.

Surely, too, but for the history and carefully drawn language of section 522(f), it might have been a close question whether Owen is correct in assuming a congressional intention against diversity in the application of lien avoidance under section 522(f). However, because the Court resolved that issue in favor of uniformity, the opt-out states may not limit the avoidance of liens on exempt property under the section. Nevertheless, the Court inconsistently may have left the final resolution of these controversial cases to the state law defining when a judicial lien attached to, i.e., the statutory "fixing," the debtor's interest in the property.

Congress would do well to turn section 522(f) back to its limited form under the Bankruptcy Commission's proposal, by adopting the amendment suggested above. That amendment would leave to the opt-out states the intertwined issues of what property is exempt and the effect of liens on their exemption. Because so many states have opted out of the federal exemptions, the amendment will largely solve the controversial divorce lien issue. States that have not opted out might well avoid the difficulties presented in the divorce cases by providing when the interest of the property-receiving party arises and when the other party's lien arises. By doing so, Congress will make the opt-out policy clear. On the other hand, Congress might revisit the entire opt-out issue, though that task is more formidable and apparently politically less attractive.
